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SYNERGY TECHNOLOGIES CORP
Form 10QSB
November 14, 2001

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended: SEPTEMBER 30, 2001

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

For the transition period from _____ to _____

Commission file number 0-26721

SYNERGY TECHNOLOGIES CORPORATION
(Exact name of small business issuer
as specified in its charter)

COLORADO	84-1379164
(State or other jurisdiction	(IRS Employer
of incorporation or organization)	Identification No.)

335 - 25th Street, S.E., Calgary, Alberta Canada T2A 7H8
(403) 269-2274
(Issuer's telephone number)

NOT APPLICABLE
(Former name, former address and former
fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 X No
--- ---

State the number of shares outstanding of each of the issuer's classes of common equity, as of the last practicable date:

33,801,596 shares of Common Stock, \$0.002 par value, as of November 7, 2001.

Transitional Small Business Disclosure Format
(check one): Yes No X
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SYNERGY TECHNOLOGIES CORPORATION
AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)

FINANCIAL STATEMENTS
(UNAUDITED)
PREPARED BY MANAGEMENT

SEPTEMBER 30, 2001

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SYNERGY TECHNOLOGIES CORPORATION
AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(PREPARED BY MANAGEMENT) FOR THE
NINE MONTH PERIOD ENDED SEPTEMBER 30, 2001

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nine months ended September 30, 2001 and 2000, and for the period from November 7, 1996 (Date of Inception) to September 30, 2001

Unaudited Consolidated Statement of Cash Flows for the three and nine months ended September 30, 2001 and 2000, and for the period from November 7, 1996 (Date of Inception) to September 30, 2001

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SYNERGY TECHNOLOGIES CORPORATION
AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED BALANCE SHEETS
ASSETS

		AS AT SEPTEMBER 30, 2001

CURRENT ASSETS		
Cash	\$	289,064
Receivables (Note 5)		39,468
Receivables - related parties		-
Prepaid expenses		46,760

TOTAL CURRENT ASSETS		375,292
INVESTMENTS (Note 3)		
SynGen Technologies		38,028,244
CPJ Technologies		1,432,500
Investment in Private US corporation		1,000,000

40,460,744		
Investment in joint venture (Note 3)		76,674

TOTAL INVESTMENTS		40,537,418
Office equipment and computers, net of accumulated depreciation \$38,881		65,251

TOTAL ASSETS	\$	40,977,961
		=====

LIABILITIES AND STOCKHOLDERS' EQUITY

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CURRENT LIABILITIES		
Accounts payable	\$	531,285
Accrued expenses		100,042

TOTAL CURRENT LIABILITIES		631,327
LONG TERM LIABILITIES (Note 6)		
Notes payable		2,384,949
Notes payable - related parties		-
Accrued interest on notes		311,470

TOTAL LONG TERM LIABILITIES		2,696,419
Investment in joint venture (Note 3)		80,726

TOTAL LIABILITIES		3,408,472
STOCKHOLDERS' EQUITY		
Common stock, \$0.002 par value, 50,000,000 shares authorized, 33,801,596 Shares issued and outstanding		68,584
Additional paid in capital		49,268,609
Deferred compensation		(39,964)
Accumulated deficit		(11,727,740)

TOTAL STOCKHOLDERS' EQUITY		37,569,489
		=====
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$	40,977,961
		=====

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

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SYNERGY TECHNOLOGIES CORPORATION
AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF OPERATIONS

	FOR THE THREE MONTHS ENDED SEPTEMBER 30		FOR THE NI ENDED SEP
	2001	2000	2001
	(UNAUDITED)	(UNAUDITED)	(UNAUDITED)

OTHER INCOME			
Interest income	3,069	18,847	4,123
Consulting income	-	-	-
	-----	-----	-----
	3,069	18,847	4,123

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EXPENSES

General and administrative	774,239	567,120	1,778,761
Stock option compensation	23,096	51,208	66,306
Compensation related to warrants	-	-	-
Technology development	139,968	143,253	547,540
Dry well expenses	-	-	-
<hr/>			
TOTAL EXPENSES	937,303	761,581	2,392,607
<hr/>			
LOSS FROM OPERATIONS	(934,234)	(742,734)	(2,388,484)
<hr/>			
OTHER EXPENSES			
Amortization of debt discount and offering costs	-	(1,350,000)	-
Accrued interest on notes payable	(56,712)	-	(177,384)
Share of expenses incurred by joint venture	(71,365)	-	(246,059)
Gain on disposition	-	-	114,643
<hr/>			
NET LOSS BEFORE TAXES	(1,062,311)	(2,092,734)	(2,697,284)
<hr/>			
PROVISION FOR INCOME TAX	-	-	-
<hr/>			
NET LOSS	\$ (955,811)	\$ (2,092,734)	\$ (2,697,284)
<hr/>			
BASIC AND DILUTED LOSS PER COMMON SHARE	\$ (0.03)	\$ (0.16)	\$ (0.09)
<hr/>			
WEIGHTED AVERAGE NUMBER OF COMMON SHARES USED IN CALCULATION	33,243,670	13,026,017	31,676,586
<hr/>			

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

SYNERGY TECHNOLOGIES CORPORATION AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF CASH FLOW

FOR THE THREE MONTHS
ENDED SEPTEMBER 30

FOR THE NINE
ENDED SEPT

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	2001	2000	2001
	(UNAUDITED)	(UNAUDITED)	(UNAUDITED)
<hr/>			
CASH FROM OPERATING ACTIVITIES			
Net loss	(1,062,311)	(2,092,734)	(2,697,284)
Adjustments to reconcile net loss to net cash from operations			
Dry well expense	-	-	-
Depreciation	9,026	5,658	27,829
Amortization of unearned compensation	23,096	51,208	66,306
Amortization of debt discount and offering costs	-	1,350,000	-
Accrued interest on notes payable	56,712	-	177,384
Issuance of shares for services	214,823	-	780,629
Issuance of warrants for services	-	-	-
Re-issue of founders shares	106,500	-	106,500
Investment in joint ventures	(32,788)	-	4,051
Exchange rate loss	23,450	18,564	24,380
Loss on disposition of assets	-	-	904
Changes in assets and liabilities			
Accounts receivable	(14,513)	(389,567)	45,291
Prepaid expenses and deposits	13,887	(36,053)	26,953
Accounts receivable - related parties	60,228	(439,482)	2,842
Accounts payable	(221,016)	(198,363)	(51,508)
Accounts payable - related parties	10,145	-	153,088
Accrued expenses	46,430	19,244	14,605
<hr/>			
NET CASH FLOWS FROM OPERATING ACTIVITIES	(766,331)	(1,711,525)	(1,318,030)
CASH FROM INVESTING ACTIVITIES			
Acquisition of oil and gas properties	-	-	-
Acquisition of property and equipment	(12,137)	(24,254)	(13,620)
Acquisition of equity security	-	-	-
<hr/>			
NET CASH FLOWS FROM INVESTING ACTIVITIES	(12,137)	(24,254)	(13,620)
CASH FROM FINANCING ACTIVITIES			
Proceeds from (payments to) notes payable - related parties	(89,827)	-	(26,983)
Proceeds from (payments to) notes payable	8,844	23,864	8,844
Proceeds from investor deposits	(266,521)	-	-
Proceeds from option income	-	-	-
<hr/>			
Net proceeds from convertible debt	-	1,282,500	-
Sales of common stock	1,317,674	323,200	1,587,174
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NET CASH FLOWS FROM FINANCING			

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ACTIVITIES	970,170	1,629,564	1,569,035
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(23,450)	(18,564)	(24,380)
NET CHANGE IN CASH	168,252	(124,779)	213,005
CASH AT BEGINNING OF PERIOD	120,812	810,766	76,059
CASH AT END OF PERIOD	\$ 289,064	\$ 685,987	\$ 289,064

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS.

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SYNERGY TECHNOLOGIES CORPORATION
AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	SHARES	AMOUNT	ADDITIONAL PAID IN CAPITAL	ACCUMULATED DEFICIT
BALANCE AT DECEMBER 31, 1999	11,989,327	\$23,980	\$ 1,484,455	\$ (2,950,000)
Cancellation of founders shares	(496,736)	-	-	-
Issuance of shares for cash	710,000	1,420	353,580	-
Issuance of shares for royalty	500,000	1,000	1,061,500	-
Issuance of stock options	-	-	981,330	-
Issuance of warrants for services September 29, 2000	-	-	343,744	-
Issuance of convertible debt	-	-	2,137,500	-
Issuance of shares from escrow	14,943,510	29,887	37,998,357	-
Warrants for stock, January through December 2000	431,000	862	430,138	-
Issuance of shares for services February 16, 2000 at average prices	1,359,063	2,718	890,919	-
Options exercised	105,000	210	104,790	-
Unearned compensation	-	-	-	-
Net loss for the period	-	-	-	(6,070,000)
BALANCE AT DECEMBER 31, 2000	29,541,164	\$60,077	\$45,786,313	\$ (9,070,000)
Units for stock - debenture	1,000,000	2,000	998,000	-
Units for stock - cash	264,000	528	263,472	-
Options exercised	5,500	11	5,489	-

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Re-issue of founders shares	157,143	300	106,200	
Issuance of stock options	-	-	16,500	
Shares for services	798,907	1,598	779,031	
Issuance of shares for cash	2,034,882	4,070	1,313,604	
Unearned compensation	-	-	-	
Net loss for the period	-	-	-	(2,69
	=====	=====	=====	=====
BALANCE AT SEPTEMBER 30, 2001	33,801,596	\$68,584	\$49,268,609	\$ (11,72
	=====	=====	=====	=====

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

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SYNERGY TECHNOLOGIES CORPORATION AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
NOTES TO AUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

All dollar amounts used herein refer to U.S. dollars unless otherwise indicated.

These statements are prepared using Generally Accepted Accounting Principals as well as the terms outlined or explained in the year end 10-KSB filing along with any changes as noted in the March 31, 2001 and June 30, 2001 10-QSB.

All significant transactions between the parent and consolidated affiliates have been eliminated. The consolidated quarterly financial statements are unaudited. These statements include all adjustments (consisting of normal recurring accruals) considered necessary by management to present a fair statement of the results of operations, financial position and cash flows. The results reported in these consolidated financial statements should not be regarded as necessarily indicative of results that may be expected for the entire year.

NOTE 2 - GOING CONCERN

BUSINESS CONDITION - The accompanying financial statements have been prepared in conformity with generally accepted accounting principles, which contemplate continuation of Synergy as a going concern. However, Synergy has had negative cash flows from operating activities during the quarter ended September 30, 2001 and cumulatively from inception through September 30, 2001. As the Company has not yet developed or constructed plants or facilities of a commercial size, it does not expect to be able to generate any substantial amounts of revenues until the construction of such facilities, or the completion of other arrangements such as for the construction of such facilities by third parties or the sale of an interest in the Company's technologies. The construction of any plants or other facilities would require the Company to raise substantial amounts of additional funds. The Company does not presently have any known sources of

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additional funds, or have other arrangements that would result in any substantial revenues in the foreseeable future. These conditions raise substantial doubt about Synergy's ability to continue as a going concern. Synergy's continued existence is dependent on its ability to obtain additional financing. The Company will attempt to continue to raise additional funds from public and private markets and through arrangements with certain related and unrelated companies with which it is negotiating mutually beneficial agreements for the use of the technologies. However, there is no assurance that additional financing will be realized. If Synergy is unable to realize this additional financing, it could cease to be a going concern.

DEVELOPMENT STAGE COMPANY - Since inception, the Company has spent most of its efforts raising capital and financing the research and development of certain technologies; however, it has not yet had sales sufficient to sustain operations and has relied upon cash flows from financing activities (primarily debt and equity issuances) to sustain operations. To date the Company has had minimal revenues and has substantial debt, therefore, the Company is considered to be in the development stage. The Company's development activities include the following:

GAS-TO-LIQUIDS TECHNOLOGY (GTL)

While the GTL technology has been used in pilot plants, the Company does not yet have any plans or arrangements for the construction of a commercial plant. Drake Synergy Petroleum Limited, a 50% owned joint venture in Nigeria, is pursuing an opportunity. The Company believes that a long-term gas supply contract on favorable terms is also critical to successful development and commercial use of the GTL technology.

CPJ

The Company has a 1/2 BOPD pilot plan that is being used to evaluate heavy oil upgrading possibilities. The Company is attempting to make arrangements with third parties such as oil and gas producing companies for the financing and construction of a 5000 BOPD demonstration plant.

SYNGEN

The Company has installed a 5-litre size SynGen reactor in its Calgary laboratory. The Company is attempting to enter into licensing or other arrangements for the use of Syngen with third parties.

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NOTE 3 - INVESTMENTS, ACQUISITIONS AND TECHNOLOGY DEVELOPMENT

Investments reported on the Consolidated Balance Sheet of the Company include the following:

	SEPTEMBER 30, 2001	DECEMBER 2000
	-----	-----
Investment in SynGen Technology (See Note 3(a) below)	\$ 38,028,244	\$ 38,028,244
Investment in CPJ Technology (See Note 3(b) below)	1,432,500	1,062,500

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Investment in private U.S. corporation (See Note 3(b) below)	1,000,000	1,000,000
	-----	-----
	\$ 40,460,744	\$ 40,090,000
	=====	=====

(a) SynGen: There were no changes during the current quarter.

(b) CPJ: During the quarter ended September 30, 2001, the Company recorded a liability of \$46,000 to the inventor, Dr. Jorgensen, based on the amended royalty agreement signed in fiscal 2000, whereby, Dr. Jorgensen was to receive proceeds of not less than \$250,000 from the sale of 100,000 shares of Synergy Technologies Corporation by February 28, 2001 and an additional \$250,000 from the sale of a further 100,000 shares by February 28, 2002. As of September 30, 2001, Dr. Jorgensen had not sold any of the shares and therefore, based on the September 28, 2001 closing stock price of \$0.65 per share, the difference in net proceeds is \$370,000, of which \$324,000 was recorded in the June 30, 2001 Financial Statements.

For the purposes of these financial statements, all operations of Carbon have been fully consolidated up to November 1, 2000, and subsequently, the Company's interest in Carbon has been recorded using the Equity Method.

Investment in Carbon as at September 30, 2001:

o Shares of Carbon		
o 2,500 shares valued at Cyprus 1.00 per share		5,029
o Advances to Carbon		686,352
o 50% of net liabilities of Carbon		(772,107)

	\$	(80,726)

Investment in Drake Synergy Petroleum as at September 30, 2001:

o Shares of Drake Synergy Petroleum Ltd.		
o 2,500,000 shares valued at Naira 1.00 per share		22,104
o Advances to Drake Synergy Petroleum		96,726
o 50% of net liabilities of Drake Synergy Petroleum		(42,156)

	\$	76,674

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- (a) Notes payable of \$89,827 reported on the Consolidated Balance Sheets of the Company as at June 30, 2001 represented the total cumulative amounts advanced to Synergy for general operations from its 50% owned joint-venture with Carbon Resources Limited. The note was retired in full during the quarter ended September 30, 2001.
- (b) During the nine-month period ended September 30, 2001, the Company and its subsidiaries were charged a total of \$134,132 in consulting fees by Glidarc Technologies Inc. (a Texas corporation) for process management services and technical personnel. Mr. Thomas Cooley, an officer of Glidarc Technologies, is also the Company's Chief Executive Officer and a member of the Board of Directors. Mr. Cooley also serves on the Board of Directors of Syngen Technologies Limited, a wholly owned subsidiary of the Company, and Carbon, the Company's 50% joint venture. An amount of \$1,409 relating to services provided by Glidarc Technologies through September 30, 2001 remained due and payable to Glidarc as at the end of the quarter.
- (c) During the quarter ended September 30, 2001, the Company was charged \$54,646 for consulting services and reimbursement of actual expenses by Huntingtown Associates LLC (a Connecticut corporation) of which Mr. Baumert is the sole proprietor. Mr. Baumert is a member of the Company's Board of Directors. Huntingtown Associates charges consulting services provided by Mr. Baumert at a rate of \$1,500 per day plus expenses. An amount of \$61,876 remained due and payable to Huntingtown Associates as at September 30, 2001.

NOTE 5- RECEIVABLES

Certain expenses for services rendered and supplies acquired in Canada are subject to a federal Goods and Services Tax of 7% which is refundable to the Company at fiscal year end. This amount is refundable to the Company in Canadian Dollars upon filing of a GST return. Total receivables of \$39,468 include a GST refund due to the Company of \$14,681, as well as certain other receivables totaling \$24,787.

NOTE 6 - LONG TERM LIABILITIES

- (a) Notes payable of \$134,949 is reported on the Consolidated Balance Sheet as at September 30, 2001 which amount represents cash advances from Stone Canyon Resources Ltd. in respect of general operations. This amount has no set terms of repayment.
- (b) Convertible promissory note's interest in the amount of \$279,374 has been accrued to September 30, 2001 and \$32,096 interest payable to SCRL is included on the Consolidated Balance Sheet as Accrued interest on notes.

NOTE 7 - COMMON STOCK

- (a) Cash proceeds of \$1,317,674 were received for the purchase of 1,934,882 Units at \$0.65 per Unit and 100,000 Units at \$0.60 per Unit pursuant to an offering commenced second quarter 2001 and made pursuant to Regulation D, Rule 506. Each Unit consists of a share of common stock and a warrant to purchase an additional share for \$1.30, exercisable at any time two years from the time of subscription. There are 280,500 Units available for purchase under this offering that has been

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subscribed for by a foreign corporation. The funds will be received during the fourth quarter.

- (b) 150,000 shares were re-issued related to the cancellation of founders' shares in September 2000. These shares were valued at the average trading value of the stock from the date of issuance. A value of \$106,500 is recorded in the Statement of Operations relating to this transaction at \$0.71 per share.
- (c) 53,763 shares were issued to a certain investment firm for financial advisory services. The shares are recorded in the Consolidated Statement of Operations under the General and administrative category at the average trading value of the stock prior to the date of execution of the agreement. A value of \$50,000 is recorded in the Statement of Operations relating to this transaction at \$0.93 per share.

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- (d) 183,137 shares were issued pursuant to an S-8 registration under the 2001 Employee Stock Option and Award Plan for fees related to various consulting services. The shares were issued at an average trading value of \$0.90.

The following table summarizes the warrants issued, exercised and expired during quarter ended September 30, 2001 and the fiscal year ended December 31, 2000 and those warrants which remain outstanding as at September 30, 2001:

	NINE MONTHS ENDED SEPTEMBER 30, 2001
=====	
Warrants to purchase common shares, beginning of year	914,666
Warrants issued during the period	-
At \$1.00 per share	-
At \$1.30 per share	2,034,882
At \$3.00 per Unit	-
At \$3.50 per share (Note 7(a))	1,264,000
Warrants exercised during the period, \$1.00 per share	-
Warrants cancelled during the period, \$1.00 per share	-
Warrants expired unexercised during the period, \$1.00 per share	(130,000)

Warrants to purchase common shares, end of period	4,083,548
	=====

STOCK OPTIONS

The Company has five stock option plans as follows:

- o 1998 Directors and Employees Stock Option Plan (Plan "A");

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- o 1999 Directors and Employees Stock Option Plan (Plan "B");
- o 1999 Directors and Advisory Board Members Stock Option Plan (Plan "C");
- o 2000 Employees Stock Option and Stock Award Plan (Plan "D"); and,
- o 2001 Employees Stock Option and Stock Award Plan (Plan "E")

The following table will summarize options and awards granted, and options and awards available for grant to the quarter ended September 30, 2001:

	PLAN A 1998	PLAN B 1999	PLAN C 1999	P
Total shares authorized under plan:	900,000	1,000,000	1,100,000	1,
Options/awards granted:				
Employees (i)	250,000	350,000	-	
Directors (i)	400,000	425,000	400,000	
Non-employees, consultants (ii)	250,000	200,000	-	1,
Advisory Board members (ii)	-	-	500,000	
Total options granted	900,000	975,000	900,000	1,
Expired or cancelled (iii)	-	25,000	200,000	
Available for grant at September 30, 2001	-	-	-	

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- (a) 10,000 employee stock options granted to various employees, under the 1999 Directors and Employees Option Plan, expired or were cancelled. Also during the quarter, 15,000 options granted under the 2000 Employees Stock Option and Stock Award Plan expired.
- (b) 100,000 options were granted to our new legal counsel, Burg Simpson Eldredge Hersh Jardine PC and an additional 50,000 options were granted to a member of the advisory board for consulting services. Both of these grants were issued outside of all Company stock option plans and have a strike price of \$1.00.
- (i) Options granted to employees and directors for their services as directors and employees are accounted for using the intrinsic value method amounting to a value of \$11,700 during the quarter.
- (ii) The options granted to non-employees and advisory board members are accounted for by the fair value method. The aggregate fair value of options granted and shares issued pursuant to these plans during the quarter ended September 30, 2001 was \$16,500, of which \$1,493 was charged to earnings in the current quarter. The remaining \$15,007 was deferred until future periods. The fair value of the options was determined by

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using the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0.0%, weighted average expected volatility of 18.16%, weighted average risk-free interest rate of 4.25% and expected life of 2 years.

- (iii) Plan "C" includes 200,000 options granted to former Chief Executive Officer, John Gradek. These options have been cancelled and are being held in escrow pending the outcome of the ongoing litigation.

The following table summarizes the status of the Company's stock options (excluding stock awards) and changes thereto during the quarter ended September 30, 2001:

	SHARES	WEIGHTED EXERCISE SEPTEMBER
Outstanding at beginning of year	2,795,000	
Granted during period	325,000	
Cancelled during period	(325,000)	
Exercised during period	(5,500)	
Outstanding at end of quarter	2,789,500	

NOTE 8 - OTHER EVENTS

There have been no material changes in the on-going litigation of the organization during the Quarter. Refer to the March 31, and June 30, 2001 10-QSB's for details on outstanding issues.

PLAN OF OPERATION

Synergy's business is the development and licensing of technologies related to the oil and gas industry. Synergy's three (3) discrete technologies consist of:

- (1) conversion of stranded natural gas into synthetic naphtha and diesel, a gas to liquids process referred to as GTL,
- (2) the CPJ process which upgrades heavy oil to more valuable and easily refined lighter oils; and
- (3) SynGen, the cold plasma technology to produce hydrogen rich streams from natural gas, LPG, gasoline, and diesel.

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We continue to evaluate opportunities to participate in the development and construction of a plant utilizing all or some of its GTL technology in the near future. Our Drake Synergy Petroleum Limited joint-venture company in Nigeria is pursuing such an opportunity. The success of a venture is predicated upon the negotiation of a gas supply for a 20-year term. To date, discussions with potential sources of financing have been promising, pending a gas contract. The sulfur free and aromatic free products manufactured at this facility would be shipped by tanker from Nigeria to markets in the US and/or Europe.

CPJ

Discussions continue with producers in Alberta and Central Alberta to construct a 5000 bpd upgrade facility. The upgraded product from the plant will likely be used as synthetic diluents to ship additional heavy crude to market by pipeline. Such a plant will have a commercial basis but will also serve as a demonstration plant for the very large heavy oil upgraders planned for the later part of the decade in Alberta. The 1/2 BPD pilot unit continues to be used to evaluate heavy oil upgrading for both Canadian bitumen's and refinery atmospheric bottoms. Just as the GTL process monetizes standard natural gas by conversion to salable synthetic fuels, the CPJ process can monetizes heavy oil to salable synthetic oil. Heavy oil reserves occur throughout the world, although the largest know reserves are in Canada and Venezuela.

SYNGEN

Beginning in the first quarter of 2001, Synergy has focused intensively on the fuel cell potential for its SynGen reforming technology. It has become readily apparent that commercial fuel cell applications, both stationary and onboard, will be fossil fuel based for the foreseeable future. A 5-litre size SynGen reactor has been installed in the Synergy Calgary laboratory. Tests have shown that natural gas, gasoline, and diesel can be reformed into hydrogen rich streams suitable for MCFC and SOFC fuel cells. Discussions are underway to develop a relationship via formal licensing of SynGen with a SOFC manufacturer. Work continues on Synergy's other SynGen systems, including the Bantry test site.

The Company requires significant funding to fully implement our near and long-term capital requirements. In the near term, we expect to relocate our principal corporate offices from Calgary, Alberta to Houston, Texas and to engage senior management including a new Chief Executive Officer and a Chief Financial Officer. We also will require funds to continue marketing our products and technologies and for the further research and development of our technologies. We anticipate that we will require approximately two million dollars to fund these near-term projects, excluding the construction of commercial facilities for which we will seek separate financing or a well-funded development partner. In the past, we have been successful in identifying outside financing to fund our operations; however, we cannot be certain that we will be successful in securing new financing on terms acceptable to us.

Our long-term programs, those we are pursuing for a date at least forty-eight months from the date hereof, include a commercial scale GTL facility and a commercial scale CPJ heavy oil upgrading facility. We are not seeking financing to fund these projects at this time but will evaluate our financing strategy and requirements at such time as we propose to implement these programs.

During the quarter ended September 30, 2001, our development activities continued to focus on efforts to identify a partner to participate in the

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construction of a demonstration plant that monetizes heavy oil to salable synthetic oil using our CPJ technology. As well, development activities continue in finalizing the implementation of a commercial scale GTL facility for the conversion of stranded natural gas into clean burning fuels. We also have focused on the development of the fuel cell potential of our SynGen reforming technology, as more fully described below.

For a more complete discussion of our business, please refer to our Annual Report on Form 10-KSB for the year ended December 31, 2000.