ALTRIS SOFTWARE INC
Form 10-Q
August 14, 2002

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

ý QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2002

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

Commission File Number 0-15935

ALTRIS SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

CALIFORNIA	**95-3634089**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9339 CARROLL PARK DRIVE, SAN DIEGO, CA 92121
(Address of principal executive offices and zip code)

(858) 625-3000
(Registrants telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ý NO o

Number of shares of Common Stock outstanding at August 10, 2002: 30,841,590

Number of Sequentially Numbered Pages: 22

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ALTRIS SOFTWARE, INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2002 (Unaudited)	September 30, 2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 364,000	$ 144,000
Receivables, net	883,000	1,150,000
Other current assets	304,000	412,000
Total current assets	1,551,000	1,706,000
Property and equipment, net	239,000	313,000
Computer software, net	1,517,000	2,164,000
Other assets	72,000	73,000
Total assets	$ 3,379,000	$ 4,256,000
LIABILITIES AND SHAREHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	$ 1,379,000	$ 958,000
Accrued liabilities	1,209,000	1,596,000
Notes payable to Spescom Ltd.	1,620,000	
Deferred revenue	1,802,000	1,620,000
Total current liabilities	6,010,000	4,174,000
Notes payable less current portion to Spescom Ltd.	3,231,000	1,377,000
Total liabilities	9,241,000	5,551,000
Shareholders Deficit:		
Common stock, no par value, 40,000,000 shares authorized; 30,841,590 issued and outstanding	74,465,000	73,838,000
Common stock warrants	133,000	718,000
Accumulated other comprehensive loss	(124,000)	(33,000)
Accumulated deficit	(80,336,000)	(75,818,000)
Total shareholders deficit	(5,862,000)	(1,295,000)
Total liabilities and shareholders deficit	$ 3,379,000	$ 4,256,000

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

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ALTRIS SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the three months ended June 30,		For the nine months ended June 30,	
	2002	**2001**	**2002**	**2001**
Revenues:				
Licenses	$ 601,000	$ 1,749,000	$ 1,248,000	$ 4,617,000
Services and other	1,230,000	1,385,000	3,868,000	4,727,000
Total revenues	1,831,000	3,134,000	5,116,000	9,344,000
Cost of revenues:				
Licenses	290,000	272,000	899,000	1,067,000
Services and other	664,000	960,000	2,526,000	2,949,000
Total cost of revenues	954,000	1,232,000	3,425,000	4,016,000
Gross profit	877,000	1,902,000	1,691,000	5,328,000
Operating expenses:				
Research and development	342,000	516,000	1,535,000	1,455,000
Marketing and sales	573,000	1,063,000	2,911,000	2,959,000
General and administrative	411,000	426,000	1,523,000	1,137,000
	1,326,000	2,005,000	5,969,000	5,551,000
Loss from operations	(449,000)	(103,000)	(4,278,000)	(223,000)
Interest and other income	1,000	16,000	6,000	54,000
Interest and other expense	(106,000)	(7,000)	(246,000)	(12,000)
Gain on sale of interest in subsidiary				125,000
Net loss	$ (554,000)	$ (94,000)	$ (4,518,000)	$ (56,000)
Basic net loss per common share	$ (0.02)	$ (0.00)	$ (0.15)	$ (0.00)
Diluted net loss per common share	$ (0.02)	$ (0.00)	$ (0.15)	$ (0.00)
Shares used in computing basic Net loss per common share	30,842,000	30,842,000	30,842,000	30,776,000
Shares used in computing diluted net loss per common share	30,842,000	30,842,000	30,842,000	30,776,000

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

ALTRIS SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the nine months ended June 30, 2002	2001
Cash flows from operating activities:		
Net loss	$ (4,518,000)	$ (56,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	804,000	893,000
Stock options issued	42,000	
Gain on sale of interest in subsidiary		(125,000)
Changes in assets and liabilities, net of effect of dispositions:		
Receivables, net	287,000	386,000
Other assets	219,000	(239,000)
Accounts payable	280,000	24,000
Accrued liabilities	(452,000)	33,000
Deferred revenue	163,000	(2,046,000)
Net cash used in operating activities	(3,175,000)	(1,130,000)
Cash flows from investing activities:		
Purchases of property and equipment	(23,000)	(30,000)
Purchases of software	(56,000)	
Net cash used in investing activities	(79,000)	(30,000)
Cash flows from financing activities:		
Proceeds from shareholder loan	3,474,000	
Proceeds from exercise of stock options		3,000
Net cash provided by financing activities	3,474,000	3,000
Effect of exchange rate changes on cash		(23,000)
Net increase (decrease) in cash and cash equivalents	220,000	(1,180,000)
Cash and cash equivalents at beginning of period	144,000	1,808,000
Cash and cash equivalents at end of period	$ 364,000	$ 628,000

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

ALTRIS SOFTWARE, INC.

CONDENSED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Altris Software, Inc. and its wholly owned subsidiaries (the Company). All significant intercompany balances and transactions have been eliminated. In the first quarter of fiscal 2001, the Company acquired certain assets and liabilities of Spescom Ltd. U.K. (formerly Altris Software Limited) along with Spescom Ltd. U.K. s document management business. Spescom Ltd. UK is a wholly owned subsidiary of Spescom Ltd., which became the majority shareholder in the Company in April 2000. (See Note 3.)

The accompanying consolidated statements of operations and cash flows for the three and nine months ended June 30, 2002 and 2001 are unaudited. The consolidated financial statements and related notes have been prepared in accordance with generally accepted accounting principles applicable to interim periods. In the opinion of management, the consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the consolidated financial position, operating results and cash flows for the periods presented.

The information contained in the following Condensed Notes to the Consolidated Financial Statements is condensed from that which would appear in the annual consolidated financial statements; accordingly, the consolidated financial statements included herein should be reviewed in conjunction with the consolidated financial statements and related notes thereto contained in the Company s Report on Form 10-K for the year ended September 30, 2001. It should be understood that the accounting measurements at an interim date inherently involve greater reliance on estimates than at year-end. The results of operations for the interim periods presented are not necessarily indicative of the results expected for the entire year.

REVENUE RECOGNITION

The Company recognizes revenue in accordance with a wide-ranging set of standards and interpretations of those standards under accounting principles generally accepted in the United States of America, consisting principally of:

Statement of Position (SOP) No. 97-2, Software Revenue Recognition, issued by the American Institute of Certified Public Accountants (AICPA)

AICPA SOP No. 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions, Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, issued by the United States Securities and Exchange Commission

The Company enters into contractual arrangements with end users of its products that may include software licenses, maintenance services, consulting services, or various combinations thereof, including the sale of such elements separately. For each arrangement, revenues are recognized when both parties have signed an agreement, the fees to be paid by the customer are fixed or determinable, collection of the fees is probable, delivery of the product has occurred and no other significant obligations on the part of the Company remain.

For multiple-element arrangements, each element of the arrangement is analyzed and the Company allocates a portion of the total fee under the arrangement to the individual elements based on the fair value of the element, regardless of any separate prices stated within the contract for each element. Fair value is generally considered the price a customer would be required to pay if the element were to be sold separately. The Company applies the residual method as allowed under SOP No. 98-9 in accounting for any element of an arrangement that remains undelivered.

License Revenues: Amounts allocated to software license revenues are recognized at the time of shipment of the software when fair value for any undelivered elements is determinable and all the other revenue recognition criteria discussed above have been met.

Consulting Service Revenues: Consulting service revenues are comprised of consulting and implementation services and, to a limited extent, training. Consulting services are generally sold on a time-and-materials or fixed fee basis and can include services ranging from software installation to data conversion to allow the software to operate in customized environments. Services are generally separable from the other elements under the same arrangement since the performance of the services are not essential to the functionality of the software and are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services. Revenues for these services, as well as for training, are generally recognized as the services are performed for time and materials contracts. Contract revenues for fixed fee contracts or programs requiring specialized systems are recognized using the percentage-of-completion method of accounting, primarily based on contract labor hours incurred to date compared with total estimated labor hours at completion. Provisions for anticipated contract losses are recognized at the time they become known.

Maintenance Service Revenues: Maintenance service revenues consist primarily of fees for providing unspecified software upgrades on a when-and-if-available basis and technical support over a specified term, which is typically twelve months. Maintenance revenues are typically paid in advance and are recognized on a straight-line basis over the term of the contract.

Revenues on sales made by the Company s resellers are generally recognized upon shipment of the Company s software to the reseller, when the reseller has an identified end user and all other revenue recognition criteria noted above are met. Under limited arrangements with certain distributors, all the revenue recognition criteria have been met upon delivery of the product to the distributor and, accordingly, revenues are recognized at that time. The Company does not offer a right of return on its products.

Foreign Currency Translation

The financial statements of the foreign subsidiary are prepared in its local currency and translated into U.S. dollars based on the current exchange rate at the end of the period for the balance sheet and a weighted-average rate for the period on the statement of operations. Accumulated translation adjustments of $(124,000) and $(33,000) are recorded at June 30, 2002 and September 30, 2001, respectively and are reflected as accumulated other comprehensive loss in Shareholders Deficit. Foreign currency transaction gains and losses are included in net loss.

Note 2 Statement of Cash Flows

For the nine months ended June 30, 2001, the following assets and liabilities, attributable to the acquisition of Spescom UK, have been excluded from the cash flow statement (see Note 3):

Accounts receivable, net	$	721,000
Other assets		26,000
Property and equipment, net		103,000
Accounts payable		(192,000)
Accrued liabilities		(228,000)
Deferred revenue		(665,000)
Net liabilities assumed	$	(235,000)

The following is additional cash flow information for the nine months ended June 30:

	2002	2001
Supplemental cash flow information:		
Interest paid	$ 4,000	$ 12,000
Schedule of noncash financing activities:		
Stock Options Granted to Consultant	$ 42,000	$

Note 3 Spescom Transaction and Related Parties

In May 1999, the Company completed a transaction with Spescom Ltd. (Spescom), whereby Spescom acquired a 60% ownership interest in the Company s former United Kingdom subsidiary, Altris Software Ltd. (ASL). In April 2000, the Company sold its remaining 40% ownership in ASL to Spescom. For the nine months ended June 30, 2001 the Company recognized a gain of $125,000, which it had previously deferred, relating to potential warranty claims arising from the sale of ASL.

In the first quarter of 2001, the Company acquired certain assets and liabilities of Spescom Ltd. U.K. (formerly ASL) along with Spescom Ltd. U.K. s document management business. Spescom Ltd. U.K. is a wholly owned subsidiary of Spescom, which became the majority shareholder in the Company in April 2000. Prior to the acquisition, Spescom Ltd. U.K. had been the Company s exclusive distributor of the Company s eB product suite outside North, Latin and South America. In exchange for the assets and the assumption of certain liabilities of Spescom Ltd. U.K., the Company issued 550,000 shares of its common stock to Spescom. The net liabilities assumed of $235,000 were recorded as a charge against common stock.

In November 2000 Spescom purchased $530,000 worth of software from the Company. Under a royalty arrangement, Spescom also resells certain of the Company s software. For the three and nine month periods ended June 30, 2002, the Company recognized royalty revenue of $0 and $9,000 compared to $30,000 and $38,000 for the three and nine month periods ended June 30, 2001, arising from this arrangement.

Spescom and the Company have entered into a license agreement pursuant to which Spescom has licensed to the Company the right to use the name Spescom and to use a trademark owned by Spescom related to certain computer software. The Company will not pay any royalties to Spescom in connection with this license. The license is for an indefinite term, but is terminable by either party upon 60 days prior written notice. Under the license agreement, Spescom has agreed to indemnify and hold harmless the Company and its directors, officers, employees and agents against liabilities arising from any claim brought against the Company that alleges that Spescom s or the Company s use of the trademark being licensed infringes the rights of any third party, provided that the Company is in material compliance with the provisions of the license agreement.

Related party liabilities consist of the following:

		June 30, 2002 (Unaudited)		September 30, 2001
Current liability:				
Notes payable to Spescom Ltd. United Kingdom	$	1,620,000	$	
Long-term liabilities:				
Loan payable Spescom Ltd., South Africa	$	1,276,000	$	1,377,000
Loan payable Spescom Ltd. United Kingdom		1,955,000		
	$	3,231,000	$	1,377,000

At June 30, 2002, the Company had three demand notes payable for $400,000, $500,000 and $700,000, respectively, each bearing an annual interest rate of 10%. The notes plus accrued interest are shown in the above table as $1,620,000. Interest expense on the notes for the nine months ended June 30, 2002 was $20,000. The Company continues to rely upon this financing from Spescom for its operating needs.

Spescom Ltd., South Africa loaned $1,377,000, including accrued interest, to the Company during the fiscal year ended September 30, 2001. As of June 30, 2002 the balance owed on this loan was $1,276,000. Interest on the outstanding loan amount accrues at the rate of 10.0% per annum and is payable at maturity on October 15, 2003. The balances in the table include accrued interest due. Interest expense on this loan totaled $67,000 and $4,000 for the nine months ended June 30, 2002 and 2001, respectively.

Spescom Ltd. United Kingdom loaned $1,955,000, including accrued interest, to the Company during the nine months ended June 30, 2002. This loan also bears interest at an interest rate of 10.0% per annum, payable at maturity, on October 15, 2003. Interest expense on this loan totaled $172,000 for the nine months ended June 30, 2002.

The notes payable are collateralized by a security interest in favor of both Spescom Ltd. South Africa and Spescom Ltd. United Kingdom in respect of all of the Company s assets.

Note 4 Receivables

Receivables consist of the following:

	June 30, 2002 (Unaudited)	September 30, 2001

Billed receivables	$	1,011,000	$	1,240,000
Less allowance for doubtful accounts		(128,000)		(90,000)
	$	883,000	$	1,150,000

Note 5 Reconciliation of Net Income (Loss) and Shares Used in Per Share Computations:

Basic net loss per common share is computed as net loss divided by the weighted average number of common shares outstanding during the period. Diluted net loss per common share is computed as net loss divided by the weighted average number of common shares and potential common shares, using the treasury stock method, outstanding during the period and assumes conversion into common stock at the beginning of each period of all outstanding shares of convertible preferred stock. Computations of basic and diluted loss per share do not give effect to individual potential common stock instruments for any period in which their inclusion would be anti-dilutive.

	For the three months Ended June 30,		For the nine months ended June 30,	
	2002	**2001**	**2002**	**2001**
Net loss used in computing basic and diluted net loss per share	$ (554,000)	$ (94,000)	$ (4,518,000)	$ (56,000)
Shares Used:				
Weighted average common shares outstanding used in computing basic net loss per common share	30,842,000	30,842,000	30,842,000	30,776,000
Weighted average common shares outstanding used in computing diluted net loss per common share	30,842,000	30,842,000	30,842,000	30,776,000

Based on the above table, the basic and diluted loss per share is $0.003 for the three months ending June 30, 2001. For the nine months ending June 30, 2001, the basic and diluted loss per share is $.002. For financial statement presentation purposes, we have rounded the basic and diluted loss per share for the three and nine months ended June 30, 2001 to $0.00.

Potentially dilutive stock options to purchase up to 199,619 and 375,331 shares of the Company s common stock, with weighted average prices of $0.44 and $1.11 were outstanding at June 30, 2002 and 2001, respectively. Warrants to purchase 100,000 shares of the Company s stock at an average exercise price of $0.72 per share were outstanding at June 30, 2002. Warrants to purchase 300,000 shares of the Company s stock at an average exercise price of $1.90 per share and warrants to purchase 100,000 shares of the Company s stock at an average exercise price of $0.72 per share were outstanding at June 30, 2001. These options and warrants were not included in the computation of diluted loss per common share for the three and nine month periods ended June 30, 2002 and 2001 because their effect was antidulitive.

Note 6 Segment and Geographic Information

The Company has one business segment which consists of the development and sale of a suite of client/server document management software products.

Revenues for the three and nine month periods ended June 30, 2002 and 2001, by customer location, are as follows:

	For the three months ended June 30,		For the nine months ended June 30,	
	2002	2001	2002	2001
United States	$ 731,000	$ 2,360,000	$ 2,439,000	$ 5,782,000
Europe, primarily United Kingdom	1,038,000	753,000	2,444,000	2,881,000
Other International	62,000	21,000	233,000	681,000
	$ 1,831,000	$ 3,134,000	$ 5,115,000	$ 9,344,000

Note 7 - Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations (Statement 141) which supersedes APB Opinion No. 16, Business Combinations and SFAS No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises. Statement 141 addresses financial accounting and reporting for business combinations and requires that all business combinations within the scope of Statement 141 be accounted for using only the purchase method. Statement 141 is required to be adopted for all business combinations initiated after June 30, 2001. The adoption of Statement 141 has not had a material effect on the financial statements.

Also in July 2001, the FASB issued SFAS No. 142, Goodwill and Other Intangible Assets (Statement 142) which supercedes APB Opinion No. 17, Intangible Assets. Statement 142 addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. Statement 142 also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. Statement 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually in accordance with the provisions of Statement 142. Statement 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment. The provisions of Statement 142 are required to be applied starting with fiscal years beginning after December 15, 2001. Statement 142, which is required to be applied at the beginning of an entity s fiscal year, is to be applied to all goodwill and other intangible assets recognized in the financial statements at that date. The adoption of Statement 142 has not had a material effect on the financial statements.

During August 2001, the FASB issued Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations, (SFAS No. 143). SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to all entities and legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal operation of a long-lived assets, except for certain obligations of lessees. SFAS No. 143 amends FASB Statement No. 19, Financial Accounting and Reporting by Oil and Gas Producing Companies, and is effective for fiscal years beginning after April 1, 2003. Management believes that the adoption of Statement 143 will not have a material effect on the Company s financial statements.

During August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, (SFAS No. 144). SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to

be Disposed Of, and the accounting and reporting provision of APB Opinion No. 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual, and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business (as previously defined in that Opinion). SFAS No. 144 is effective for fiscal years beginning after April 1, 2002. The Company is in the process of evaluating the financial statement impact of adoption of SFAS No. 144.

Note 8 Comprehensive Loss

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2002	**2001**	**2002**	**2001**
Net loss	$ (554,000)	$ (94,000)	$ (4,518,000)	$ (56,000)
Other comprehensive income (loss):				
Foreign currency translation gain adjustments	(124,000)	30,000	(91,000)	34,000
Comprehensive loss	$ (678,000)	$ (64,000)	$ (4,609,000)	$ (22,000)

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

THREE AND NINE MONTH PERIODS ENDED JUNE 30, 2002 COMPARED WITH THREE AND NINE MONTH PERIODS ENDED JUNE 30, 2001.

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results or anticipated results, including those set forth under Certain Factors That May Affect Future Results below and elsewhere in, or incorporated by reference into, this report.

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. As such, management is required to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The significant accounting policies which are most critical to aid in fully understanding and evaluating reported financial results include the following:

Revenue Recognition

The Company enters into contractual arrangements with end users that may include licensing of the Company s software products, product support and maintenance services, consulting services or various combinations thereof, including the sale of such products or services separately. The Company s accounting policies regarding the recognition of revenue for these contractual arrangements is fully described in Note 1 of Notes to Consolidated Financial Statements.

The Company considers many factors when applying accounting principles generally accepted in the United States of America related to revenue recognition. These factors include, but are not limited to:

The actual contractual terms, such as payment terms, delivery dates, and pricing of the various product and service elements of a contract

Availability of products to be delivered

Time period over which services are to be performed

Creditworthiness of the customer

The complexity of customizations to the Company s software required by service contracts

The sales channel through which the sale is made (direct, VAR, distributor, etc.)

Discounts given for each element of a contract

Any commitments made as to installation or implementation go live dates

Each of the relevant factors is analyzed to determine its impact, individually and collectively with other factors, on the revenue to be recognized for any particular contract with a customer. Management is required to make judgments regarding the significance of each factor in applying the revenue recognition standards, as well as whether or not each factor complies with such standards. Any misjudgment or error by management in its evaluation of the factors and the application of the standards, especially with respect to complex or new types of transactions, could have a material adverse effect on the Company s future operating results.

Allowance for Doubtful Accounts

The Company sells its products directly to end users, generally requiring a significant up-front payment and remaining terms appropriate for the creditworthiness of the customer. The Company also sells its products to VARs and other software distributors generally under terms appropriate for the creditworthiness of the VAR or distributor. Management believes that no significant concentrations of credit risk existed at June 30, 2002. Receivables from customers are generally unsecured. The Company continuously monitors its customer account balances and actively pursues collections on past due balances. The Company maintains an allowance for doubtful accounts which is comprised of a general reserve based on historical collections performance plus a specific reserve for certain known customer collections issues. If actual bad debts are greater then the reserves calculated based on historical trends and known customer issues, the Company may be required to book additional bad debt expense which could have a material adverse impact on our operating results for the periods in which such additional expense occurs.

Capitalized Software Development Costs

Software development costs incurred subsequent to the determination of technological feasibility and marketability of a software product are capitalized. Amortization of capitalized software development costs commences when the products are available for general release. Amortization is determined on a product by product basis using the greater of a ratio of current product revenues to projected current and future product revenues or an amount calculated using the straight-line method over the estimated economic life of the product, generally three to five years. In addition to in-house software development costs, the Company purchases certain software from third-party software providers and capitalizes such costs in software development costs. The Company continually evaluates the recoverability of its capitalized software development costs and considers any events or changes in circumstances that would indicate that the carrying amount of an asset may not be recoverable. Any material changes in circumstances, such as a large decrease in revenues or the discontinuation of a particular product line could require future write-downs in the Company s capitalized software development costs and could have a material adverse impact on our operating results for the periods in which such write-downs occur.

RESULTS OF OPERATIONS

Revenues

Revenues for the three and nine month periods ended June 30, 2002 were $1,831,000 and $5,116,000 as compared to $3,134,000 and $9,344,000 for the three and nine month periods ended June 30, 2001.

For the three months ended June 30, 2002 revenues consisted of $601,000 (33%) in software licenses and $1,230,000 (67%) related to services and other revenue. This compares to software license revenues of $1,749,000 (56%) and services and other revenue of $1,385,000 (44%) for the three months ended June 30, 2001. For the nine months ended June 30, 2002 revenues consisted of $1,248,000 (24%) in software license revenues and $3,868,000 (76%) in services and other revenue. This compares to software license revenues of $4,617,000 (49%) and services and other revenue of $4,727,000 (51%) for the nine months ended June 30, 2001. License revenue for the nine months ended June 30, 2001 included a license to Spescom of $530,000.

Software license revenues decreased $1,148,000 and $3,369,000 for the three and nine month periods ended June 30, 2002 compared to the three and nine month periods ended June 30, 2001. The decrease is due to lower sales of the eB product, which management believes is a result of customers deferring capital expenditures due to an economic slowdown in the United States.

Revenues generated from services decreased $155,000 and $859,000 for the three and nine month periods ended June 30, 2002 over the three and nine month periods ended June 30, 2001. Management attributes this decline to the decline in software sales, which reduced the potential for service fees for implementing the eB product.

A small number of customers has typically accounted for a large percentage of the Company s annual revenue. One customer accounted for 18% of total revenue for the nine months ended June 30, 2002 and another customer accounted for 18% of revenue for the nine month period ended June 30, 2001. One consequence of this dependence has been that revenue can fluctuate significantly on a quarterly basis. The Company s reliance on relatively few customers could have a material adverse effect on the results of its operations on a quarterly basis. Additionally, a significant portion of the Company s revenues has historically been derived from the sale of systems to new customers.

Cost of Revenues

Gross profit consists of gross profit from licenses and gross profit from services and other. Gross profit as a percentage of revenue was 48% and 33% for the three and nine month periods ended June 30, 2002 compared to gross profit percentages of 61% and 57% for the three and nine month periods ended June 30, 2001. The decrease in gross profit for the three and six month periods ended June 30, 2002 was due to the amortization of software costs over lower software license revenues.

Cost of license revenues consists of costs associated with reselling third-party software products and amortization of internal software development costs. Gross profit from license revenues as a percentage of license revenues was 52% and 28% for the three and nine month periods ended June 30, 2002 compared to 84% and 77% for the three and nine months ended June 30, 2001. The decrease to 52% from 84% and to 28% from 77% was the result of a decrease in sales of eB software. As sales decline, our fixed costs remain constant and result in a lower gross profit percentage on licenses sold.

Cost of services and other revenues consists primarily of personnel-related costs in providing consulting services, training to customers and support. It also includes costs associated with reselling third-party hardware and maintenance. Gross profit from services and other revenue as a percentage of services and other revenue was 46% and 35% for the three and nine month periods ended June 30, 2002 compared to 31% and 38% for the three and nine month periods ended June 30, 2001. The increase in the gross profit margin from services and other revenue for the three month period ended June 30, 2002 was due principally to lower personnel and related costs associated with performing services, therefore achieving a higher amount of profit for less personnel cost. The decrease in gross profit for the nine month period was due to higher personnel and related costs for the nine month period ending June 30, 2002 than in the prior year same period. In response to the lower service revenues, the Company reduced the number of service personnel and their associated costs in March of 2002 in an effort to bring personnel related costs of services more in line with the lower revenues currently being achieved.

The Company s software and services are sold at a significantly higher margin than third party products which are resold at a lower gross profit percentage in order for the Company to remain competitive in the marketplace for such third party products. Gross profit percentages can fluctuate quarterly based on the revenue mix of Company software, services and third party software or hardware.

Operating Expenses

Research and development expense for the three and nine month periods ended June 30, 2002 was $342,000 and $1,535,000 as compared to $516,000 and $1,455,000 for the three and nine month periods ended June 30, 2001. The decreases in research and development for the three month period ended June 30, 2002 was primarily due to decreases in personnel and associated costs as a result of a reduction in personnel in March 2002. The reductions were implemented with a view to retaining the Company s core technological competencies and maintaining its abilities to continue to enhance its eB product suite. As a result of these changes, research and development expense is expected to decline in future quarters. The increase in research and development for the nine month period ending June 30, 2002 as compared to the prior year same period was a result of personnel and associated costs as a result of assigning personnel to development activities whereas they were previously assigned to software implementation, sales and marketing activities in the previous year.

Marketing and sales expense for the three and nine month periods was $573,000 and $2,911,000 as compared to $1,063,000 and $2,959,000 for the three and nine month periods ended June 30, 2001. Due to the continued downturn in the economy and the decrease in revenues in March 2002, the Company reduced its sales and marketing personnel and associated costs, along with certain marketing expenditures, in an effort to achieve a reduced level of sales and marketing expenditures, which management believes will be more in line with revenues in future quarters. These efforts have led to the decreases in the three and nine month periods ending June 30, 2002.

General and administrative expense was $411,000 and $1,523,000 for the three and nine month periods ended June 30, 2002 as compared to $426,000 and $1,137,000 for the three and nine month periods ended June 30, 2001. The decrease in general and administrative expense for the three month period ending June 30, 2002 was a result of the reduction in general and administrative personnel and their associated costs that took place in March 2002. Of the increase in general and administrative expense in the nine month period ended June 30, 2002, $277,000 was from severance and related personnel costs incurred in connection with the termination of 38 employees throughout the organization. Additionally, general and administrative expense in fiscal 2001 was comparatively lower as a result of lowering reserves for a certain customer dispute.

Interest and other income was $1,000 and $6,000 for the three and nine month periods ended June 30, 2002 as compared to $16,000 and $54,000 for the three and nine month periods ended June 30, 2001. The decrease is primarily due to a decrease in investments in 2002 as compared to 2001.

Interest and other expense was $106,000 and $246,000 for the three and nine month periods ended June 30, 2002 as compared to $7,000 and $12,000 for the three and nine month periods ended June 30, 2001. The increase was due to additional interest expense on the Company s higher debt balances during 2002 as compared to 2001.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2002, the Company s cash and cash equivalents totaled $364,000 as compared to $1,444,000 at September 30, 2001, and its current ratio was .26 to 1. For the nine month period ended June 30, 2002, cash used in operating and investing activities totaled $3,254,000, while cash provided by financing activities totaled $3,474,000.

The Company has received loans from Spescom in the past to meet its obligations. The outstanding balance of its loans from Spescom increased from $1,377,000 on September 30, 2001 to $4,851,000 on June 30, 2002. Such loans are secured by all of the assets of the Company. See Related Party Transactions below.

The funding to date has enabled the Company to restructure its operation and meet its obligations. In addition, management believes that our strategic restructuring plan will enable the Company to reduce our costs to a level that is aimed at achieving a breakeven cash flow by our fiscal year-end, while still maintaining our core competencies. The amou