



**ELECTRIC AQUAGENICS UNLIMITED, INC.
(OTC BB: EAQU.OB)**

Rating: Speculative Buy maintained
Price target: \$6.26

Share Statistics

Symbol	EAQU
Current Price	\$3.14
High/Low 52 Weeks	2.9 - 6.5
Avg. daily vol. (3m)	12,738.5
Market Cap., \$ mn	25.2
Shares outstg., mn	8.0

Source: Yahoo Finance, SEC Filings

Analyst Summary

We maintain the Speculative Buy rating on EAQU and price target at \$6.26 per share. We consider EAQU is poised to witness a strong progress in the forthcoming quarters through multiple strategic partnerships, including the recent: (1) license agreement with Water Sciences, LLC of \$1 million payment plus a \$3 million strategic investment in EAQU; (2) distribution agreement with Hydration Performance Recovery Ltd; (3) business partnership with Robby Gordon Motorsports.

We expect EAQU to finally find the niche for its unique cleaning and sanitation technology. The recent injections of capital in the form of private placement and strategic investment from Water Science should help EAQU to implement its business strategy, including further development and marketing of its trademarks, brand and product offerings.

Highlights

- **Management is rather optimistic on the future sales**

Although the revenue grew by 28% during Q2FY05 over the similar period of 2004, EAQU still reported marginal revenue compared to what the management expects to achieve in the coming quarters. The management expects to start generating significant revenues from bottled drinking water, hand sanitizer and other consumer products. In addition, management considers that the company will post revenue from its poultry processing plant operations during the next few quarters. Management also expects an increase in revenues from the orders placed by its affiliate franchisees. By the end of 2005, Zerorez Franchising Systems is expected to open 45 new franchises.

So far, during Q2FY05, the sales of equipment through EAQU's affiliate, Zerorez Franchising Systems, Inc. continued to be the main revenue contributor. Among other segments are revenues from bottled drinking water, known as Perfect Empowered Drinking Water™, and Zero+™ hand sanitizer.

Income statement

US\$ 000's, except per share data	Actual			Our estimates		Actual		
	Q2FY04	Q2FY05	YoY%	Q2FY05	actual vs. our estimates	H1FY04	H1FY05	YoY%
Year end Dec. 31								
Net sales	100.0	128.5	28%	100.0	28%	175.0	216.3	24%
Gross profit	66.0	98.5	49%	60.0	64%	118.9	163.2	37%
<i>Gross profit margin</i>	66%	77%	+11 p.p.	60%	+17% p.p.	68%	75%	+7 p.p.
Total operating expenses	1,722.0	1,374.5	-20%	1,720.0	-20%	2,519.0	3,167.0	26%
Loss from operations	-1,655.6	-1,276.0	n/m	-1,660.0	n/m	-2,400.1	-3,003.8	n/m
Other income	0	496.8	n/m	359.0	38%	0	497.8	n/m
Net loss	-1,729.8	-785.0	n/m	-1324.0	n/m	-2,481.2	-2,536.4	n/m
EPS	\$(0.41)	\$(0.11)	n/m	\$(0.24)	n/m	\$(0.48)	\$(0.37)	n/m

Source: SEC Filings

- **With the diversification of the revenue mix, the gross profit margin improved**

During Q2FY05, the gross profit margin increased significantly climbing to 77%. It leapt 11 percentage points as compared to Q2FY04 2003 when it was 66%. The margin improvement is attributable to the revenue growth and is partially attributable to the fact that EAQU enjoys higher profit margins in its bottled drinking water and other consumer products, and that revenue from those products began to be generated during Q2FY05.

- **EAQU still incurred significant losses**

The net loss during Q2FY05 was about \$785 thousand, or a diluted EPS of \$(0.11), as compared to \$1.7 million during Q2FY04. Although there is a positive track of diminishing net losses, the actual revenue level is too small compared to operating costs for the company to break even. The company anticipates that its main expenditure – general and administrative expenses – will remain constant during the next several quarters. Following the anticipated growth of revenue, we consider that EAQU will diminish gradually its net loss.

During Q2FY05, a significant role in reducing the net loss played the transaction whereby EAQU sold its capital stock in Biofilm Strategies Corporation. As a result, it recognized a non-recurring gain of \$467 thousand.

Financial statistics

US\$ 000's	FY03	FY04	H1FY05
Year end December 31	31-Dec-03	31-Dec-04	30-Jun-05
Cash	593.2	382.9	212.4
Inventories	48.8	503.3	2,263.7
Total current assets	978.5	1,389.6	3,063.5
Total assets	1,019.9	3,907.0	5,977.9
Total current liabilities	399.0	370.8	1,903.0
Long term debt	134.0	233.3	215.3
Total stockholders' equity	486.9	3,302.8	3,859.5
Working capital	579.5	1,018.8	1,160.5
Operating cash flow	-1,005.7	-2,680.5	-3,382.7

Source: SEC Filings

- **The company estimates that it will need to raise additional capital in 2005 in order to continue its operations**

Since its foundation, EAQU financed its operations through private placements. The company is not yet able to cover the operations from revenues. For instance, in 2004, EAQU recorded a deficit of operating cash stream of more than \$2.7 million, which was covered by an issuance of common stock. In 2004, it raised approximately \$4 million through a registered private offering. Management recognizes that additional funding will be required to finance growth and to achieve strategic objectives. The company plans to finance its FY05 operations through private placements.

In June'05, EAQU commenced a private placement offering to sell 1 million units. As of June 30'05, the company raised more than \$0.5 million in the private placement.

Risks

In spite of the optimistic vision of the management based on EAQU's technology, we consider a number of factors that have to be taken into account at this stage:

- **Customer concentration.** EAQU derives most of its revenues through its affiliate Zerorez Franchising Systems. Although the company identified a series of new channels for distributing its products and plans to rely on other products, we consider that there is a high risk in case EAQU fails to diversify its revenue sources.

- **History of losses.** Since its foundation in 2000, EAQU has incurred losses in each of the subsequent years. The amount of losses has an ascending trend. If the management fails to increase revenue and control operating costs there is a high probability that the company will continue the current negative trend.

- **The going concern risk.** In 2004, EAQU incurred significant losses and a negative cash flow from operations. As a result, it financed its operations primarily through private placements. In the past, management succeeded in attracting new funds. However, there is a risk that the development and implementation period of the technologies will last too long and the company will fail to generate sufficient cash flows to sustain its operations.

Recent events

On September 20'05, EAQU announced that it had licensed the exclusive rights to market its Empowered Water and protectant technologies and other products and services to Water Sciences, LLC for Central and South America, including Mexico. Water Science paid \$1 million for the right to market and distribute EAQU's products and services in Latin America. According to the agreement, EAQU will receive royalty on some of the Water Science's gross revenue. In addition, Water Science made a \$3 million strategic investment in EAQU.

On August 22'05, EAQU signed a distribution agreement with Hydration Performance Recovery Ltd, whereby the latter will be the exclusive distributor of EAQU's Oxygen Therapy Products in the U.K., starting with Perfect Oxygenated Drinking Water. Upon the signing of the contract, Hydration Performance Recovery placed the first order for 31,680 bottles of Perfect Oxygenated Drinking Water. The order will be distributed to hundreds of Hydration Performance Recovery's existing retail store locations.

On July 27'05, EAQU announced a business partnership with Robby Gordon Motorsports. Pursuant to the agreement, EAQU will become the exclusive provider of bottled water for the Robby Gordon Motorsports team throughout the 2005 NASCAR Nextel Cup Season.

On July 15'05, EAQU announced that it had hired Phil Adams as a new Vice President of its Regulatory Division. Mr. Adams has a vast experience in sales and engineering within the chemical disinfectant business. During the last two years he worked as the National Product Manager for Hoshizaki America, Inc., providing sales and technical support for its ROX Water Electrolyzers. Hoshizaki supplies ice machines and refrigeration equipment to restaurants and other food service businesses. Prior to that, Mr. Adams served as an R&D

chemist, applications engineer and sales representative. Mr. Adams graduated from California State Polytechnic University, Pomona with a degree in biochemistry.

EAQU versus S&P 500

ELECTRIC AGUAGENICS UNLIMITED
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