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PureSafe Water Systems, Inc.
Form 10-Q
November 21, 2012

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

FORM 10-Q

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

For the quarterly period ended September 30, 2012

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

Commission File Number: 001-09478

PureSafe Water Systems, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation
or organization)

86-0515678
(I.R.S. Employer Identification No.)

160 Dupont Street, Plainview, New York
(Address of principal executive offices)

11803
(Zip Code)

(516) 208-8250
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

| | | | |
|-------------------------|--------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.
As of November 16, 2012, 469,578,679 shares of the common stock of the registrant were issued and 469,574,279 were outstanding.

EXPLANATORY NOTE

The Company is filing this Quarterly Report for the three-month period ended September 30, 2012, late due to delays in the preparation and review of the unaudited financial statements included herein. Our offices in Plainview, Nassau County, New York did not recommence limited operations until Monday, November 5, 2012. Nassau County was particularly hard hit by the hurricane. Resumption of full operations in our offices has been delayed further by northeaster storm that hit this area following the hurricane Sandy and the shortage of gas on Long Island that prevented our staff from showing up at work. Full operations were not resumed until Monday, November 12, 2012. In summary, ten or more days were lost in our preparation of the Company's quarterly financial statements, which are complex and require a substantial amount of review time and work with Marcum LLP and an outside accountant. We have been advised by both firms that their work schedules were impacted by Hurricane Sandy, as have those of many other accounting and financial firms in the New York area. In conformity with and reliance upon the Order (the "Order") under Section 36 of the Securities Exchange Act of 1934 Granting Exemptions from Specific Provisions of the Exchange Act and Certain Rules Thereunder (Securities Exchange Act of 1934 Release No. 68224, November 14, 2012), the Company is filing this Quarterly Report on or before November 21, 2012, in reliance on and as permitted by the Order, since the Company was not able to meet the November 19, 2012 Form 12b-25 extended filing deadline applicable to its Quarterly Report on Form 10-Q for the above stated reasons.

PURES SAFE WATER SYSTEMS, INC.

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PART I — FINANCIAL INFORMATION

ITEM CONSOLIDATED FINANCIAL STATEMENTS.

1.

Certain information and footnote disclosures required under accounting principles generally accepted in the United States of America have been condensed or omitted from the following consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. The following unaudited consolidated financial statements should be read in conjunction with the year-end restated consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2011.

The results of operations for the three and nine months ended September 30, 2012 and 2011 are not necessarily indicative of the results for the entire fiscal year or for any other period.

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PureSafe Water Systems Inc. and Subsidiary
Condensed Consolidated Balance Sheets
(Unaudited)

| | September 30, 2012 | December 31, 2011 |
|--|--------------------------|-------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash | \$75,148 | \$118,228 |
| Inventories | 414,265 | 468,093 |
| Prepaid expenses and other current assets | 26,478 | 56,674 |
| Total Current Assets | 515,891 | 642,995 |
| Property and equipment, net of accumulated depreciation of \$127,866 and \$151,710, respectively | 85,858 | 136,718 |
| Patents and trademarks, net of accumulated amortization of \$40,290 and \$35,712, respectively | 59,594 | 64,172 |
| Other assets | 63,886 | 58,560 |
| TOTAL ASSETS | \$725,229 | \$902,445 |
| LIABILITIES AND STOCKHOLDERS' DEFICIENCY | | |
| Current Liabilities: | | |
| Accounts payable and accrued expenses | \$588,265 | \$582,446 |
| Accrued compensation | 821,036 | 402,249 |
| Deferred rent payable | 7,050 | 32,800 |
| Accrued consulting and director fees | 144,000 | 144,000 |
| Customer deposits | 271,768 | 130,000 |
| Convertible notes payable to officer and director (including accrued interest of \$120,312 and \$83,932 and net of debt discount of \$0 and \$12,623 respectively) | 856,312 | 743,309 |
| Convertible promissory note (including accrued interest of \$142,125 and \$83,929 and net of debt discount of \$178,556 and \$39,923, respectively) | 1,238,753 | 989,006 |
| Promissory notes payable (including accrued interest of \$209,909 and \$190,521, respectively) | 666,754 | 838,265 |
| Fair value of detachable warrants and conversion option | 395,900 | 515,200 |
| Accrued dividends payable | 190,328 | 190,328 |
| Total Current Liabilities | 5,180,166 | 4,567,603 |
| Long Term Liabilities: | | |
| Promissory notes payable, net of current portion | 11,464 | 15,200 |
| Total Long Term Liabilities | 11,464 | 15,200 |
| TOTAL LIABILITIES | \$5,191,630 | \$4,582,803 |
| Commitments and Contingencies | | |
| Stockholders' Deficiency: | | |
| Preferred stock \$.001 par value; 10,000,000 shares authorized; 184,144 shares issued and outstanding (liquidation preference \$2,890,075 and \$2,808,850, as of | 184 | 184 |

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September 30, 2012 and December 31, 2011, respectively)

| | | |
|--|------------------|------------------|
| Common stock, \$.001 par value; 450,000,000 authorized; 394,308,382 shares issued and 394,303,982 shares outstanding at September 30, 2012; 340,389,004 shares issued and 340,384,604 outstanding at December 31, 2011 | 394,308 | 340,388 |
| Additional paid-in capital | 39,869,170 | 38,667,448 |
| Treasury Stock, at cost, 4,400 shares of common stock | (5,768) | (5,768) |
| Subscriptions receivable (including accrued interest of \$88,725 and \$73,538, respectively) | (425,925) | (410,738) |
| Accumulated deficit | (44,298,370) | (42,271,872) |
| Total Stockholders' Deficiency | (4,466,401) | (3,680,358) |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY | \$725,229 | \$902,445 |

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

PureSafe Water Systems Inc. and Subsidiary
Consolidated Statements of Operations
(Unaudited)

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|------------------------------------|------------|-----------------------------------|--------------|
| | 2012 | 2011 | 2012 | 2011 |
| Sales | \$-- | -- | \$265,000 | \$-- |
| Cost of Sales | 3,602 | -- | 286,320 | -- |
| Gross Profit (Loss) | (3,602) | -- | (21,320) | -- |
| Operating Expenses: | | | | |
| Compensation and related benefits, including stock-based compensation \$12,400 and \$214,600 for the three months and \$166,700 and \$969,425 for the nine months ended September 30, 2012 and 2011, respectively | 240,608 | 360,837 | 804,652 | 1,392,190 |
| Insurance and medical benefits | 18,689 | 17,656 | 62,538 | 54,598 |
| Research and development | -- | 52,130 | 58,239 | 135,470 |
| Professional, legal and consulting fees, including stock-based compensation of \$0 and \$0 for the three months and \$4,500 and \$0 for the nine months ended September 30, 2012 and 2011, respectively | 73,140 | 26,531 | 138,238 | 158,243 |
| Marketing, including stock-based compensation of \$0 and \$0 for the three months and \$6,400 and \$0 for the nine months ended September 30, 2012 and 2011, respectively | 176,723 | 2,211 | 190,377 | 91,662 |
| Occupancy | 54,335 | 99,054 | 193,967 | 195,747 |
| Loss on abandonment of property | -- | -- | 34,708 | -- |
| Other administrative and general | 188,680 | 128,806 | 369,652 | 417,201 |
| Total Operating Expenses | 752,175 | 687,225 | 1,852,371 | 2,445,111 |
| Loss from Operations | (755,777) | (687,225) | (1,873,691) | (2,445,111) |
| Other Income (Expense): | | | | |
| Interest income | 5,161 | 5,099 | 15,248 | 15,280 |

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| | | | | |
|--|--------------|--------------|----------------|----------------|
| Interest expense, including interest to related parties of \$17,676 and \$17,135 for the three months and \$52,901 and \$48,373 for nine months ended September 30, 2012 and 2011, respectively | (662,021) | (278,598) | (958,654) | (519,885) |
| Change in fair value of derivative liability | 392,700 | (445,000) | 790,600 | (445,000) |
| Total Other Income (Expense) | (264,160) | (718,499) | (152,806) | (949,605) |
| Net Loss | (1,019,937) | (1,405,724) | (2,026,497) | (3,394,716) |
| Dividend on preferred stock | (27,075) | (27,075) | (81,225) | (81,225) |
| Net Loss Attributable to Common Stockholders' | (1,047,012) | (1,432,799) | \$(2,107,722) | \$(3,475,941) |
| Net Loss Attributable to Common Stockholders Per Share basic and diluted | \$(0.00) | \$(0.00) | \$(0.00) | \$(0.00) |
| Weighted average number of shares outstanding | 369,164,922 | 335,839,212 | 353,956,221 | 329,227,487 |

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

PureSafe Water Systems, Inc. and Subsidiary
Condensed Consolidated Statement of Stockholders' Deficiency
For the Nine Months ended September 30, 2012
(Unaudited)

| | Preferred Stock | | Common Stock | | Additional Paid-In Capital | Treasury Stock At Cost | Subscription Receivable | Accumulated Deficit | Total Stockholders' Deficiency |
|---|-----------------|--------|--------------|------------|----------------------------|------------------------|-------------------------|---------------------|--------------------------------|
| | Shares | Amount | Shares | Amount | | | | | |
| BALANCE – January 1, 2012 | 184,144 | \$ 184 | 340,389,004 | \$ 340,388 | \$ 38,667,448 | \$ (5,768) | \$ (410,738) | \$ (42,271,872) | \$ (3,680,355) |
| Proceeds from sale of common stock: | -- | -- | 8,704,076 | 8,704 | 192,296 | -- | -- | -- | 200,000 |
| Common stock issued for loan conversion | -- | -- | 33,978,764 | 33,979 | 466,663 | -- | -- | -- | 500,642 |
| Common stock issued for services | -- | -- | 2,674,038 | 2,674 | 165,226 | -- | -- | -- | 167,900 |
| Common stock issued in connection with debt | -- | -- | 4,375,000 | 4,375 | 170,625 | -- | -- | -- | 175,000 |
| Common stock issued for settlement of customer deposits (includes 37,500 of stock issued in compensation) | -- | -- | 4,187,500 | 4,188 | 163,312 | -- | -- | -- | 167,500 |
| Reclassification of derivative liability | -- | -- | -- | -- | (43,000) | -- | -- | -- | (43,000) |
| Amortization of warrants and option over the vesting period for | -- | -- | -- | -- | 87,600 | -- | -- | -- | 87,600 |

| | | | | | | | | | |
|-----------------------------|---------|-----|-------------|---------|------------|---------|-----------|--------------|-------------|
| Employees and non-employees | | | | | | | | | |
| Accrued interest | -- | -- | -- | -- | -- | -- | (15,187) | -- | (15,187) |
| Net loss | | | | | | | | (2,026,497) | (2,026,497) |
| BALANCE-September 30, 2012 | 184,144 | 184 | 394,308,382 | 394,309 | 39,869,169 | (5,768) | (425,925) | (44,298,369) | (4,466,400) |

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

PureSafe Water Systems Inc. and Subsidiary
Consolidated Statements of Cash Flows
(Unaudited)

| | Nine Months Ended September 30, | |
|--|------------------------------------|--------------------|
| | 2012 | 2011 |
| Cash Flows from Operating Activities: | | |
| Net loss | \$ (2,026,497) | \$ (3,394,715) |
| Adjustments to reconcile net loss to net cash used in operating activities - | | |
| Loss on abandonment of property | 34,707 | -- |
| Depreciation and amortization | 16,153 | 62,723 |
| Amortization of patents and trademarks | 4,578 | 4,578 |
| Interest expense – amortization of deferred financing | 87,493 | -- |
| Stock based compensation | 310,200 | 969,425 |
| Loss on conversion of convertible notes to notes payable | 85,000 | -- |
| Interest receivable | (15,187) | (15,131) |
| Deferred rent | (25,750) | -- |
| Accretion of debt discount | 660,090 | 313,921 |
| Change in fair value of warrants and embedded conversion option | (790,600) | -- |
| Change in assets and liabilities - | | |
| Prepaid expenses and other current assets | 30,196 | 19,172 |
| Inventories | 53,828 | (102,337) |
| Customer deposits | 271,768 | 162,250 |
| Other assets | 27,830 | (9,405) |
| Accounts payable, accrued expenses, accrued dividends, accrued compensation, accrued consulting and director fees, customer deposits and other current liabilities | 573,760 | 131,398 |
| Net Cash Used in Operating Activities | (702,431) | (1,326,881) |
| Cash Flows from Investing Activities: | | |
| Patent costs | -- | (7,400) |
| Net Cash Used in Investing Activities | -- | (7,400) |
| Cash Flows from Financing Activities: | | |
| Proceeds from sale of common stock | 200,000 | 392,000 |
| Proceeds from exercise of warrants | -- | 236,420 |
| Proceeds from sale of common stock to be issued | -- | -- |
| Proceeds from officers and directors loans | 80,000 | 225,000 |
| Proceeds from convertible promissory note | 656,000 | 425,000 |
| Cash paid for loan costs | (120,649) | -- |
| Proceeds from notes payables | -- | 47,091 |
| Repayment of officers and directors loans | (16,000) | (40,000) |
| Repayment of notes payable | (140,000) | (4,150) |
| Net Cash Provided by Financing Activities | 659,351 | 1,281,361 |
| Net decrease in cash | (43,080) | (52,920) |
| Cash at beginning of period | 118,228 | 166,758 |
| Cash at end of period | \$ 75,148 | \$ 113,838 |

Supplemental Disclosure of Cash Flow Information:

| | | |
|--|--------|--------|
| Cash paid during the year for interest | 23,337 | 23,564 |
|--|--------|--------|

Non-Cash Investing and Financing Activities:

| | | |
|---|----------|---------|
| Common stock issued in satisfaction of liabilities | 500,641 | 150,537 |
| Common stock issued for the settlement of a customer deposit | 130,000 | -- |
| Common stock issued in connection with debt | 175,000 | -- |
| Reclassification of equity instrument to derivative liabilities | (43,000) | 685,600 |
| Debt discount for beneficial conversion feature and warrants | -- | 103,132 |
| Conversion of convertible notes payable to notes payable | 185,000 | -- |
| Conversion of notes payable to convertible notes payable | 247,771 | -- |

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

PureSafe Water Systems Inc. and Subsidiary
Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE 1: DESCRIPTION OF BUSINESS.

PureSafe Water Systems, Inc. (the "Company") is a Delaware corporation engaged in the design, development, manufacturing and sales of the PureSafe™ First Response Water System (the "FRWS"), both within and outside of the United States. The Company's corporate headquarters and factory are located in Plainview, New York.

NOTE 2: BASIS OF PRESENTATION AND ACCOUNTING POLICIES.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, these interim financial statements do not include all of the information and footnotes required for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to make the financial statements not misleading have been included.

The operating results for the nine month period ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. These financial statements should be read in conjunction with the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission on April 16, 2012.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period.

Management bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. The most significant estimates, among other things, are used in accounting for allowances for deferred income taxes, expected realizable values for long-lived assets (primarily intangible assets and property and equipment), contingencies, as well as the recording and presentation of its common stock. Estimates and assumptions are periodically reviewed and the effects of any material revisions are reflected in the consolidated financial statements in the period that they are determined to be necessary. Actual results could differ from those estimates and assumptions.

Principles of Consolidation

The consolidated financial statements of PureSafe Water Systems, Inc. include accounts of the Company and its wholly-owned subsidiary, PureSafe Manufacturing and Research Corporation. Intercompany transactions and balances are eliminated in consolidation.

Inventories

Inventory amounts are stated at lower of first-in, first-out ("FIFO") cost or market.

Deferred Financing Costs

Cost incurred in conjunction with the debt financing has been capitalized and will be amortized to interest expense using the straight line method, which approximates the interest rate method over the term of the debt and is included as a component of other assets.

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Derivative Liabilities

In connection with the issuance of certain convertible promissory notes, the terms of the convertible notes included an embedded conversion feature; which provided for the settlement of certain convertible promissory notes into shares of common stock at a rate which was determined to be variable. The Company determined that the conversion feature was an embedded derivative instrument pursuant to ASC 815 “Derivatives and Hedging”

The accounting treatment of derivative financial instruments requires that the Company record the conversion option and related warrants at their fair values as of the inception date of the agreements and at fair value as of each subsequent balance sheet date. As a result of entering into the convertible promissory notes, the Company is required to classify all other non-employee warrants as derivative liabilities and record them at their fair values at each balance sheet date. Any change in fair value was recorded as a change in the fair value of derivative liabilities for each reporting period at each balance sheet date. The Company reassesses the classification at each balance sheet date. If the classification changes as a result of events during the period, the contract is reclassified as of the date of the event that caused the reclassification.

The fair value of conversion options at a fixed number of shares are recorded using the intrinsic value method and conversion options at variable rates are deemed to be a “down-round protection” and therefore, do not meet the scope exception for treatment as a derivative under ASC 815. Since, “down-round protection” is not an input into the calculation of the fair value of the conversion option and cannot be considered “indexed to the Company’s own stock” which is a requirement for the scope exception as outlined under ASC 815. The Company determined the fair value of the Binomial Lattice Model and the Intrinsic Value Method to be materially the same. Warrants that have been reclassified to derivative liability that did not contain “down-round protection” were valued using the black-scholes model. The Company’s outstanding warrants did not contain any down round protection.

The Black-Scholes option valuation model is used to estimate the fair value of the warrants or options granted. The model includes subjective input assumptions that can materially affect the fair value estimates. The model was developed for use in estimating the fair value of traded options or warrants. The expected volatility is estimated based on the most recent historical period of time equal to the weighted average life of the warrants or options granted. The principal assumptions used in applying the Black-Scholes model were as follows:

| | For the nine months ended September 30, 2012 |
|-------------------------|---|
| Assumptions: | |
| Risk-free interest rate | 0.31% to 1.04% |
| | 0.22 to 5.84 |
| Expected life | years |
| Expected volatility | 110 % |
| Dividends | 0.0 % |

Stock-Based Compensation

The Company reports stock-based compensation under Accounting Standard Codification (“ASC”) 718 “Compensation – Stock Compensation”. ASC 718 requires all share-based payments to employees, including grants of employee stock options, to be recognized in the consolidated financial statements based on their fair values.

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The Company accounts for equity instruments issued to non-employees as compensation in accordance with the provisions of ASC 718, which require that each such equity instrument is recorded at its fair value on the measurement date, which is typically the date the services are performed.

The Black-Scholes option valuation model is used to estimate the fair values of options. The model includes subjective input assumptions that can materially affect the fair value estimates. The model was developed for use in estimating the fair value of traded options or warrants. The expected volatility is estimated based on the most recent historical period of time equal to the weighted average life of the subject options or warrants.

The principal assumptions used in applying the Black-Scholes model were as follows:

| | For the nine months ended September 30, 2012 | |
|-------------------------|---|---|
| Assumptions: | | |
| Risk-free interest rate | 0.31 | % |
| Expected life | 3 | |
| Expected volatility | 110 | % |
| Dividends | 0.0 | % |

NOTE 3: GOING CONCERN.

The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred a net loss of approximately \$2,026,000 and \$3,395,000 for the nine months ended September 30, 2012 and 2011, respectively. The Company has a working capital deficit of approximately \$4.7 million and \$3.9 million as of September 30, 2012 and December 31, 2011, respectively. The Company continues to incur recurring losses from operations and has an accumulated deficit since inception of approximately \$44 million. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The Company's plans with respect to these matters include restructuring its existing debt and raising additional capital through future issuances of stock and/or debt. The Company is seeking to raise an additional \$2 million within the next six months and an additional 3 million within the next twelve months to fund the following activities: to manufacture 10 commercial PureSafe FRWS units within the next six months and an additional 15 units within the next twelve months; to expand production capability to meet the expected demand for the FRWS domestically and internationally by a combination of expanding the current production facility at 160 Dupont Street, re-engineering and value engineering the FRWS to outsource assembly where appropriate; continue to implement our established marketing program, to establish a sales and marketing network which includes hiring a Vice President of Marketing and Sales Directors to achieve additional sales by the second quarter of 2013.

On August 16, 2012 the Company filed Schedule 14 C with the Securities and Exchange Commission to notify the Shareholders that on August 7, 2012 the Company received unanimous written consent from the Board and the holder of Series B Preferred Stock to authorize an increase in the authorized shares of Common Stock from 450,000,000 to 800,000,000 shares. The Series B Preferred Stock, 51 shares authorized and issued to Leslie J. Kessler had voting rights equal to 7,488,254 shares per each share of Series B Preferred Stock. The number of votes that voted in favor of the action was 381,900,954.

The extent of these initiatives will be contingent upon the amount of capital raised.

The Company can give no assurance that such financing will be available on terms advantageous to us, or at all. Should the Company not be successful in obtaining the necessary financing to fund its operations, the Company would need to curtail certain or all of its operational activities. The accompanying unaudited condensed consolidated financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

NOTE 4: RECENT ACCOUNTING PRONOUNCEMENTS.

Recent accounting pronouncements issued by the FASB and the SEC did not have, or are not believed by management to have, a material impact on the Company's present or future consolidated financial statements.

NOTE 5 – INVENTORIES

Inventories consist of the following at September 30, 2012,

| | |
|----------------|-----------|
| Raw materials | \$271,536 |
| Finished Goods | 142,729 |
| Total | \$414,265 |

NOTE 6: NET LOSS PER SHARE OF COMMON STOCK.

Basic loss per share was computed using the weighted average number of outstanding common shares. Diluted loss per share includes the effect of dilutive common stock equivalents from the assumed exercise of options, warrants, convertible preferred stock and convertible notes. Common stock equivalents were excluded in the computation of diluted loss per share since their inclusion would be anti-dilutive.

Total shares issuable upon the exercise of warrants and conversion of preferred stock and convertible promissory notes for the nine months ended September 30, 2012 and 2011 were as follows:

| | September 30, | |
|------------------------------|---------------|------------|
| | 2012 | 2011 |
| Warrants | 34,474,018 | 25,239,588 |
| Convertible promissory notes | 88,273,045 | 15,662,465 |
| Convertible preferred stock | 1,545,760 | 1,545,760 |
| Total | 124,292,823 | 42,447,813 |

Fair Value

ASC 820 “Fair Value Measurements and Disclosures” defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. As defined in ASC 820, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Standard clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date and emphasizes that fair value is a market-based measurement and not an entity-specific measurement.

ASC 820 establishes the following hierarchy used in fair value measurements and expands the required disclosures of assets and liabilities measured at fair value:

Level 1 – Inputs use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

Level 2 – Inputs use other inputs that are observable, either directly or indirectly. These inputs include quoted prices for similar assets and liabilities in active markets as well as other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 – Inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company’s assessment of the significance of particular inputs to these fair measurements requires judgment and considers factors specific to each asset or liability.

Liabilities measured at fair value on a recurring basis at September 30, 2012 are as follows:

| | Quoted Prices in Active Markets for Identical Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at September 30, 2012 |
|-------------------------------|--|---|--|-------------------------------------|
| Embedded conversion feature | \$ -- | \$ -- | \$ 325,000 | \$ 325,000 |
| Warrant liability | -- | -- | 70,900 | 70,900 |
| Balance at September 30, 2012 | \$ -- | \$ -- | \$ 395,900 | \$ 395,900 |

Financial assets are considered Level 3 when their fair values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. The Company's Level 3 liabilities consist of derivative liabilities associated with convertible debt that contains an indeterminable conversion share price and the tainted warrants as the Company cannot determine if it will have sufficient authorized common stock to settle such arrangements.

The following table provides a summary of the changes in fair value, including net transfers in and/or out, of all financial assets measured at fair value on a recurring basis using significant unobservable inputs during the nine months ended September 30, 2012.

| | Warrants | Conversion Feature | Total |
|--|------------|-----------------------|------------|
| Balance at - January 1, 2012 | \$ 446,400 | \$ 68,800 | \$ 515,200 |
| Included in stock based compensation | 17,200 | - | 17,200 |
| Change in fair value of derivative liability | (472,800) | (317,800) | (790,600) |
| Included in liabilities (debt discount) | 28,100 | 583,000 | 611,100 |
| Included in stockholder's equity | 52,000 | (9,000) | 43,000 |
| Transfers in and /or out of Level 3 | -- | -- | -- |
| Balance at - September 30, 2012 | \$ 70,900 | \$ 325,000 | \$ 395,900 |

NOTE 7: STOCKHOLDERS' DEFICIENCY.

Debt

During the nine months ended September 30, 2012, the Company issued a total of 33,978,764 shares of common stock upon the requests from note holders to convert partial principal plus accrued interest totaling \$500,642 into the Company's common stock based on the terms set forth in the loans. The conversion rates were from \$0.008515 to \$0.032.

In May 2011 the Company entered into an agreement and received a deposit of \$130,000 for the sale of one PSWS unit. Under the terms of the agreement the Company guaranteed the customer a minimum of \$37,500 of rental income under the Company's rental pool. The Company was not able to provide the customer with delivery of the unit in a timely manner. Subsequently on July 2, 2012 the Company reached an agreement with the customer to refund the deposit of \$130,000 and the \$37,500 rental income by issuing 4,187,500 shares of common stock and three year

warrants with an exercise price of \$0.048. Accordingly the Company recorded a charge to operations for the guaranteed rental income of \$37,500.

On July 2, 2012, the Company issued 4,375,000 shares of common stock to a note lender in connection with a debt financing transaction. The Company recorded \$175,000 of debt discount in connection with such issuance. The debt discount will be amortized over the term of the loan.

Cash

Through Equity Financing:

During the nine months ended September 30, 2012, for gross proceeds of \$200,000 the Company sold 8,704,076 shares of common stock and warrants to purchase additional 2,176,019 shares of common stock at exercise price of \$0.0196 to \$0.072. The warrants have a term of three years.

Services

On January 23, 2012, the Company issued 1,000,000 shares of common stock to the Company's Chief Executive Officer per grant that was approved by the Company's Board of Directors on January 11, 2012. The shares were fully vested on the date of the grant and accordingly, the Company recorded \$65,000 of stock-based compensation in connection with this issuance.

On January 23, 2012, the Company issued 1,000,000 shares of common stock to the Company's Chief Financial Officer per grant that was approved by the Company's Board of Directors on January 11, 2012. The shares were fully vested on the date of the grant and accordingly, the Company recorded \$65,000 of stock-based compensation in connection with this issuance.

On January 24, 2012, the Company issued an aggregate 300,000 shares of common stock to multiple employee and contractors per grant that was approved by the Company's Board of Directors on January 11, 2012. The shares were fully vested on the date of the grant and accordingly, Company recorded \$19,500 of stock-based compensation in connection with this issuance.

On February 7, 2012, the Company issued 86,538 shares of common stock as part of the retainer fee we paid to a consultant for their services rendered. The Company recorded a \$4,500 consultant fee in connection with this issuance.

On March 2, 2012, the Company issued 100,000 shares of common stock as part of the consultant fee we paid to a consultant for services rendered. The Company recorded a \$6,400 marketing fee in connection with this issuance.

On July 27, 2012, the Company issued 187,500 shares of common stock as part of the consultant fee we paid to a consultant for services rendered. The Company recorded a \$7,500 marketing fee in connection with this issuance.

NOTE 8 - NOTES PAYABLE

During the nine months ended September 30, 2012, at the request of the lender, the Company converted \$247,771 of notes payable and accrued interest to convertible notes payable.

During the nine months ended September 30, 2012, at the request of the lender the Company converted \$100,000 of convertible notes payable to \$185,000 of notes payable. The newly issued notes payable bear interest at rates of 6% and have maturity dates in December 2012 through January 2013. The Company is required to repay the notes payable in 5 installment with the final payment of \$65,000 in January 2013.

The conversion of the notes was deemed to be a debt modification in accordance with ASC 470 "Debt" whereby an extinguishment results in recognition by the debtor a gain or loss on the date of modification. Accordingly, the Company recorded a charge of \$85,000 to interest expense for the additional principal payable under the new promissory notes.

NOTE 9 - CONVERTIBLE PROMISSORY NOTES PAYABLE

(a) During the nine months ended September 30, 2012, the Company issued multiple convertible promissory notes for gross proceeds of \$656,000. The Company issued the lender for each loan a convertible promissory note bearing interest at rates of 8% to 12% per annum with maturity dates of September 15, 2012 to August 31, 2013. The loans and accrued interest are to be paid on the maturity dates. Each loan is evidenced by the promissory note the Company issued to the lender which contains conversion clauses that allow the lenders the option to convert the loan amount plus all accrued and unpaid interest due under the note into common stock. Each of the notes contains variable conversion prices representing discount rates between 5% to 50% of market price. In addition, the Company also issued total 1,100,000 warrants to the lenders to purchase additional shares of common stock at exercise of \$0.025 to \$0.05. These warrants have term of 5 years. In addition a noteholder received 4,375,000 shares of common stock in consideration for entering into the note.

The Company accounted for the issuance of the convertible promissory notes and the warrants/shares attached to these notes in accordance with ASC 815 "Derivatives and Hedging". Accordingly, the warrants and the embedded conversion option of the convertible notes are recorded as derivative liabilities at their fair market value and are marked to market through earnings at the end of each reporting period. The gross proceeds from the sale of these notes are recorded net of a total discount of \$611,100. The debt discount relates to the beneficial conversion feature embedded in the conversion option and the fair value of the warrants attached to the notes. The debt discount is charged to interest expense ratably over the term of the convertible note.

In addition, the Company incurred approximately \$120,000 of financing cost related to these transactions which will be amortized over the term of the loans.

(b) During the nine months ended September 30, 2012, at the request of the lender the Company converted \$247,771 of notes payable and accrued interest to convertible notes payable. The Company issued the lender for each loan a convertible promissory note bearing interest at rates 10% per annum and accrued interest are to be paid on demand. Each loan is evidenced by the promissory note the Company issued to the lender which contains conversion clauses that allow the lenders the option to convert the loan amount plus all accrued and unpaid interest due under the

note into common stock. Each of the notes contains variable conversion prices representing discount rates between 20% to 50% of market price.

The conversion of the notes was deemed to be a debt modification in accordance with ASC 470 "Debt" where by a gain or loss is recognized by the debt on the date of modification. In addition, the Company accounted for the issuance of the convertible promissory notes in accordance with ASC 815 "Derivatives and Hedging". Accordingly, the embedded conversion option of the convertible notes are recorded as derivative liabilities at their fair market value and are marked to market through earnings at the end of each reporting period. On the date of the notes the Company recorded a charge to interest expense of \$71,000 and relates to the fair value of the embedded in the conversion option.

- (c) During the nine months ended September 30, 2012, the Company and a lender entered into an agreement to amend certain Convertible Notes issued by the Company to the lender, dated as of March 27, 2012 and April 25, 2012 in the aggregate principal amount of \$100,000. The lender agreed to forgo the right to convert those notes into common stock and in exchange, the Company agreed to issue a note payable for \$185,000 to the lender. Company recorded \$85,000 interest expense for the additional notes payable.

NOTE 10: RELATED PARTY TRANSACTIONS.

- (a) On January 1, 2012, the Company issued a total of 1,077,585 warrants to purchase common stock to its five directors, including warrants issued to the Chief Executive Officer and Chief Financial Officer, each of which received 215,517 warrants for their first quarter of 2012 director fees. The issuance is part of the annual compensation that was authorized by the Company's Board of Directors on December 6, 2011, when the Board approved to replace directors annual compensation of \$50,000 with three year warrants payable quarterly. The Company recorded \$42,000 stock-based compensation in connection with this issuance.
- (b) As further discussed in Note 7, on January 23, 2012, the Company issued 1,000,000 shares of common stock to each of the Company's Chief Executive Officer and Chief Financial Officer per grants that were approved by the Company's Board of directors on January 11, 2012. The shares were fully vested on the date of the grants and accordingly, the Company recorded \$130,000 of stock-based compensation in connection with this issuance.
- (c) On April 2, 2012, the Company issued a total of 1,302,085 warrants to purchase common stock to its five directors, including warrants issued to the Chief Executive Officer and Chief Financial Officer, each of which received 260,417 warrants for their second quarter of 2012 director fees. The issuance is part of the annual compensation that was authorized by the Company's Board of Directors on December 6, 2011, when the Board approved to replace directors annual compensation of \$50,000 with three year warrants payable quarterly. The Company recorded \$33,200 stock-based compensation in connection with this issuance.
- (d) On June 21, 2012, the Company repaid \$3,000 principal to each of the Company's Chief Executive Officer and Chief Financial Officer for loans payable to them.
- (e) On July 3, 2012, the Company repaid \$5,000 principal to Company's Chief Financial Officer for loans payable to him.
- (f) On July 16, 2012, the Company repaid \$5,000 principal to Company's Chief Financial Officer for loans payable to him.
- (g) On July 2, 2012, the Company issued a total of 1,470,588 warrants to purchase common stock to its four directors, including warrants issued to the Chief Executive Officer and Chief Financial Officer, each of which received 367,647 warrants for their third quarter of 2012 director fees. The issuance is part of the annual compensation that was authorized by the Company's Board of Directors on December 6, 2011, when the Board approved to replace directors annual compensation of \$50,000 with three year warrants payable quarterly. The Company recorded \$12,400 stock-based compensation in connection with this issuance.
- (h) On August 7, 2012 the Company issued by unanimous Board consent 51 shares of Series B Preferred stock to Leslie Kessler. Each share of Series B Preferred Shares has voting rights equal to (x) 0.019607 multiplied by the total issued and outstanding Common Stock eligible to vote at the time of the respective vote (the "Numerator") divided by (y) 0.49, minus (z) the Numerator On August 14, 2012 a Schedule 14C Information Statement was filed with the SEC reflecting the unanimous vote by the Series Preferred B Shareholder to increase the authorized Common Shares of the Company from 450,000,000 to 800,000,000.

- (j) On September 28, 2012, the Company's Chief Executive Officer loaned the Company \$80,000. It is a short-term bridge loan. On October 1, 2012, the Company repaid the entire loan. No interest was accrued.

NOTE 11: COMMITMENTS AND CONTINGENCIES.

Litigation

The Company is not aware of any pending or ongoing litigation.

Operating Leases

In March 2012 management exercised a Good Guy Clause” in its lease and abandoned the space at 25 Fairchild Avenue. Accordingly the Company recorded a charge of \$34,707 for the loss on abandonment of property.

On June 28, 2012, the Company signed a lease renewal agreement to extend our lease at 160 Dupont Street for another three years. The minimum annual lease payments due under this lease are as follows:

| Year ending | Amount |
|-------------|------------|
| 2013 | \$ 132,178 |
| 2014 | 136,143 |
| 2015 | 140,227 |
| | \$ 408,548 |

All other existing terms remain the same.

NOTE 12: SUBSEQUENT EVENTS.

(a) On October 25, 2012, the Board of Directors of the Company approved the awards to grant warrants to the following:

- i.) 15,000,000 warrants to the Chief Executive Officer at the exercise price of \$0.006. The warrants contain cash-less clause and have term of 5 years,
- ii.) 15,000,000 warrants to the Chief Financial Officer at the exercise price of \$0.006. The warrants contain cash-less clause and have term of 5 years,
- iii.) 3,000,000 warrants to the Chief Operating Officer at the exercise price of \$0.006. The warrants contain cash-less clause and have term of 5 years,
- iv.) 1,500,000 warrants to each of the two independent directors at the exercise price of \$0.006. The warrants contain cash-less clause and have term of 5 years.

The Company recorded \$175,000 stock-based compensation in connection with this issuance.

(b) On November 5, 2012, the Company issued a total of 1,470,588 warrants to purchase common stock to its four directors, , including warrants issued to its Chief Executive Officer and Chief Financial Officer, each of which received 961,538 warrants for their fourth quarter of 2012 director fees. The issuance is part of the annual compensation that was authorized by the Company’s Board of Directors on December 6, 2011, when the Board approved to replace directors annual compensation of \$50,000 with three year warrants payable quarterly. The Company recorded \$20,400 stock-based compensation in connection with this issuance.

(c) From October 1, 2012 through November 15, 2012, for gross proceeds of \$87,270 the Company sold 8,416,490 shares of common stock and warrants to purchase an additional 2,104,123 shares of common stock at exercise price of \$0.0108 to \$0.0144. The warrants have a term of three years.

(d)

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From October 1, 2012 through November 15, 2012, the Company issued total 66,853,807 shares of common stock upon the requests from note holders to convert partial principal plus accrued interest totaling \$231,690 into the Company's common stock based on the terms set forth in the loans. The conversion rates were from \$0.0024 to \$0.00655.

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

Introductory Comment

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our financial statements and related notes contained elsewhere in this Quarterly Report on Form 10-Q, as well as our audited financial statements and related notes contained in our Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission (the "SEC") on April 16, 2012.

Note Regarding Forward-Looking Statements

This quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"). To the extent that any statements made in this Form 10-Q contain information that is not historical, these statements are essentially forward-looking. Forward-looking statements can be identified by the use of words such as "anticipate," "believe," "continue," "could," "estimate" "expect," "hope," "intend," "may," "plan," "potential," "product," "see," "would" and variations of such words. Forward-looking statements are subject to risks and uncertainties that cannot be predicted or quantified and, consequently, actual results may differ materially from those expressed or implied by such forward-looking statements. Such risks and uncertainties include, without limitation:

our ability to raise capital to finance our research and development and operations, when needed and on terms advantageous to us;

our ability to manage growth, profitability and marketability of our products;
general economic and business conditions;

the effect on our business of recent credit-tightening throughout the United States and the world, especially with respect to federal, state, local and foreign government procurement agencies, as well as quasi-public, charitable and private emergency response organizations;

the effect on our business of recently reported losses within the financial, banking and other industries and the effect of such losses on the income and financial condition of our potential clients;

the impact of developments and competition within the industries in which we intend to compete
adverse results of any legal proceedings;

the impact of current, pending or future legislation and regulation on water safety, including, but not limited to, changes in zoning and environmental laws and regulations within our target areas of operations;

our ability to maintain and enter into relationships with suppliers, vendors and contractors of acceptable quality of goods and services on terms advantageous to us;

the volatility of our operating results and financial condition;

our ability to attract and retain qualified senior management personnel; and

the other risks and uncertainties detailed in this Form 10-Q and, from time to time, in our other filings with the Securities and Exchange Commission.

Readers of this Report on Form 10-Q should carefully consider such risks, uncertainties and other information, disclosures and discussions which contain cautionary statements identifying important factors that could cause our actual results to differ materially from those provided in forward-looking statements. Readers should not place undue reliance on forward-looking statements contained in this Form 10-Q. We do not undertake any obligation to publicly update or revise any forward-looking statements we may make in this Form 10-Q or elsewhere, whether as a result of new information, future events or otherwise.

General

PureSafe Water Systems, Inc. (herein referred to as the “Company”, “Puresafe”, “we”, “us” or “our”) was incorporated in Delaware in 1987. The manufacture and marketing of water coolers and filters constituted a substantial part of our business from 1993 until the fourth quarter of 2001, at which time such operations were sold and we began concentrating on the further development, manufacturing and marketing of a patented line of water purification systems. Between January 2002 and November 2011, we have generated nominal revenues and were deemed for accounting purposes to be a development stage enterprise.

We have generated our first sale of the FRWS in December of 2011 followed by our second sale in the first quarter of 2012. Accordingly, we are no longer deemed to be a development stage enterprise. We are, however, an early stage commercial enterprise. The accompanying unaudited consolidated financial statements have been prepared assuming our company will continue as a going concern. The PureSafe FRWS is the product line by which we have generated our first significant sales since 2001.

Comparison of Results of Operations for the Three Months Ended September 30, 2012 and 2011

Revenues. We recognized \$0 revenues for the three month period ended September 30, 2012 as compared with \$0 for the same period in 2011.

Cost of goods sold. Cost of goods sold for the three month period ended September 30, 2012 was \$3,602 as compared with \$0 for the same period in 2011.

Selling, general and administrative. Selling, general and administrative expenses for the three month period ended September 30, 2012 was \$752,175 compared to \$687,225 for the same period in 2011, a \$64,950 or 9% decrease.

The following is an analysis of some categories that have significant fluctuations between 2012 and 2011.

Total professional fees increased \$46,609 from \$26,531 to \$73,140. The \$46,609 or 175% increase was largely due to billing adjustment for prior quarter activities. Director Fees decreased from \$62,500 in 2011 to \$12,400 in 2012, a \$50,100 or 80% decrease. The main reason for the decrease in director fees is that, effective January 1, 2012, the directors receive warrants instead of shares since after the Board on December 6, 2011, approved replacing directors annual compensation of \$50,000 with three year warrants payable quarterly. Rent related expenses decreased \$44,719 or 45% from \$99,054 in 2011 to \$54,335 in 2012. The 45% decrease is primarily due to the consolidation of our two facilities that is occurred in March 2012. Marketing expense increased \$174,512 from \$2,211 in 2011 to \$176,723 in 2012. We made a one-time adjustment to accrue \$169,444 in marketing consulting fees that we owed to a consultant. Stock Based Compensation decreased \$202,200 from \$214,600 in 2011 to \$12,400 in 2012. As discussed earlier, Director Fees, which is one component of total Stock Based Compensation, decreased \$50,100 because we have replaced the share based compensation with warrant based compensation. In the 3rd quarter of 2011, we awarded 1,000,000 shares each to our Chief Executive Officer and Chief Financial Officer. We recorded \$138,000 stock based compensation in connection with such issuances. We did not have any stock based compensation activities other than the director fee in the same period of 2012.

Research and development. Research and development expenses for the three month periods ended September 30, 2012 were \$0, compared to \$52,130 in 2011. Due to fund restriction, we have curtailed the expenses on research and development and focus on production. However, we understand the vital importance of research and development for our overall success. We are committed to continue to conduct research and development activities to ensure PureSafe FRWS has the most advanced technology within the water filtration equipment industry.

Interest expense - non-debt discount related incurred in the three month periods ended September 30, 2012 and 2011 was \$181,957 and \$128,273, respectively, a \$53,684 or 41% increase. The increase of non-debt discount related interest expense was primarily due to the new loans created in the 3rd quarter of 2012.

Interest expense - debt discount related incurred in the three month periods ended September 30, 2012 and 2011 was \$480,064 and \$150,325, respectively, a \$329,739 or a 219% increase. The large increase on the debt related debt discount was the result of increased cost of borrowing in this quarter.

Change in fair value of warrants and embedded conversion options. Changes in fair value of warrants and embedded conversion options for three months ended September 30, 2012 and 2011 were \$392,700 and \$(445,000), respectively.

The accounting treatment, pursuant to ASC 815 "Derivatives and Hedging", of derivative financial instruments requires that we record the conversion option and related warrants at their fair values as of the inception date of the convertible debenture agreements and at fair value as of each subsequent balance sheet date. As a result of issuing the convertible promissory notes, we were required to reclassify all other non-employee warrants and options as derivative liabilities and record them at their fair values at each balance sheet date. Any change in fair value was recorded as

non-operating, non-cash income or expense for each reporting period at each balance sheet date. We reassess the classification of the instruments at each balance sheet date. If the classification changes as a result of events during the period, the contract is reclassified as of the date of the event that caused the reclassification.

Comparison of Results of Operations for the Nine months Ended September 30, 2012 and 2011

Revenues. We recognized \$265,000 revenues for the nine month period ended September 30, 2012 as compared with \$0 for the same period in 2011.

Cost of goods sold. Cost of goods sold for the nine month period ended September 30, 2012 was \$286,237 as compared with \$0 for the same period in 2011.

Gross Profit. Gross profit before selling, general and administrative expenses and other income(loss) for the nine month period ended September 30, 2012 was (\$21,320) as compared with \$0 for the same period in 2011.

Selling, general and administrative. Selling, general and administrative expenses for the nine month period ended September 30, 2012 was \$1,852,371 compared to \$2,445,111 for the same period in 2011, a \$592,740 or 24% decrease.

The following is an analysis of some categories that have significant fluctuations between 2012 and 2011. Director Fees decreased from \$187,500 in 2011 to \$87,600 in 2012, a \$99,900 or 53% decrease. The main reason for the decrease in director fees is that, effective January 1, 2012, the directors receive warrants instead of shares after the Board on December 6, 2011 approved replacing directors annual compensation of \$50,000 with three year warrants payable quarterly. Production related overhead incurred in the nine months ended September 30, 2012 is \$68,667, compared with \$208,749 in the same period of 2011, a \$140,082 or 66% decrease. The primarily reason for the decrease in the production related expenses was i.) we reclassified \$85,659 manufacturing overhead to cost of goods sold and ii.) we incurred \$56,946 less in production labor in 2012 than in the same period of 2011 because we used less outside labor which usually has higher labor rates. Marketing expense increased \$98,715 from \$91,662 in 2011 to \$190,377 in 2012. As discussed in the Results of Operation for the three month period ending September 30, 2012, we made a one-time adjustment to accrue \$169,444 in marketing consulting fees that we owed to a consultant.

Compensation and related benefits, including stock based compensation, decreased \$587,538 or 42% from \$1,392,190 in 2011 to \$804,652 in the same period of 2012. The 42% decrease was due to the following factors: a.)effective January 1, 2012, the directors receive warrants instead of shares since after the Board approved replacing directors annual compensation of \$50,000 with three year warrants payable quarterly—thus, the fair value for the director fees in 2012 is significantly lower than in 2011; and b.) we incurred \$615,225 less in stock based compensation, from \$781,925 in 2011 to \$166,700 in the same period of 2012.

Research and development. Research and development expenses for the nine month period ended September 30, 2012 were \$58,239, compared to \$135,470 in 2011, a decrease of \$77,231 or 57%. As discussed in the three month comparison section, due to fund restrictions, we have curtailed the expenses on research and development in 2012. We understand the vital importance of research and development for our overall success and are committed to continue to conduct research and development activities to ensure PureSafe FRWS has the most advanced technology within the water filtration equipment industry.

Loss on disposal of Leasehold Improvement. We moved our headquarters to our 160 Dupont Street facility on March 16, 2012. As a result, we wrote-off \$34,708 of leasehold improvement from our books and recorded as loss on disposal of equipment.

Interest expense - non-debt discount related incurred in nine month periods ended September 30, 2012 and 2011 was \$298,564 and \$205,964, respectively. The \$92,600 or 44% increase was primarily attributable to interest from the new loans that we obtained during the nine months of 2012.

Interest expense - debt discount related incurred in nine month periods ended September 30, 2012 and 2011 was \$660,090 and \$313,921, respectively, a \$346,169 or 110% increase. The large increase on the debt related debt discount was the result of increased cost of borrowing in 2012.

Change in fair value of warrants and embedded conversion options. Changes in fair value of warrants and embedded conversion options for nine month ended September 30, 2012 and 2011 were \$790,600 and \$(445,000), respectively.

The accounting treatment, pursuant to ASC 815 “Derivatives and Hedging”, of derivative financial instruments requires that we record the conversion option and related warrants at their fair values as of the inception date of the convertible debenture agreements and at fair value as of each subsequent balance sheet date. As a result of issuing the convertible promissory notes, we were required to reclassify all other non-employee warrants and options as derivative liabilities and record them at their fair values at each balance sheet date. Any change in fair value was recorded as non-operating, non-cash income or expense for each reporting period at each balance sheet date. We reassess the classification of the instruments at each balance sheet date. If the classification changes as a result of events during the period, the contract is reclassified as of the date of the event that caused the reclassification.

On August 3, 2011, the Company borrowed \$125,000 from a private investor and issued to the investor a secured convertible promissory note in the principal amount of \$125,000 (the “Note”). The Note bears an interest rate of 8% per annum and is convertible at any time after the maturity date (December 1, 2011) into shares of common stock of the Company at a 30% discount from the current market price (as defined in the Note). Because the conversion clause in the note made the total shares that could be converted from the convertible notes not determinable, we were required to reinstate and reclassify all other non-employee warrants and options and embedded conversion options that were reclassified to equity on December 31, 2010 as derivative liabilities and record them at their fair values on the date we issued this convertible promissory note and record any change in fair value as non-operating, non-cash income or expense for each reporting period at each balance sheet date.

The change in fair value of warrants and embedded conversion options for any period is always primarily the result of the following factors. The first factor is the fair value we recorded as the result of new issuances of warrants and the embedded conversion value. The second factor is the reduction of outstanding options or warrants at the end of each period due to warrant/options exercise or warrants/options expired during the same period. The third factor is the fluctuation of the Company's stock price.

Liquidity and Capital Resources

As of September 30, 2012, we maintained a cash balance of \$75,148 as compared to \$113,838 as of the same date in 2011.

Net cash used in the operating activities in the nine months ended September 30, 2012, compared to same period of 2011 decreased by \$624,450 or 47% from \$1,326,881 to \$702,431 respectively. The main factor for the decrease of net cash used in operating activities is that we spent considerable less cash on purchasing inventories in 2012 compared to the same period of 2011.

Net cash used in investing activities in 2012 and 2011 was \$0 and \$7,400.

In the nine months ended September 30, 2012 and 2011, we raised \$200,000 and \$628,420 through sales of our common stock and warrant exercises, respectively. Funds received in the nine month periods ended September 30, 2012 and 2011 from convertible promissory notes and promissory notes were \$656,000 and \$472,091, respectively. We paid \$120,649 in financing costs associated with loans created in the nine month period ended September 30, 2012, compared to \$0 in the same period of 2011. Funds received from officers' and directors' convertible loans for the nine month periods ended September 30, 2012 and 2011 were \$80,000 and \$225,000, respectively. Cash used to repay notes payable in the nine month period ended September 30, 2012 and 2011 were \$140,000 and \$4,150, respectively. Cash used to repay officers and directors notes were \$16,000 and \$40,000, respectively. From the above activities, net cash provided by financing activities in the nine months ended September 30, 2012 and 2011 were \$659,351 and \$1,281,361, respectively.

From all the above activities, net cash used for nine month periods ended September 30, 2012 and 2011 was \$43,080 and \$52,920, respectively.

At September 30, 2012, we had a working capital deficit of approximately \$4.7 million. We continue to suffer recurring losses from operations and have an accumulated deficit since inception of approximately \$44 million. These conditions raise substantial doubt about our ability to continue as a going concern.

Our plans with respect to these matters include restructuring its existing debt and raising additional capital through future issuances of stock and/or debt. We are seeking to raise an additional \$2 million within the next six months and an additional 3 million within the next twelve months to fund the following activities: to manufacture 10 commercial PureSafe FRWS units within the next six months and an additional 15 units within the next twelve months; to expand production capability to meet the expected demand for the FRWS domestically and internationally by a combination of expanding the current production facility at 160 Dupont Street, re-engineering and value engineering the FRWS to outsource assembly where appropriate; continue to implement our established marketing program, to establish a sales and marketing network which includes hiring a Vice President of Marketing and Sales Directors to achieve additional sales by the second quarter of 2013.

On August 16, 2012 we filed Schedule 14 C with the Securities and Exchange Commission to notify the Shareholders that on August 7, 2012 the Company received unanimous written consent from the Board and the holder of Series B Preferred Stock to authorize an increase in the authorized shares of Common Stock from 450,000,000 to 800,000,000

shares. The Series B Preferred Stock, 51 shares authorized and issued to our Chief Executive Officer had voting rights equal to 7,488,254 shares per each share of Series B Preferred Stock. The number of votes that voted in favor of the action was 381,900,954.

The extent of these initiatives will be contingent upon the amount of capital raised.

We can give no assurance that such financing will be available on terms advantageous to us, or at all. Should we not be successful in obtaining the necessary financing to fund our operations, we would need to curtail certain or all of our operational activities. The accompanying unaudited condensed consolidated financial statements do not include any adjustments that might be necessary should we be unable to continue as a going concern.

Recent Accounting Pronouncements

Recent accounting pronouncements issued by the FASB and the SEC did not have, or are not believed by management to have, a material impact on the Company's present or future consolidated financial statements.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. Preparation of the statements in accordance with these principles requires that we make estimates, using available data and our judgment, for such things as valuing assets, accruing liabilities and estimating expenses. The following is a list of what we believe are the most critical estimations that we make when preparing our consolidated financial statements.

Stock-Based Compensation

We reports stock-based compensation under ASC 718. ASC 718 requires all share-based payments to employees, including grants of employee stock options, to be recognized in the consolidated financial statements based on their fair values.

We account for equity instruments issued to non-employees as compensation in accordance with the provisions of ASC 718 and 505, which require that each such equity instrument is recorded at its fair value on the measurement date, which is typically the date the services are performed.

The Black-Scholes option valuation model is used to estimate the fair value of the options or their equivalent granted. The model includes subjective input assumptions that can materially affect the fair value estimates. The model was developed for use in estimating the fair value of traded options or warrants that have no vesting restrictions and that are fully transferable. The expected volatility is estimated based on the most recent historical period of time equal to the weighted average life of the options granted.

We have issued equity instruments in the past to raise capital and as a means of compensation to employees and for the settlement of debt.

Income taxes

We account for income taxes under guidance provided by ASC 740 "Income Taxes" which prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. Differences between tax positions taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to the interpretation are referred to as "unrecognized benefits." A liability is recognized (or amount of net operating loss carry forward or amount of tax refundable is reduced) for an unrecognized tax benefit because it represents an enterprise's potential future obligation to the taxing authority for a tax position that was not recognized as a result of applying the provisions of ASC 740.

In accordance with ASC 740, interest costs related to unrecognized tax benefits are required to be calculated (if applicable) and would be classified as "Interest expense, net" in the consolidated statements of operations. Penalties would be recognized as a component of "General and administrative expenses."

Our uncertain tax positions are related to tax years that remain subject to examination by relevant tax authorities. We file income tax returns in the United States (federal) and in various state and local jurisdictions. We are no longer subject to federal, state and local income tax examinations by tax authorities for years prior to 2007.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

This Item is not applicable to smaller reporting companies.

ITEM 4.

CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed by us in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. Our management identified the following material weaknesses as of September 30, 2012.

Entity Level. We recognize the need to provide leadership and guidance to our employees regarding the maintenance and preparation of financial matters. There is a weakness due to the fact that there are not documented policies and procedures in place for certain procedures. An audit committee has not been established.

Financial Reporting. There needs to be a more structured mechanism for evidence of review in the financial reporting process. The following procedures have been implemented since the beginning of 2009, (a) CFO signs and date all financial documents upon the completion of reviewing such documents, (b) all approval or permission will be evidenced by either email or in writing. No oral approval or permission is allowed, (c) General Journal is recorded only after CFO approves (in writing) such entry and (d) monthly bank reconciliations must complete within 15 days after month ends and reviewed by CFO 5 days after the completion of bank reconciliation.

Confidential Reporting Mechanism. We recognize that we need to provide leadership and guidance to our employees, clients and vendors regarding business ethics and professional conduct. A confidential reporting mechanism must be in place for anonymous reporting of a breach to these ethics that will enable prompt and thorough investigation. In January 2009, we implemented a whistleblower program. A toll-free number, as well as an email address, were posted on the homepage of our website to encourage our employee, contractors, sub-contractors, vendors to report any unethical or illegal behavior they suspect.

The entire staff consists of three officers, one Controller and one receptionist. Therefore, we have relied heavily on entity or management review controls to lessen the issue of segregation of duties. Upon receiving adequate financing the Company plans to increase its controls in these areas by hiring more experienced employees in financial reporting, establishing an audit committee and formally documenting the controls the Company has in place.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The design of any system of controls is also based in part on certain assumptions regarding the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Given these and other inherent limitations of control systems, there is only reasonable assurance that our controls will succeed in achieving their stated goals under all potential future conditions.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the third quarter of our 2012 fiscal year that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Not applicable

ITEM 1A. RISK FACTORS.

This Item is not applicable to smaller reporting companies.

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

The following table sets forth the sales of unregistered securities by the Company in the quarterly period ended September 30, 2012.

| Date | Title and Amount(1) | Purchaser | Principal Underwriter | Total Offering Price/Underwriting Discounts |
|-------------------|--|-------------------------|-----------------------|---|
| January 1, 2012 | Three-year Warrants to purchase 1,077,585 shares of common stock at an exercise price of \$0.058 per share issued for compensation to directors of the Company | Board of directors | NA | \$-0-/NA |
| January 13, 2012 | 500,000 shares of common stock and three year warrants to purchase 125,000 shares of common stock at exercise price \$0.072 through 2011 Private Placement. | Private investor | NA | \$0.06 per share/NA |
| January 23, 2012 | 1,000,000 shares of common stock issued as compensation. | Chief Executive Officer | NA | \$0.065 per share/NA |
| January 23, 2012 | 1,000,000 shares of common stock issued as compensation. | Chief Financial Officer | NA | \$0.065 per share/NA |
| January 23, 2012 | 300,000 shares of common stock issued as compensation. | Corporate employee | NA | \$0.065 per share/NA |
| February 7, 2012 | 86,538 shares of common stock issued for service. | Consultant | NA | \$0.052 per share/NA |
| February 27, 2012 | 1,245,020 shares of common stock issued through loan conversion. | Private investor | NA | \$0.04428 per share/NA |
| March 2, 2012 | 100,000 shares of common stock issued for service. | Consultant | NA | \$0.064 per share/NA |

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|----------------|--|--------------------|----|-----------------------|
| March 22, 2012 | 1,518,265 shares of common stock issued through loan conversion. | Private investor | NA | \$0.0336 per share/NA |
| April 2, 2012 | Three-year Warrants to purchase 1,602,085 shares of common stock at an exercise price of \$0.048 per share issued for compensation to directors of the Company | Board of directors | NA | \$-0-/NA |
| April 5, 2012 | 500,000 shares of common stock and three year warrants to purchase 125,000 shares of common stock at exercise price \$0.06 through 2011 Private Placement. | Private investor | NA | \$0.05 per share/NA |
| April 4, 2012 | 818,412 shares of common stock issued through loan conversion. | Private investor | NA | \$0.0312 per share/NA |

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| | | | | |
|----------------|--|--------------------|----|-----------------------|
| May 8, 2012 | 312,500 shares of common stock issued through loan conversion. | Private investor | NA | \$0.0324 per share/NA |
| May 31, 2012 | 937,500 shares of common stock issued through loan conversion. | Private investor | NA | \$0.0162 per share/NA |
| June 4, 2012 | Three-year Warrants to purchase 30,000 shares of common stock at an exercise price of \$0.043 per share issued for service | Consultant | NA | \$-0-/NA |
| June 7, 2012 | Three-year Warrants to purchase 20,000 shares of common stock at an exercise price of \$0.043 per share issued for service | Consultant | NA | \$-0-/NA |
| July 2, 2012 | 818,412 shares of common stock issued through loan conversion. | Private investor | NA | \$0.0312 per share/NA |
| July 2, 2012 | 4,375,000 shares of common stock issued in connection with loan transaction | Private investor | NA | \$0.04 per share/NA |
| July 2, 2012 | Three-year Warrants to purchase 1,470,588 shares of common stock at an exercise price of \$0.034 per share issued for compensation to directors of the Company | Board of directors | NA | \$0/NA |
| July 3, 2012 | 4,187,500 shares of common stock and three year warrants to purchase 1,046,875 shares of common stock at exercise price \$0.048 through conversion of customer deposit | Private investor | NA | \$0.04 per share/NA |
| July 3, 2012 | 1,500,000 shares of common stock issued through loan conversion | Private investor | NA | \$0.0208 per share/NA |
| July 23, 2012 | 1,500,000 shares of common stock issued through loan conversion | Private investor | NA | \$0.0156 per share/NA |
| July 27, 2012 | 187,500 shares of common stock issued for service | Private investor | NA | \$0.04 per share/NA |
| July 31, 2012 | 446,429 shares of common stock issued through loan conversion | Private investor | NA | \$0.0168 per share/NA |
| August 2, 2012 | 1,056,338 shares of common stock issued through loan conversion | Private investor | NA | \$0.0142 per share/NA |
| August 6, 2012 | 1,495,637 shares of common stock issued through loan conversion | Private investor | NA | \$0.0162 per share/NA |
| August 6, 2012 | 1,692,308 shares of common stock issued through loan conversion | Private investor | NA | \$0.0156 per share/NA |

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|--------------------|---|------------------|----|------------------------|
| August 8, 2012 | 1,323,529 shares of common stock issued through loan conversion | Private investor | NA | \$0.0136 per share/NA |
| August 10, 2012 | 468,750 shares of common stock issued through loan conversion | Private investor | NA | \$0.0160 per share/NA |
| August 22, 2012 | 1,250,000 shares of common stock issued through loan conversion | Private investor | NA | \$0.0120 per share/NA |
| August 22, 2012 | 3,866,908 shares of common stock issued through loan conversion | Private investor | NA | \$0.0117 per share/NA |
| August 28, 2012 | 1,165,049 shares of common stock issued through loan conversion | Private investor | NA | \$0.0103 per share/NA |
| August 31, 2012 | 1,125,000 shares of common stock and three year warrants to purchase 281,250 shares of common stock at exercise price \$0.024 through 2011 Private Placement | Private investor | NA | \$0.02 per share/NA |
| August 31, 2012 | 1,125,000 shares of common stock and three year warrants to purchase 281,250 shares of common stock at exercise price \$0.024 through 2011 Private Placement | Private investor | NA | \$0.02 per share/NA |
| September 5, 2012 | 1,658,333 shares of common stock issued through loan conversion | Private investor | NA | \$0.0096 per share/NA |
| September 6, 2012 | 4,473,684 shares of common stock and three year warrants to purchase 1,118,421 shares of common stock at exercise price \$0.0228 through 2011 Private Placement | Private investor | NA | \$0.00190 per share/NA |
| September 10, 2012 | 980,392 shares of common stock and three year warrants to purchase 245,098 shares of common stock at exercise price \$0.02 through 2011 Private Placement | Private investor | NA | \$0.00196 per share/NA |
| September 11, 2012 | 644,460 shares of common stock issued through loan conversion | Private investor | NA | \$0.0117 per share/NA |
| September 17, 2012 | 852,273 shares of common stock issued through loan conversion | Private investor | NA | \$0.0088 per share/NA |
| September 20, 2012 | 10,227,052 shares of common stock issued through loan conversion | Private investor | NA | \$0.0085 per share/NA |

(1) The issuances to executives, employees, lenders, consultants and investors are viewed by the Company as exempt from registration under the Securities Act of 1933, as amended (“Securities Act”), alternatively, as transactions either not involving any public offering, or as exempt under the provisions of Regulation D or Rule 701 promulgated by the SEC under the Securities Act.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None

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

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

The following exhibits are being filed as part of this Quarterly Report on Form 10-Q.

| Exhibit Number | Description |
|----------------|---|
| <u>31.1</u> * | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002. |
| <u>31.2</u> * | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002. |
| <u>32.1</u> ** | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| <u>32.2</u> ** | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Filed herewith

** Furnished herewith

Copies of the following documents are included as exhibits to this report pursuant to Item 601 of Regulation S-K.

SEC Ref.

| No. | Title of Document |
|---------|--|
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Presentation Linkbase Document |

The XBRL related information in Exhibits 101 to this Quarterly Report on Form 10-Q shall not be deemed “filed” or a part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, and is not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of those sections.

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.

PureSafe Water Systems, Inc.

Dated: November 21, 2012

By: /s/ Leslie J. Kessler
Leslie J. Kessler
Chief Executive Officer

By: /s/ Terry R. Lazar
Terry R. Lazar
Chief Financial Officer