UPGRADE INTERNATIONAL CORP /FL/
Form 10QSB
May 21, 2001

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-QSB

(Mark One)

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

For the quarterly period ended MARCH 31, 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 No. 0-27649

UPGRADE INTERNATIONAL CORPORATION
(Exact name of small business issuer as specified in its charter)

Washington	58-2441311
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1411 FOURTH AVENUE - SUITE 629 SEATTLE, WASHINGTON 98101
(Address of principal executive offices)

(206) 903-3116
(Issuer's telephone number, including area code)

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 latest practicable date: As of April 30, 2001, 23,122,576 shares of common stock, $.0001 par value were outstanding.

Transitional Small Business Disclosure Format (Check one): Yes [ ] No [X]

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Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED BALANCE SHEETS

ASSETS

	September 30, 2000	March 31, 2001
		(unaudited)
CURRENT ASSETS		
Cash and cash equivalents	$ 398,989	$ 600,661
Restricted deposit	805,687	300,000
Subscription receivable	32,725	-
Note receivable from related party	-	130,000
Equipment held for sale	-	3,054,125
Prepaid expenses, deposits and other	121,491	356,355
Total current assets	1,358,892	4,441,141
PROPERTY AND EQUIPMENT - AT COST, less accumulated depreciation and amortization	1,791,257	2,041,116
EQUIPMENT UNDER CONSTRUCTION	3,301,625	-

ADVANCES TO THE PATHWAYS GROUP, INC	1,900,825	3,250,780
ADVANCES TO ROCKSTER, INC.	-	560,000
OTHER ASSETS		
Intangible and deferred assets, net of accumulated amortization	370,206	580,769
Deposits and other	328,051	332,845
Total assets	$ 9,050,856	$ 11,206,651
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Accounts payable	$ 1,993,796	$ 4,073,049
Accrued liabilities	733,241	1,463,571
Bridge loans	799,177	82,185
Notes payable	-	481,231
Equipment purchase contract payable	2,307,025	1,850,000
Royalty fee payable to Card Tech, Inc., net	487,500	812,500
Payable to related parties	175,240	1,259,840
Total current liabilities	6,495,979	10,022,376
NOTES PAYABLE, net of unamortized discount	-	400,000
CONVERTIBLE DEBENTURES, net of unamortized discount	809,043	1,035,858
MINORITY INTEREST	-	-
COMMITMENTS AND CONTINGENCIES	-	-
STOCKHOLDERS' EQUITY (DEFICIT)		
Common stock - $.001 par value, 50,000,000 shares authorized	20,341	21,463
Stock subscriptions	323,640	3,957,239
Additional paid in capital	36,925,837	44,172,085
Receivable from stockholders of subsidiary	(266,621)	(266,621)
Accumulated development stage deficit	(35,257,363)	(48,135,749)
	1,745,834	(251,583)
Total liabilities and stockholders' equity (deficit)	$ 9,050,856	$ 11,206,651

The accompanying notes are an integral part of these statements.

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Six months ended March 31,		Three months ende March 31,	
	2000	2001	2000	200
Costs and expenses	(unaudited)	(unaudited)	(unaudited)	(unaud
Research and development	$ 1,869,127	$ 3,539,415	$ 1,109,319	$ 1,12
Purchased in-process research and development	425,800	-	269,600	
Sales and marketing	928,535	1,135,651	185,552	42
General and administrative	4,389,930	7,089,692	2,670,686	5,48
	7,613,392	11,764,758	4,235,157	7,03
Other expenses (income)				
Equity in losses of UltraCard	-	-	-	
Interest expense	520,644	1,026,842	63,893	72
Other, net	(86,491)	86,786	(45,632)	6
	434,153	1,113,628	18,261	78
Minority interest in losses of subsidiaries	(1,687,333)	-	(823,763)	
NET LOSS	$ 6,360,212	$ 12,878,386	$ 3,429,655	$ 7,82
LOSS PER COMMON SHARE-BASIC AND DILUTED	$ 0.38	$ 0.62	$ 0.18	$

The accompanying notes are an integral part of these statements.

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

STATEMENT OF STOCKHOLDERS' EQUITY

Six months ended March 31, 2001 (unaudited)

	Voting common stock		Common stock subscribed		Additional paid-in Capital	Receivable fro Stockholder of subsidia
	Shares	Amount	Shares	Amount		
Balances at October 1, 2000	20,340,610	$20,341	102,609	$ 323,640	$36,925,837	$ (266,62
Issuance of shares in October 2000 subscribed to shares in May 2000	102,609	102	(102,609)	(323,640)	323,538	
Issuance of common						

shares at $10.50 per share in October 2000, net of costs	142,860	143	-	-	1,349,857
Shares subscribed to at $6.00 per share in October 2000, net of costs	-	-	233,333	920,000	(100,000)
Allocation of debenture proceeds to common stock	167,768	168			444,435
Allocation of debenture proceeds to common stock warrants	-	-	-	-	829,551
Allocation of debenture proceeds to beneficial conversion feature	-	-	-	-	1,051,096
Allocation of promissory note proceeds to common stock	40,000	40	-	-	136,167
Common stock subscribed to at $4.00 per share in December 2000	-	-	125,000	500,000	-
Common shares subscribed at $2.00 per share in December 2000, net of issuance costs	-	-	464,128	928,257	(102,208)
Common shares subscribed in December 2000 at $0.25 through the exercise of stock warrants	-	-	20,000	5,000	-

Issuance of common shares at $2.02 per share pursuant to conversion of debenture	107,981	108	-	-	218,014
Common shares subscribed pursuant to warrant exercise at $0.25 per share	-	-	200,000	50,000	-
Common shares					

subscribed at $2.50 per share in January 2001, net of costs	-	-	200,000	500,000	(50,000)	
Modification of warrants granted to officer	-	-	-	-	2,414,000	
Issuance of common shares at $1.43 per share pursuant to conversion of debentures	307,509	307	-	-	438,049	
Common shares subscribed to at $2.50 per share in February 2001, net of costs	-	-	80,000	200,000	(20,000)	
Common shares subscribed at $3.75 per share as additional finance fees	-	-	16,267	61,001	-	
Common shares subscribed at $3.31 as additional finance fees	-	-	18,429	61,001	-	
Common stock issued in March for shares previously subscribed	253,334	254	(253,334)	(925,000)	924,746	
Warrants issued with a Strike price of $3.31 to $6.00 per share as additional finance fees	-	-	-	-	35,082	
Common shares subscribed at $2.00 per share net of replacement costs	-	-	828,496	1,656,980	(5,000)	
Placement fees accrued on prior financings	-	-	-	-	(921,133)	
Allocation of debenture proceeds to beneficial conversion feature	-	-	-	-	790,369	
Adjustment to remeasurement of attorney stock options	-	-	-	-	(510,315)	
Net consolidated loss for the six months ended March 31, 2001	-	-	-	-	-	
Balances March 31, 2001	21,462,671	$21,463	1,932,319	$3,957,239	44,172,085	$ (266,62

The accompanying notes are an integral part of this statement.

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Six months ended March 31,	
	2000	2001
Increase (Decrease) in Cash and Cash Equivalents		
Cash flows from operating activities		
Net loss	$(6,360,212)	$(12,878
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	102,993	297
Amortization of beneficial conversion feature and debenture discount	477,745	963
Loss on sale of property and equipment	-	3
Adjustment to receivable from subsidiary's shareholders		
Write off of option cost		
Common stock subscribed for financing fees	-	122
Equity in loss of UltraCard		
Purchased in-process research and development	425,800	
Warrants and options issued for services	339,500	1,903
Warrants issued for financing fees	-	35
Shares issued for services	242,900	
Expenses incurred through loan assumption	-	
Stock of subsidiary issued in exchange for contribution of intellectual property charged to expense	-	
Minority interest	(1,687,333)	
Changes in assets and liabilities:		
Prepaid expenses, deposits and other	(148,167)	(251
Accounts payable and accrued liabilities	(200,072)	3,127
Net cash used in operating activities	(6,806,846)	(6,677
Cash flows from investing activities		
Advances to The Pathways Group, Inc.	-	(1,349
Advances to Rockster, Inc.	-	(560
Payments on equipment under construction	(1,200,000)	
Acquisition of property and equipment, net	(446,641)	(429
Acquisition of Centurion Technologies, Inc., net of cash acquired	-	
Acquisition of UltraCard, Inc., net of cash acquired	(260,300)	
Acquisition of additional equity interest in EforNet from a minority shareholder	(200,000)	
Additions to note receivable from related party	-	(130
Proceeds from sale of property and equipment		
Acquisition deposit	-	(15
Additions to intangible assets	(1,084)	(65

Net cash used in investing activities	(2,108,025)	(2,549
Cash flows from financing activities		
Proceeds from sale of common stock and stock subscriptions	6,258,844	5,575
Borrowings, net of loan costs	930,000	4,604
Principal payments on borrowings	(367,628)	(1,311
Release of restricted cash	-	505
Purchase of collateral on subsidary's letter of credit	-	
Proceeds from exercise of stock options and warrants	-	55
Net cash provided by financing activities	6,821,216	9,428
Net increase (decrease) in cash and cash equivalents	(2,093,655)	201
Cash and cash equivalents at the beginning of the period	4,781,330	398
Cash and cash equivalents at the end of the period	$ 2,687,675	$ 600

The accompanying notes are an integral part of these statements.

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UPGRADE INTERNATIONAL CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2001
(UNAUDITED)

NOTE A - FINANCIAL STATEMENTS

The unaudited consolidated financial statements of the Company and its subsidiaries have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (GAPP) have been condensed or omitted pursuant to such rules and regulations. The results of operations for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year ending September 30, 2001. This form 10-QSB should be read in conjunction with the form 10-KSB that includes audited consolidated financial statements for the year ended September 30, 2000 and 1999 filed on January 16,2001 and the form 10-QSB that included consolidated financial results for the three months ended December 31,2000 and 1999, filed on February 20, 2001.

NOTE B - BASIS OF PRESENTATION

The Company consolidates all companies in which it has a controlling financial interest. This generally occurs when the Company owns more than 50% of the outstanding voting shares of the company. The Company also consolidates 50%-owned companies in which it has voting control through agreements with other shareholders. Investments in Companies where the Company has significant influence through ownership of 20% to 50% of the investors voting shares or contractual arrangements are accounted for by the equity method.

The balance sheet as of March 31, 2001 and September 30, 2000, reflects the consolidated financial position of the Company and its subsidiaries (Subsidiaries) as follows: UltraCard, Inc. (UltraCard); cQue Corporation (formerly Centurion Technologies, Inc.); CTI Acquisition Corporation (CTI); Global CyberSystems, Inc. (Global); EforNet Corporation (EforNet); Global CyberSystems SA. (GCSA) and Global CyberSystems PLC (GCPLC). The statements of operations and cash flows for the six months ended March 31, 2001, reflect the consolidated results of operations and cash flows of the Company and the results of the subsidiaries beginning on the dates the Company acquired control. The statements of operations and cash flows for the six months ended March 31, 2001 include the consolidated results of the Company and its Subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Minority interest represents the minority stockholders' proportionate share in the equity of the Company's consolidated Subsidiaries. The losses incurred by a subsidiary are allocated on a proportionate basis to minority interest until the carrying amount of minority interest is eliminated. Further losses are then included in the net loss of the Company.

NOTE C - LOSS PER COMMON SHARE

Basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. The weighted average number of shares outstanding was 20,938,724 and 21,191,279 for the six and three months ended March 31, 2001, respectively, 16,905,166 and 19,147,677 for the six and three months ended March 31, 2000, respectively and 11,891,020 since inception (February 5, 1997) through March 31, 2001. Diluted loss per share for all periods presented equaled basic loss per share due to antidilutive effect of the potentially dilutive securities. As of March 31, 2001, total warrants and options of 5,745,830 were not included in loss per share computations due to their antidilutive effect.

NOTE D - MANAGEMENT PLANS

The Company is a development stage enterprise as defined under Statement of Financial Accounting Standards No. 7. The Company is devoting its present efforts into establishing a new business in the information technology industry and, is currently in the process of identifying markets and establishing applications for its technologies. The process of commercialization of the Company's core technology is being facilitated in part through the acquisition of strategically aligned Companies in the information technology industry. To date, no operating revenues have been generated. The Company's operations to date have consumed substantial and increasing amounts of cash. The Company's negative cash flow from operations is expected to continue and to accelerate in the foreseeable future. The development of the Company's technology and potential products will continue to require a commitment of substantial funds. The Company expects that its existing and expected financings will be adequate to satisfy the requirements of its current and planned operations until at least the end of second quarter of fiscal year 2002.

However, the rate at which the Company expends its resources is variable, may be accelerated, and will depend on many factors. The Company will need to raise substantial additional capital to fund its operations and may seek such additional funding through public or private equity or debt financing. There can be no assurance that such additional funding will be available on acceptable terms, if at all. The Company's continued existence as a going concern is ultimately dependent upon its ability to secure additional funding for completing and marketing its technology and the success of its future operations.

During the three months ended March 31, 2001, the Company completed the following debt and equity transactions:

A debtholder converted $218,122 and $438,356, respectively, in then outstanding convertible debentures (including $18,122 and 38,356, respectively, in accrued interest) into 107,981 and 307,509 shares of the Company's common stock at $2.02 and $1.43 per share pursuant to the original debenture terms.

The Company issued 200,000 shares of its common stock at $0.25 per share pursuant to a warrant exercise for gross proceeds of $50,000.

The Company completed a private placement offering of 280,000 shares of its common stock at $2.50 per share for gross proceeds of $700,000.

The Company completed a private placement offering of 828,496 shares of its common stock at $2.00 per share for gross proceeds of $1,656,980.

The Company is actively pursuing various financing opportunities. Such financing could take the form of equity, debt, or other hybrid types of securities.

NOTE E - DEBT

In March 2001, the Company issued $790,369 in subordinated debentures that are convertible immediately into common stock. The debentures bear simple interest at 8% per annum, are due May 31, 2001 and are collateralized by UltraCard's interest in the equipment held for sale.

In March 2001, the Company issued 16,267 and 18,429 shares of its common stock at $3.75 and $3.31 per share as additional financing fees under the terms of a modified promissory note. In addition, under the terms of the aforementioned note, the Company granted warrants entitling the holder to purchase 20,277, 40,664 and 23,034 shares of its common stock at $3.75, $6.00 and $3.31 per share, respectively. The warrants are exercisable immediately and expire 90 days from the date of grant.

In March 2001, the Company obtained a 12.5% simple interest mortgage loan totaling $400,000. The loan calls for interest only monthly payments with the first payment due May 1, 2001 and principal plus unpaid interest due February 2002. The loan is collateralized by the condominiums owned by UltraCard.

NOTE F - ACQUISITIONS

On September 8, 2000 the Company signed an Agreement and Plan of Reorganization ("Agreement") to acquire 100% of The Pathways Group, Inc. (Pathways) On February 15, 2001 the Company delivered notice to Pathways terminating the merger agreement between the two Companies. The advances to Pathways by the Company are secured by a blanket assignment over the Pathways assets. Management believes the advances are fully recoverable.

On December 11, 2000 the Company entered into a letter of intent to acquire majority interest totaling 57 percent in Rockster, Inc. (Rockster), an entertainment distribution technology developer. The Company and Rockster are currently in the process of developing a definitive agreement.

On January 16, 2001, the Company discontinued negotiations with Cards & More GMBH, for the acquisition of 60% of that Company announced in September 2000.

NOTE G - COMMITMENTS

The Company has a contract with SciVac, Inc. (SciVac) to purchase and install a sputtering machine for $3,000,000. As of March 31, 2001, the Company has advanced $1,200,000 to SciVac under this contract and recorded a liability of $1,800,000. The Company decided that it no longer requires the machine for its operations. As a result, the Company has entered into an oral agreement with SciVac, whereas, SciVac will market and sell the sputtering machine on behalf of the Company. This asset is classified in the accompanying condensed consolidated balance sheet as equipment held for sale in the amount of $3,054,125. The Company believes it will realize the carrying amount of the asset in a sale during 2001.

On March 13, 2001, the Company entered into an operating lease agreement to lease a 28,500 square foot facility in Los Angeles, California. The agreement calls for monthly payment of $43,200 commencing August 1, 2001. The lease terminates August 1, 2011.

On October 10, 1997, UltraCard licensed the rights to two technology patents from CardTech, Inc. (CardTech). UltraCard's President is also the controlling stockholder of CardTech. UltraCard is required to pay CardTech a minimum annual royalty fee of $650,000. Royalty fees are due on January 1 of each calendar year. As of March 31, 2001, $1,300,000 for both the calendar year 2000 and 2001 royalty fees remained unpaid, causing UltraCard to be past due on the agreement. CardTech has deferred the required 2000 and 2001 payments to June 30, 2001. In consideration for the deferral, UltraCard has granted a patent mortgage to CardTech on all its intellectual property.

NOTE H - CONTINGENCIES

The class action lawsuits filed during February and March 2000, in the United States District Court, against the Company and its President alleging securities violations were dismissed, with prejudice by the United States District Court. Plaintiffs appealed the Court's order, and the defendants filed a cross appeal seeking sanctions. The parties have since entered into a stipulated agreement to dismiss their appeals.

NOTE I - SUBSEQUENT EVENTS

During April, 2001, the Company issued common stock at $2 per share for a total of $1,030,000. The offer and sales of securities was made pursuant to an exemption from registration under Regulation S of the Securities Act of 1933 (Act), due to the foreign nationality of the investors.

During May, 2001 to the date of this report, the Company issued common stock at $2 per share for a total of $196,000. The offer and sales of securities was made pursuant to an exemption from registration under Regulation S of the Act, due to the foreign nationality of the investors.

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

Certain statements contained in this Quarterly Report on Form 10-QSB, including, without limitation, statements containing the words "believes, " anticipates," "estimates," "expects," and words of similar import, constitute "forward looking statements." You should not place undue reliance on these forward- looking statements. Our actual results could differ materially from those anticipated in these forward- looking statements for many reasons, including the risks faced by us described in this Quarterly Report and in other documents we file with the Securities and Exchange Commission.

Net losses aggregated $12.9 million in the first six months of the current fiscal year ending September 30, 2001 compared with a $6.3 million net loss for the corresponding period of the prior fiscal year. This increase in net loss reflects a continued and growing level of investment into the Company's technology, production processes and the development of commercialization of the Companies core technology through the acquisition of application companies. During the quarter, the Company's subsidiary, UltraCard Inc. has completed their move into new facilities in Los Gatos completing the consolidation of the operations into one location. Significant administrative costs have been incurred in reorganizing the Company's acquisitions of application companies and in their capital raising initiatives. UltraCard Inc., has again increased its research and development expenditures by $2.1 million over the corresponding prior period in a concentrated effort to complete a commercialized version of its high memory capacity UltraCard and read write device. These increasing expenditures reflect the Company's focused efforts upon completing its research and development initiatives, while at the same time, establishing production processes and specifications to facilitate the Company to engage others to produce the UltraCard and its read write device. The other significant operating subsidiary cQue (formerly Centurion) contributed only 3% of the total loss reflecting the focus of the consolidated groups efforts to complete the UltraCard technology. During the six month period, EforNet discontinued their research and development program in light of acquisitions being developed during the period, however the developments that they had achieved are being maintained and protected and will be further developed within the Company's developing infrastructure. A significant portion of the increase in research and development expenditures was due to the addition of new personnel, prototype development and contracts with external research and development contractors. For the near future, research and development expenditures are expected to be increased to meet the Company's numerous potential market opportunities. All of the Company's research and development costs are expensed as incurred.

The net loss for the three month period ended March 31, 2001 of $7.8 million represents a $4.4 million increase over the corresponding period in the prior year. A significant portion of this increased loss ($2.98 million) is comprised of non-cash financing costs associated with warrants issued for services, the extension of warrants previously issued, debenture discounts and common shares issued for financing fees. The additional increase is comprised of a step up in sales and marketing expenditures of $240,000 reflecting the Company's increasing efforts to raise market awareness of its products and potential. The balance of the increase is allocated to general and administrative expenditures incurred by the growing group of companies.

Interest expense has also increased significantly as the result of the valuation of shares and warrants issued in relation to unpaid notes and debentures issued during the period.

In an effort to accelerate the Company's market penetration with the UltraCard and related products, and in order to augment internally developed research and development initiatives, the Company will license technology from other businesses, engage others to develop components and/or acquire other businesses as an alternative to internal research and development and marketing efforts. The marketplace is

beginning to recognize the UltraCard as a leader and superior product in the smart card industry and management are focused upon accelerating the Companies access to this multi-billion dollar marketplace.

Sales and marketing expenditures have decreased by approximately $0.3 million from the prior quarter as the prior quarter costs included a technology symposium in San Francisco, in which the Companies in the consolidated Group showcased their products to investors, industry and the media. Sales and marketing expenditures are associated with the Company's attendance at trade shows and industry awareness programs as the Company builds market awareness to establish and develop new markets and prepare for effective product launches for products which are currently under development.

LIQUIDITY AND CAPITAL RESOURCES

Cash and equivalents were approximately $400,000 at March 31, 2001, an increase of approximately $500,000 from December 31, 2000. The Company is managing tight cash flows in providing funding for an aggressive research and development program at UltraCard while developing acquisitions in the software development area of business. Cash flows from financing activities of $9.4 million in the current six month period represents a 38% increase in the capital raised in the corresponding period of the preceding year. The proceeds were used for operations of $6.7 million, with the balance of $2.5 million allocated to investing activities for acquisitions in process of Pathways and Rockster and the development of the UltraCard facilities. The Company is successfully raising capital on an ongoing basis as it has done for the last three years since inception.

In order for the Company to meet the funding requirements from its investee Companies and to meet ongoing operating requirements, the Company will have to raise additional financing. The Company expects that its existing and planned capital resources will be adequate to satisfy the requirements of the current and planned operations until the end of the current fiscal year. However the rate at which the Company expends its resources is variable, may be accelerated, and will depend on many factors. The Company will need to raise substantial additional capital to fund its operations and may seek such additional funding through public or private equity or debt financing, or through the licensing of its technology. There can be no assurance that such additional funding will be available on acceptable terms, if at all.

PART II Other Information

Item 1. Legal Proceedings

In Re Upgrade International Corporation Securities Litigation, U.S. District Court, Western District of Washington at Seattle, c/a #C00-0298, the class action against Upgrade and its president, Daniel S. Bland, was dismissed by court dated February 9, 2001. Plaintiffs appealed the court's order, and the defendants filed a cross appeal seeking sanctions. The parties have since entered into a stipulated agreement to dismiss their appeals.

Lewis v. The Pathways Group, Inc. and Upgrade International Corporation, U.S. District Court, Western District of Washington at Seattle, c/a #C01-0600R. The complaint alleges copyright infringement, misappropriation of trade secrets, and tortuous interference with business expectancies against Upgrade by virtue of the proposed merger between Upgrade and The Pathways Group, which merger proposal was terminated by Upgrade on February 15, 2001. The complaint seeks injunctive relief and unspecified damages.

The Company filed an answer on May 17, 2001. Management believes the case is without merit and intends to defend it vigorously.

Item 2. Changes in Securities and Use of Proceeds

During the three months ended March 31, 2001, the Company sold unregistered securities as follows:

In January 2001, Upgrade issued 107,981 shares of its common stock at a price of $2.02 per share pursuant to the conversion of debentures. As reported in the Company's Form 10-QSB for the period ended December 31, 2000, the issuance was exempt under Rule 506 under and Section 4(2) of the Securities Act of 1933 (the "Act").

In January 2001, Upgrade issued 200,000 shares of its common stock at a price of $0.25 per share pursuant to the exercise of warrants. The issuance was exempt from registration pursuant to Regulation S of the Securities Act of 1933, due to the foreign nationality of the investor.

In January 2001, Upgrade completed a private placement offering of 200,000 shares of its common stock at a price of $2.50 per share for total proceeds of $500,000. The offer and sale of securities was made pursuant to an exemption from registration under Regulation S of the Act, due to the foreign nationality of the investor.

In January 2001, Upgrade completed a private placement offering of 265,000 shares of its common stock at a price of $2.00 per share for total proceeds of $530,000. The offer and sale of securities was made pursuant to an exemption from registration under Regulation S of the Securities Act of 1933, due to the foreign nationality of the investor.

In February 2001, Upgrade issued 307,509 shares of its common stock at a price of $1.43 per share pursuant to the conversion of debentures. As reported in the Company's Form 10-QSB for the period ended December 31, 2000, the issuance was exempt under Rule 506 under and Section 4(2) of the Act.

In February 2001, Upgrade completed a private placement offering of 358,496 shares of its common stock at a price of $2.00 per share for total proceeds of $716,980. The offer and sale of securities was made pursuant to an exemption from registration under Regulation S of the Securities Act of 1933, due to the foreign nationality of the investor.

In February 2001, Upgrade completed a private placement offering of 80,000 shares of its common stock at a price of $2.50 per share for total proceeds of $200,000. The offer and sale was exempt under Rule 506 under and Section 4(2) of the Act.

In March 2001, Upgrade completed a private placement offering of 205,000 shares of its common stock at a price of $2.00 per share for total proceeds of $410,000. The offer and sale was exempt under Rule 506 under and Section 4(2) of the Act.

In March 2001, Upgrade issued 16,267 shares of its common stock at a price of $3.75 per share in lieu of financing fees under the terms of a promissory note. The issuance was exempt under Rule 506 under and Section 4(2) of the Act.

In March 2001, Upgrade issued 18,429 shares of its common stock at a price of $3.31 per share in lieu of financing fees under the terms of a promissory note. The issuance was exempt under Rule 506 under and Section 4(2) of the Act.

In March 2001, Upgrade issued warrants to purchase 20,277 shares of its common stock at an exercise price of $3.75 per share in lieu of financing fees under the terms of a promissory note. The issuance was exempt under Rule 506 under and Section 4(2) of the Act.

In March 2001, Upgrade issued warrants to purchase 40,664 shares of its common stock at an exercise price of $6.00 per share in lieu of financing fees under the terms of a promissory note. The issuance was exempt under Rule 506 under and Section 4(2) of the Act.

In March 2001, Upgrade issued warrants to purchase 23,034 shares of its common stock at an exercise price of $3.31 per share as additional compensation under the terms of a promissory note. The issuance was exempt under Rule 506 under and Section 4(2) of the Act.

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

On March 27, 2001, the Company held its Annual Meeting of Shareholders. The shareholders voted on and approved the following matters, with the voting results indicated:

Election of Directors:

Daniel S. Bland, Class 3 (term expiring 2004)

For: 11,273,980 Withheld Vote: 123,068

Malcolm P. Burke, Class 3 (term expiring 2004)

For: 11,277,580 Withheld Vote: 119,468

Ronald P. Erickson, Class 2 (term expiring 2003)
For: 11,132,474 Withheld Vote: 264,574

Howard A. Jaffe, Class 2 (term expiring 2003)
For: 11,271,930 Withheld Vote: 125,118

For approval of the Company's 2000 Omnibus Stock Option Plan

For	Against	Abstain	Broker Non-Votes
7,127,515	63,314	60,055	4,146,164

The appointment of Grant Thornton, L.L.P. as the Company's independent auditors for the fiscal year 2001.

For	Against	Abstain	Broker Non-Votes
11,353,455	13,801	29,792	9,758,113

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

Item 6. Exhibits

Exhibit No. Description

10.1	Form of Debenture
10.2	Form of Promissory Note

Upgrade International Corporation

Date: May 15, 2001

Daniel Bland, President and Chief Executive Officer, and Secretary

Date: May 15, 2001

Howard A. Jaffe, Chief Operating and Financial Officer