

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

UPGRADE INTERNATIONAL CORP /FL/
Form 10QSB
May 20, 2002

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended MARCH 31, 2002

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 May 15, 2002, 44,173,400 shares of common stock, \$.0001 par value were outstanding. (Excludes 45,000,000 shares registered in the Company's name and deposited into a custody account to support loan transaction to the Company. See Footnote F)

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

INDEX

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

PART I - Financial Information

Item 1. Financial Statements

Consolidated balance sheets at September 30, 2001 (audited) and March 31, 2002 (unaudited)

Consolidated statements of operations for the three and six months ended March 31, 2001 and 2002 cumulative since inception (February 5, 1997) through March 31, 2002 (unaudited)

Consolidated statement of stockholders' equity since inception through September 30, 2001 and for ended March 31, 2002 (unaudited)

Consolidated statement of cash flows for the six months ended March 31, 2001 and 2002 (unaudited) Cumulative since inception (February 5, 1997) through March 31, 2002 (unaudited)

Notes to the Financial Statements (unaudited)

Item 2. Management's Discussion and Analysis or Plan of Operation

PART II - Other Information

Item 1. Legal Proceedings

Item 2. Changes In Securities and Use of Proceeds

Item 5. Other Information

Item 6. Exhibits and Reports on Form 8 - K

Signatures

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED BALANCE SHEETS

ASSETS

	September 30, 2001	March 31, 2002
	-----	-----
		(unaudited)
CURRENT ASSETS		
Cash and cash equivalents	\$ 2,551,465	\$ 668,786
Restricted deposit	300,000	300,000
Subscriptions receivable	500,000	-0-

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

Note receivable from related party	135,243	135,300
Prepaid expenses, deposits and other	110,022	92,583
	-----	-----
Total current assets	3,596,730	1,196,669
PROPERTY AND EQUIPMENT - AT COST, less accumulated depreciation and amortization	2,071,663	1,750,458
SPUTTERING MACHINE, held for sale	2,000,000	2,000,000
ADVANCES TO ROCKSTER GROUP	1,084,000	1,590,500
OTHER ASSETS		
Intangible and deferred assets, net of accumulated amortization	466,256	889,033
Acquisition deposits	1,820,715	1,820,715
Deposits	194,128	194,128
	-----	-----
Total assets	\$ 11,233,492	\$ 9,441,503
	=====	=====
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	\$ 3,853,950	\$ 4,825,003
Payable to related parties	5,503,022	3,271,911
Accrued liabilities	2,972,713	2,781,733
Notes payable	1,717,231	1,967,594
Equipment purchase contract payable	2,024,748	2,024,748
Royalty and license fee payable to CardTech, Inc.	1,161,873	2,426,918
	-----	-----
Total current liabilities	17,233,537	17,297,907
CONVERTIBLE DEBENTURES, net of unamortized discount	2,004,488	1,075,756
LOAN PAYABLE	-0-	1,210,000
MINORITY INTEREST	1,473,179	-0-
COMMITMENTS AND CONTINGENCIES	-	-
STOCKHOLDERS' DEFICIT		
Common stock - \$.0001 par value, 250,000,000 shares authorized	24,524	40,059
Stock subscriptions	2,742,586	1,793,248
Additional paid in capital	53,947,618	74,776,915
Deferred compensation	(498,559)	(407,686)
Receivable from stockholders of subsidiary	(266,621)	(266,621)
Accumulated development stage deficit	(65,427,260)	(86,078,075)
	-----	-----
	(9,477,712)	(10,142,160)
	-----	-----
Total liabilities and stockholders' deficit	\$ 11,233,492	\$ 9,441,503
	=====	=====

The accompanying notes are an integral part of these statements.

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

	Six months ended March 31,		Three months ended March 31,	
	2001	2002	2001	2002
Costs and expenses	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Research and development	\$ 3,539,415	\$ 2,609,469	\$ 1,124,990	\$ 83,000
Purchased in-process research & development	-	-	-	-
Sales and marketing	1,135,651	141,214	421,814	3,000
General and administrative	7,089,692	5,361,813	5,489,902	3,040,000
	11,764,758	8,112,496	7,036,706	3,900,000
Other expenses (income)				
Equity in losses of UltraCard	-	-	-	-
Interest expense	1,026,842	11,655,096	723,230	4,040,000
Loss on advances to Pathways	-	-	-	-
Other, net	86,786	1,628,754	62,081	710,000
	1,113,628	13,283,850	785,311	4,750,000
Minority interest in losses of subsidiaries	-	(745,531)	-	(4,000)
NET LOSS	\$12,878,386	\$ 20,650,815	\$ 7,822,017	\$ 8,610,000
LOSS PER COMMON SHARE-BASIC AND DILUTED	\$ 0.62	\$ 0.57	\$ 0.37	\$ 0.37

The accompanying notes are an integral part of these statements.

4

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

STATEMENT OF STOCKHOLDERS' EQUITY

Since September 30, 2001 through March 31, 2002 (unaudited)

Voting common stock	Common stock subscribed	Additional paid-in	D
---------------------	-------------------------	--------------------	---

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

	Shares	Amount	Shares	Amount	capital	co
	-----	-----	-----	-----	-----	-----
Balances at September 30, 2001	24,523,523	24,524	3,892,323	2,742,586	53,947,618	
Shares issued on October 5, 2001 in connection with September 2001 conversions of debentures at \$.54 to \$1.30 per share	971,725	972	(971,843)	(636,625)	635,653	
Contribution from minority interest	-	-	-	-	727,648	
Shares issued on October 11, 2001 in lieu of loan interest and penalties at \$1.48 per share	52,434	52	-	-	77,550	
		Accumulated development stage deficit	Total			
		-----	-----			
Balances at September 30, 2001		(65,427,260)	(9,477,712)			
Shares issued on October 5, 2001 in connection with September 2001 conversions of debentures at \$.54 to \$1.30 per share		-	-			
Contribution from minority interest		-	727,648			
Shares issued on October 11, 2001 in lieu of loan interest and penalties at \$1.48 per share		-	77,602			

The accompanying notes are an integral part of these statements.

5

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - Continued
Since September 30, 2001 through March 31, 2002 (unaudited)

	Voting common stock		Common stock subscribed		Additional paid-in capital
	Shares	Amount	Shares	Amount	-----
	-----	-----	-----	-----	-----
Shares issued on October 20 and 21, 2001 at \$1.58 per share in					

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

lieu of loan interest and penalties	151,671	152	-	-	239,488
Shares issued on November 7, 2001 in connection with October 10, 11 and 12, 2001 conversion of debentures at \$.535 per share	3,116,633	3,117	-	-	1,684,299
Shares issued on November 7, 2001 in connection with October 12, 2001 conversion of convertible debentures \$.543 per share	979,095	979	-	-	595,830
Shares issued on November 7, 2001 at \$1.48 per share in lieu of penalties in connection with October 11, 2001 conversion of convertible debentures	351,743	352	-	-	520,228
Shares issued on November 7, 2001 at \$1.41 per share in lieu of penalties in connection with October 12, 2001 conversion of convertible debentures	445,540	445	-	-	627,766
Shares issued on November 7, 2001 at \$1.71 per share in lieu of penalties in connection with October 10, 2001 conversion of convertible debentures	413,864	414	-	-	707,293
Shares issued on November 9, 2001 (previously subscribed to in September 2001 at \$.50, \$.70, and \$1.00 per share)	2,800,000	2,800	(2,800,000)	(1,820,000)	1,817,200
Shares issued on November 9, 2001 in lieu of finder's fees on previous placements	750,000	750	-	-	(750)
Shares issued on November 9, 2001 at a \$1.00 in lieu of settlement of payables to stockholders and cash, net of fees	905,205	905	-	-	901,700
Shares issued on November 9, 2001 at a \$1.41 lieu of fees in connection with a private placement	25,000	25	-	-	(25)
Shares issued on November 9, 2001 (previously subscribed to in July 2001 at \$2.00 per share)	25,000	25	(25,000)	(50,000)	49,975
Shares issued on November 9, 2001 in connection with October 15, 2001 conversion of debentures at \$1.25 and \$1.50 per share	776,919	777	-	-	1,010,433
Shares subscribed to on November 11, 2001 at \$1.41 per share in lieu of interest and					

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

penalties	-	-	56,970	80,328	-
Shares subscribed to on November 19 and 21, 2001 at \$1.15 per share in lieu of interest and penalties	-	-	48,532	55,812	-
Shares subscribed to on December 1 and 2, 2001 at \$1.34 per share in lieu of interest and penalties	-	-	56,419	75,601	-
Shares subscribed to on December 9, 2001 at \$1.09 per share in lieu of interest and penalties	-	-	32,593	35,526	-
Shares subscribed to on December 12, 2001 at \$1.05 per share in lieu of interest and penalties	-	-	22,070	23,102	-
Shares subscribed to on December 19, 2001 at \$0.88 per share in lieu of interest and penalties	-	-	47,124	41,469	-
Shares subscribed to on December 22 and 29, 2001 at \$0.80 per share in lieu of interest and penalties	-	-	33,914	27,131	-
Shares subscribed to on December 31, 2001 at \$0.78 per share in lieu of interest and penalties	-	-	26,253	20,477	-
Shares issued on November 26, 2001 in lieu of payment of legal fees	100,000	100	-	-	99,900
Shares issued on November 26, 2001 in connection with a private placement at \$1.36 per share	18,437	18	-	-	24,982
Shares issued on November 26, 2001 in connection with a private placement and satisfaction of liabilities at \$1.10, net of transactions costs per share	562,171	562	-	-	443,184
Shares issued on December 7, 2001 at \$1.09 per share in lieu of fees and penalties in connection with October 10 through 12, 2001 conversion of convertible debentures	948,843	949	-	-	972,536

Accumulated development stage deficit	Total
-----	-----

Shares issued on October 20 and

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

21, 2001 at \$1.58 per share in lieu of loan interest and penalties	-	239,640
Shares issued on November 7, 2001 in connection with October 10, 11 and 12, 2001 conversion of debentures at \$.535 per share	-	1,687,416
Shares issued on November 7, 2001 in connection with October 12, 2001 conversion of convertible debentures \$.543 per share	-	596,809
Shares issued on November 7, 2001 at \$1.48 per share in lieu of penalties in connection with October 11, 2001 conversion of convertible debentures	-	520,580
Shares issued on November 7, 2001 at \$1.41 per share in lieu of penalties in connection with October 12, 2001 conversion of convertible debentures	-	628,211
Shares issued on November 7, 2001 at \$1.71 per share in lieu of penalties in connection with October 10, 2001 conversion of convertible debentures	-	707,707
Shares issued on November 9, 2001 (previously subscribed to in September 2001 at \$.50, \$.70, and \$1.00 per share)	-	-
Shares issued on November 9, 2001 in lieu of finder's fees on previous placements	-	-
Shares issued on November 9, 2001 at a \$1.00 in lieu of settlement of payables to stockholders and cash, net of fees	-	902,605
Shares issued on November 9, 2001 at a \$1.41 lieu of fees in connection with a private placement	-	-
Shares issued on November 9, 2001 (previously subscribed to in July 2001 at \$2.00 per share)	-	-
Shares issued on November 9, 2001 in connection with October 15, 2001 conversion of debentures at \$1.25 and \$1.50 per share	-	1,011,210
Shares subscribed to on November 11, 2001 at \$1.41 per		

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

share in lieu of interest and penalties	-	80,328
Shares subscribed to on November 19 and 21, 2001 at \$1.15 per share in lieu of interest and penalties	-	55,812
Shares subscribed to on December 1 and 2, 2001 at \$1.34 per share in lieu of interest and penalties	-	75,601
Shares subscribed to on December 9, 2001 at \$1.09 per share in lieu of interest and penalties	-	35,526
Shares subscribed to on December 12, 2001 at \$1.05 per share in lieu of interest and penalties	-	23,102
Shares subscribed to on December 19, 2001 at \$0.88 per share in lieu of interest and penalties	-	41,469
Shares subscribed to on December 22 and 29, 2001 at \$0.80 per share in lieu of interest and penalties	-	27,131
Shares subscribed to on December 31, 2001 at \$0.78 per share in lieu of interest and penalties	-	20,477
Shares issued on November 26, 2001 in lieu of payment of legal fees	-	100,000
Shares issued on November 26, 2001 in connection with a private placement at \$1.36 per share	-	25,000
Shares issued on November 26, 2001 in connection with a private placement and satisfaction of liabilities at \$1.10 per share, net of transaction costs	-	443,746
Shares issued on December 7, 2001 at \$1.09 per share in lieu of fees and penalties in connection with October 10 through 12, 2001 conversion of convertible debentures	-	973,485

The accompanying notes are an integral part of these statements.

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - Continued

Since September 30, 2001 through March 31, 2002 (unaudited)

	Voting common stock		Common stock subscribed		Additional paid-in capital
	Shares	Amount	Shares	Amount	
Warrants granted in lieu of interest and penalties	-	-	-	-	1,956,457
Shares subscribed to and warrants issued in lieu of additional interest on convertible debentures	-	-	434,220	594,881	580,035
Shares subscribed at \$.80 through \$1.37 per share in connection with November and December 2001 promissory notes	-	-	202,167	182,265	-
Warrants issued in connection with November through December 2001 promissory notes	-	-	-	-	217,898
Adjustment due to modification of warrants	-	-	-	-	32,922
Adjustment due to added conversion feature on notes payable	-	-	-	-	200,000
Allocation to beneficial conversion feature	-	-	-	-	150,000
Amortization of deferred compensation for the three months ended December 31, 2001	-	-	-	-	-
Shares issued on January 13, 2002 pursuant to penalty and interest adjustments to convertible debenture at prices of \$1.02 & \$1.03	59,953	60			50,103
Shares issued February 4, 2002 as loan inducement fees for shares previously subscribed in November & December 2001	354,300	354	(354,300)	(119,024)	118,670
Shares issued February 4, 2002 at prices from \$1.03 to \$1.08 pursuant to loan inducement fees for loans provided to the Company in January 2002	35,063	35			131,380
Shares issued February 4, 2002 as payment of penalties and interest on					

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

Loan agreements	345,683	346	(323,875)	(329,036)	412,072
Shares issued February 4, 2002 as payment of penalty and interest on loan agreements incurred in January 2002	299,993	300			315,446
Shares and warrants issued February 4, 2002 as payment of penalties and interest On loan agreements incurred in February 2002	34,231	34			48,574
Shares issued and warrants granted on January 15, 2002 and Issued on February 26, 2002 in settlement of debts	1,000,000	1,000			1,465,000
Shares issued March 4, 2002 for shares previously subscribed Pursuant to private placements at \$2.00 per share	12,000	12	(12,000)	(24,000)	23,988
Shares subscribed in connection with February penalties and interest on loan Agreements			350,204	526,255	
Adjustment to shares subscribed and warrants issued in March in connection with notes payable				29,300	484,846
Warrants issued during the three months ended March 31, 2002 as penalties and interest on promissory notes					2,923,527
Shares and warrants granted in Connection with March 2002 notes			350,000	181,275	166,245
Shares and warrants granted in March 2002 at \$1.01 to \$1.08 per share pursuant to loan inducement fees for loan provided in March 2002			144,375	155,925	417,244
Amortization of deferred compensation for the three months ended March 31, 2002					
Net loss for the six months ended March 31, 2002					
Balances at March 31, 2002	40,059,026	\$40,059	\$ 1,210,146	\$ 1,793,248	\$74,776,915

-----	-----	-----	-----	-----
Accumulated				
development				
stage deficit		Total		
-----	-----	-----	-----	-----

Warrants granted in lieu of

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

interest and penalties	-	1,956,457
Shares subscribed to and warrants issued in lieu of additional interest on convertible debentures	-	1,174,916
Shares subscribed at \$.80 through \$1.37 per share in connection with November and December 2001 promissory notes	-	182,265
Warrants issued in connection with November through December 2001 promissory notes	-	217,898
Adjustment due to modification of warrants	-	32,922
Adjustment due to added conversion feature on notes payable	-	200,000
Allocation to beneficial conversion feature	-	150,000
Amortization of deferred compensation for the three months ended December 31, 2001	-	49,326
Shares issued on January 13, 2002 pursuant to penalty and interest adjustments to convertible debenture at prices of \$1.02 & \$1.03		50,163
Shares issued February 4, 2002 as loan inducement fees for shares previously subscribed in November & December 2001		-
Shares issued February 4, 2002 at prices from \$1.03 to \$1.08 pursuant to loan inducement fees for loans provided to the Company in January 2002		131,415
Shares issued February 4, 2002 as payment of penalties and interest on Loan agreements		83,382
Shares issued February 4, 2002 as payment of penalty and interest on loan agreements incurred in January 2002		315,746
Shares and warrants issued February 4, 2002 as payment of penalties and interest On loan agreements incurred in February 2002		48,608
Shares and warrants issued February 26, 2002 in settlement of debts		1,466,000

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

Shares issued March 4, 2002 for shares previously subscribed Pursuant to private placements at \$2.00 per share		-
Shares subscribed in connection with February penalties and interest on loan Agreements		526,255
Adjustment to shares subscribed and warrants issued in March in connection with notes payable		514,146
Warrants issued during the three months ended March 31, 2002 as penalties and interest on promissory notes		2,923,527
Shares and warrants granted in Connection with March 2002 notes		347,520
Shares and warrants granted in March 2002 at \$1.01 to \$1.08 per share pursuant to loan inducement fees for loan provided in March 2002		573,169
Amortization of deferred compensation for the three months ended March 31, 2002		41,547
Net loss for the six months ended March 31, 2002	(20,650,815)	(20,650,815)
Balances at March 31, 2002	\$ (86,078,075)	\$ 10,097,160

The accompanying notes are an integral part of this statement.

7

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Six months ended March 31	
	2001	2000
Increase (Decrease) in Cash and Cash Equivalents		
Cash flows from operating activities		
Net loss	\$ (12,878,386)	\$ (20,
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	297,683	

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

Amortization of beneficial conversion feature and debt discount	963,023	1,
Amortization of loan costs	-	
Write off of leasehold improvements	-	
Modification of loan agreements	-	
Equity securities issued in lieu of interest and penalties on debt	-	11,
Employee stock options issued below fair value	-	
Adjustment to receivables from subsidiary's stockholders	-	
Write off of uncollectible advances	-	
Write off due to impairment	-	
Write off of option cost	-	
Loss on sale of property and equipment	3,883	
Common stock subscribed for Financing fees	122,002	
Equity in loss of UltraCard	-	
Purchased in-process research and development	-	
Warrants and options issued for services	1,903,685	
Warrants issued for financing fees	35,082	
Shares issued for services	-	
Expenses incurred through loan assumption	-	
Stock of subsidiary issued in exchange for contribution of intellectual property charged to expense	-	
Minority interest	-	(
Changes in assets and liabilities:		
Prepaid expenses, deposits and other	(251,264)	
Payables, accrued liabilities and other	3,127,025	3
	-----	-----
Net cash used in operating activities	(6,677,267)	(4,
Cash flows from investing activities		
Advances to The Pathways Group, Inc.	(1,349,955)	(
Advances to Rockster, Inc.	(560,000)	
Advances to eCourier	-	
Payments on equipment under construction	-	
Acquisition of property and equipment, net	(429,364)	
Acquisition of Centurion Technologies, Inc., net of cash acquired	-	
Acquisition of UltraCard, Inc., net of cash acquired	-	(
Acquisition of equity interest in EforNet Corp. from a minority shareholder	-	
Additions to note receivable from related party	(130,000)	
Acquisition deposit	(15,000)	
Additions to intangible assets	(65,490)	
	-----	-----
Net cash used in investing activities	(2,549,809)	(
Cash flows from financing activities		
Proceeds from sale of common stock and stock subscriptions	5,575,614	
Borrowings, net of loan costs	4,604,039	2,
Principal payments on borrowings	(1,311,592)	
Purchase of collateral on subsidiary's letter of credit	-	
Release of restricted cash	505,687	
Proceeds from exercise of stock options and warrants	55,000	
	-----	-----
Net cash provided by financing activities	9,428,748	3,
	-----	-----
Net increase (decrease) in cash and cash equivalents	201,672	(1,

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

Cash and cash equivalents at the beginning of the period	398,989	2,
	-----	-----
Cash and cash equivalents at the end of the period	\$ 600,661	\$
	=====	=====

The accompanying notes are an integral part of these statements.

8

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2001 and 2002

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 of the United States of America (GAAP) 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, 2002. 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 2001, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for the years then ended and since inception (February 5, 1997), and the form 10-QSB for the quarters ended December 31, 2000 and 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 September 30, 2001 and March 31, 2002, 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), Global CyberSystems PLC (GCPLC) and UltraCard China Inc. The statements of operations for the three and six months ended March 31, 2001 and 2002 and for the period from inception (February 5, 1997) and the statements of cash flows for the six months ended March 31, 2001 and 2002 and for the period from inception (February 5, 1997) 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. All

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

significant inter-company 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 AND SHARES OUTSTANDING

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 for the six and three months ended March 31, 2002 was 36,355,727 and 39,182,748, respectively and 20,938,724 and 21,191,279 for the six and three months ended March 31, 2001 respectively, and 15,360,066 since inception (February 5, 1997) through December 31, 2001. Diluted loss per share for all periods presented equaled basic loss per share due to antidilutive effect of the potentially dilutive securities.

In addition at March 31, 2002, 48,356,000 shares of the Company's common stock were not included in the shares issued and outstanding on the consolidated statement of stockholders' deficit or loss per share computations. The excluded shares were as follows:

- Shares issued in lieu of finders' fees in connection with future findings - 1,365,000 (with 1,000,000 shares outstanding at September 30, 2001 and 365,000 shares issued during the quarter ended December 31, 2001).
- Shares held by the Company in connection with loan assumptions - 2,000,000 shares. In October 2001, the Company issued 2,000,000 to replace the 2,000,000 shares originally transferred by the Company's president to an unrelated third party as a collateral for \$1,210,000 loan payable. In October 2001, the Company assumed the president's liability on the loan and issued 2,000,000 shares. The original collateral shares were then transferred into the Company's name by the president.
- Contingently issued, 45,000,000 restricted shares issued to an institutional syndicator, held as collateral on a future financing as described in note F.

9

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2001 and 2002

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. Accordingly, 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 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

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

will be adequate to satisfy the requirements of its current and planned operations until the end of the 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, debt financing or through strategic relationships with development partners. 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.

The following summarizes the debt and equity transactions completed by the Company during the three months ended March 31, 2002:

In January 2002, the Company borrowed \$170,000 from existing debt holders pursuant to 30-day note agreements. Interest and penalties are required under the terms of the notes payable every 30 days comprised of 10% interest, 10% to 12.5% of the original loan amount payable in common stock and up to 37.5% of the original loan amount in warrants at an exercise price of market but not more than \$1.00. In addition, as a cost of the financing, the Company granted a \$18,700 note payable, 35,063 shares of common stock, and warrants entitling holder to purchase 105,188 shares of common stock at \$.80 to \$1.00 per share. The warrants are exercisable immediately and expire five years from the date of grant.

In February 2002, the Company issued 350,204 shares pursuant to the terms of certain loan agreements maturing within 30 days of the date of issuance. Loan penalties and interest payable in shares is required for a 30 day extension on the loans.

In March 2002, the Company issued 371,427 shares pursuant to the terms of certain loan agreements maturing within 30 days of the date of issuance. Loan penalties and interest payable in shares is required for a 30 day extension on the loans.

In March 2002, the Company borrowed \$700,000 from existing debt holders pursuant to 30-day note agreements. Interest and penalties are required under the terms of the notes payable every 30 days comprised of 10% interest, 10% to 12.5% of the original loan amount payable in common stock and up to 37.5% of the original loan amount in warrants at an exercise price of market but not more than \$.80. In addition, as a cost of the financing, the Company granted a \$77,000 note payable, 144,375 shares of common stock, and warrants entitling holder to purchase 433,125 shares of common stock at \$.80 per share. The warrants are exercisable immediately and expire five years from the date of grant.

10

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2001 and 2002

NOTE D - MANAGEMENT PLANS - Continued

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

During the three month period ended March 31, 2002, the Company borrowed \$587,500 from an officer. On April 30, 2002 this balance, combined with then outstanding \$150,000 loan due to the officer, along with additional advances subsequent to March 31, 2002, which brought the total to \$775,000, was rolled into a convertible note payable bearing interest at a rate of 8% per annum and convertible into the common stock of the Company at \$0.75 per share. The convertible debenture is due December 31, 2002. In addition, on April 30, 2002, the Company granted 750,000 warrants issued as part of the debt transaction, to acquire common stock at a price of \$0.75 per share with a cashless exercise provision and a five-year term. In connection with this transaction, the Company recognized \$150,000 in debt discount, with \$87,500 being expensed in the first quarter of the year ending September 30, 2002.

In January 2002, the Company settled a payable to a related party of approximately \$955,000 for services performed and the reimbursement of expenses incurred, in exchange for the payment of \$25,000, \$125,000 payable in cash in the future, the issuance of 1,000,000 shares of the Company's common stock and the granting of warrants to purchase 500,000 shares of common stock at \$1.25 per share on or before January 15, 2005. In connection with this transaction, the Company recognized \$666,730 in additional compensation expense representing excess of equity consideration granted over the fair value of the debt settled.

In February 2002, the Company entered into a debt financing agreement with an institutional syndicator to obtain up to \$15 million in working capital for Upgrade and its group of Companies. The debt instrument is for a seven-year term with the principal due at maturity, and interest payable quarterly commencing in year three of the financing. The loan is secured by the issuance of 40 million shares of Company Stock, which have been issued under Rule 144A along with 5 million restricted common shares issued under Rule 506D. The shares issued under Rule 144A carries a different CUSIP number from the Company's Common Stock. These shares are restricted, and can only be traded among qualified institutional investors. Upon repayment of the credit facility, the shares are to be returned to the Company. Contained in the agreement is the stipulation that the voting rights of the 45 million shares by way of proxy will be voted in proportion with the existing shareholder base. The Company also retains the right to substitute collateral 18 months after closing of the transaction. This transaction has not yet funded and continues to be unfunded subsequent to period end.

The Company is actively pursuing new investment into the Company. This financing may take the form of equity, convertible debentures and other types of debt instruments.

11

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2001 and 2002

NOTE E - COMMITMENTS AND CONTINGENCIES

The Company is in default on its payments on its ten-year lease for office space located in Los Angeles, California. As of March 31, 2002, the Company is past due on approximately \$170,000 in lease payments, plus facility expenses. Rockster, Inc. had been occupying this facility, but vacated it in April 2002. Subsequent to March 31, 2002, the Company began negotiations with the landlord to terminate the lease and settle the amounts owing. These negotiations are

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

expected to be completed during the current fiscal year. Additional amounts owing, if any, will be recorded upon settlement. The carrying amount of the related leasehold improvements were approximately \$211,000, which were written off during the quarter ended March 31, 2002.

The Company remains in default on its payments under various agreements to purchase 826,482 shares of UltraCard, Inc. common stock and 10,000 shares of CardTech, Inc. (CardTech) common stock. Cash flow permitting, the Company plans to become current on its obligations under these agreements during the quarter ending June 30, 2002. If the Company is unable to do this, it may have to write-off as much as \$1,820,715 in acquisition deposits recorded at March 31, 2002.

As of March 31, 2002, \$2,426,918 in license and royalty payments remained unpaid for the calendar years 2000, 2001 and 2002, resulting in UltraCard being past due on the CardTech license agreement. CardTech has agreed to defer payment of amounts owed until June 30, 2002.

NOTE F - SUBSEQUENT EVENTS

In April 2002, the Company borrowed a further \$425,000 from existing shareholders pursuant to certain 30-day note agreements. Interest and penalties are required under the terms of the notes payable upon maturity comprised of 10% interest, 12.5% payable in share capital and warrants of 37.5% of the loan value, at a current market strike price but not to exceed \$0.80. In addition, as a cost of the financing, the Company entered into note payable agreements of \$33,000, issued 33,000 shares of common stock, and granted warrants entitling holder to purchase 33,000 shares of common stock at a price of \$0.25 per share. The warrants are exercisable immediately and expire five years from the date of grant.

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.

BUSINESS OPPORTUNITIES & THE COMMERCIALIZATION PROCESS

Since the Company's year-end, there has been good progress toward completing the commercialization process for the UltraCard technology. As pointed out in the previously filed 2001 Form 10-KSB, among the steps necessary to complete the process include: final design and production of the cardbody; (the proprietary hard drive like media, "shim", which is housed inside the cardbody, which meets the international standards for card size, thickness and flexibility), final design of the first read-write device and the operating and application software which resides on the "shim". The software includes the operating system and specific application software that will define the functionality of the UltraCard.

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

The Company is in the process of aligning with others to commercialize the UltraCard technology. This has taken form in the case of contracted manufacturing or consulting services, i.e. Pemstar, Infineon, and Komag, or potential partnerships / joint ventures, like the one currently being negotiated with Giesecke & Devrient, Inc. ("G & D"). Pemstar, Infineon and Komag have made significant contributions to the commercialization of the UltraCard technology. Without their individual efforts, the accomplishments to date would have taken longer. These types of relationships have proven successful for the Company, and management believes they will continue to provide the necessary resources to achieve commercialization of the UltraCard technology.

Management believes that the UltraCard technology can be commercialized much sooner by using contract manufacturing from disk drive companies to produce its products than by establishing its own manufacturing facilities. As a result of the excess in manufacturing capacity in the disk drive industry today, the contract manufacturing approach should result in lower short-term investment by the Company, maximize the ability to vary production levels to meet demand and lower the risk of early manufacturing start-up problems.

Additionally, chip manufacturers are readily available, and with the low cost memory afforded using the UltraCard solution, low cost chips can be used while still increasing the overall functionality of the card.

However, the Company does intend to maintain control over manufacturing from the perspectives of manufacturing process and inventory exposure. The Company intends to monitor the quality processes in the individual contract manufacturers' plants including incoming inspection procedures, in-cycle quality assurance and final burn-in and test. The Company also will establish ongoing reliability inspection to ensure they meet specifications and reliability goals before shipping to customers.

The negotiations with G & D are continuing as the parties identify the various aspects of the relationship, including both pre and post commercialization timeframes. This includes the points of manufacturing, as well as, licensing, marketing and potential joint-venture relationships. At the present time, G&D and the Company are continuing their dialogue attempting to work out all of the details with respect to the agreement. The Company will make an announcement upon the signing of the definitive agreement.

The commercial version of the read-write device design, 5 1/4" half-height, (similar in size to a CD-ROM drive that can be inserted into the standard computer tower, has been substantially completed during the quarter and the pre-production soft tooled units for the initial pilot tests and demonstration are expected to be completed by the Research and Development team at UltraCard prior to the end of the fiscal year 2002. The Company is currently in negotiations with a number of potential manufacturing partners to complete the commercial version of the read-write device.

Another significant issue toward commercialization is that of the operating system for the UltraCard technology. We believe that there are several systems available with only slight modifications necessary. However, we believe that a more attractive and longer-term option would be for the Company to develop its own operating system. The advantage of developing its own system would be that the Company would then enjoy proprietary rights over the initial and later applications. This would result in licensing revenues being earned on a continuing basis. The Company is exploring this possibility and has hired consultants and contract employees for this purpose.

These perspectives lead to the conclusion that a time-horizon based on this calendar year cannot at all be ruled out. In fact, it is quite likely that the process will be done within that timeframe.

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

It cannot be stressed enough that an upward shift in the priority given by Upgrade is to complete the commercialization process of its core, patented technology as soon as possible. Through strategic partnerships and licensing of its proprietary technology, the Company can plan its revenue stream. The UltraCard technology product development strategy is guided by the tactic to accumulate and retain ownership of as broad and comprehensive an intellectual property package as possible in order to retain as much ownership of intellectual property as possible.

It is planned that all research and development activities will be controlled in house by the Company.

13

FINANCIAL RESULTS

Net losses aggregated \$8.6 million in the three months ended March 31, 2002 compared with a \$7.8 million net loss for the corresponding period of the prior fiscal year. This increase in net loss is reflective of the increased cost of capital incurred by the Company from financings through short-term loan agreements. Interest costs of \$4.0 million have been recorded in the current quarter which is comprised, in the most part, of shares, warrants and notes issued for interest and penalties on short term loans payable

The Company's general and administrative costs of \$3.9 million in the current quarter represents a decrease in the quarterly general and administrative expenditure from the prior year attributed in the most part to curtailing certain expenditures as a result of limited cash resources. The Company is managing to keep its expenses to a minimum during the tight cash flow periods. Expenses relating to cQue were kept to a minimum reflecting the focus of the consolidated groups efforts to complete the UltraCard technology. For the near future research and development expenditures are expected to increase to meet the Company's numerous potential market opportunities. All of the Company's research and development costs have been expensed as incurred.

Sales and marketing expenditures of \$34,000 represent a significant decrease over the same quarter the prior fiscal year reflecting the Company's focus upon product completion, and not necessarily of potential sales. Sales and marketing expenditures typically 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 nearing the first phase of completion.

For the first six months of the fiscal year, net losses were \$20.7 million, of which \$11.7 related to the costs of capital. During this period the capital markets has been difficult in raising capital, as a result, the Company has had to pay higher costs to obtain operating capital. The cost is significantly higher than the Company would prefer; and Management continues to spend a significant amount of time and resources seeking other forms and lower cost capital to support operations. However, the Company's investment in research and development, of \$2.6 million for the first six months, illustrates management's objective of moving the technology forward towards commercialization. Other expenses have been kept to only those essential in keeping the business operational with minimal discretionary expenses during this tight cash flow period. General and administrative expenses were reduced 25%, as the Company reduced all non-essential expenses.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2001 the Company had available cash balances of approximately \$668,000. The Company is managing very tight cash flows but still providing

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

funding for its research and development program at UltraCard. During the six months ended March 31, 2002, the Company raised approximately \$870,000 in smaller financings comprised of promissory notes with equity kickers (common stock and warrants) and equity penalties (common stock and warrants) for failure either to repay the notes or register shares owned by the noteholders. The Company is not in default under these notes as long as it complies with the equity penalty provisions. At March 31, 2002, the Company had total indebtedness of approximately \$2,553,000 under these arrangements.

Other funds were raised in the forms of convertible debentures of approximately \$588,000 from a related party of the Company. The Company's cash used in operations was \$4.2 million, which represents a decrease compared to the prior quarter of \$2.5 million. This decrease results from the increase in accounts payable and accrued liability levels.

Cash flows from financing activities of \$3.3 million in the six month period ended March 31, 2002 represents a level consistent with the last two quarters of the year ended September 30, 2001. The Company has begun to focus it's efforts upon financing initiatives which have a much larger magnitude than prior financings and such initiatives have much longer lead times. While these initiatives are in progress the Company is limiting the number of smaller more expensive financings to critical needs.

In order for the Company to meet the funding requirements of its investee companies and to meet ongoing operating requirements, it will have to raise additional financing. 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. 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.

14

PART II Other Information

Item 1. Legal Proceedings

Upgrade, its president, Daniel S. Bland, and Chief Financial Officer, Howard Jaffe, are defendants in The Pathways Group, Inc. v. Upgrade International

Corporation et al., Superior Court of the State of California in for the County

of Sonoma, c/a 227650. The complaint, filed August 3, 2001, alleges breach of merger and collateral agreements between Upgrade and plaintiff, breach of oral argument, fraud, and negligent material misrepresentation, and seeks specific performance of the agreements, an injunction against exercising provisions pursuant to the merger agreement whereby Upgrade could obtain control of Pathways, and damages in excess of \$150 million. Specifically, the complaint alleges that Upgrade failed to provide interim financing to Pathways pending consummation of the proposed merger transaction, and prevented Pathways from obtaining alternate sources of financing. Upgrade believes that the plaintiff's allegations are without legal or factual basis and therefore it has not accrued any potential losses resulting from this claim except for the \$3.4 million debt owed by Pathways to Upgrade, which Upgrade has recorded a provision for potentially uncollectible advances to Pathways as of June 30, 2001. The case is

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

currently is discovery.

Item 2. Changes in Securities and Use of Proceeds

During the Three Months ended March 31, 2002 the Company made the following sales of unregistered securities;

In January, 2002, the Company issued 48,776 shares of its common stock pursuant to the conversion of debentures at prices ranging from \$1.02 to \$1.03 per share. The issuances were pursuant to contractual rights granted in prior securities offerings that were exempt under Rule 506 and Section 4(2) of the Act.

During the period November and December 2001 the Company entered into 13 promissory notes for aggregate proceeds to the Company of \$1,008,500. In February, 2002, the Company issued 354,300 shares of the common stock of the Company to the note holders as an inducement to enter into the said note agreements.

The shares were valued at \$119,024. Each note carries an interest rate of 10%, as well as penalties in the form of stock and warrants for failure either to repay the notes or register shares owned by the noteholders. The Company is not in default under these notes as long as it complies with the equity penalty provisions. None of the notes was paid at maturity. The notes and share issuances were issued pursuant to exemptions from registration under Regulation S, Rule 506 and Section 4(2).

During January 2002 the Company entered into a further 4 promissory notes for aggregate proceeds to the Company of \$170,000, net of financing costs of 18,700. In February, 2002, the Company issued 77,563 shares of the common stock of the Company to the note holders as an inducement to enter into the said note agreements. The shares were valued at \$1.03 to \$1.08 per share. Each note carries an interest rate of 10%, as well as penalties in the form of stock and warrants for failure either to repay the notes or register shares owned by the note holders. The Company is not in default under these notes as long as it complies with the equity penalty provisions. None of the notes was paid at maturity. The notes and share issuances were issued pursuant to exemptions from registration under Regulation S, Rule 506 and Section 4(2).

On February 4, 2002 the Company issued 1,094,160 shares to holders of promissory notes in payment of penalties and interest on the notes outstanding (including 678,175 of shares previously subscribe unissued). but. In addition the Company issued 3,178,954 warrants to acquire common stock in the Company at prices ranging from \$.47 to \$1.34. The warrants were issued in payment of penalties and interest on the notes payable. The share and warrant issuances were issued pursuant to exemptions from registration under Regulation S, Rule 506 and Section 4(2).

On February 26, 2002 the Company issued 1,000,000 shares to a related party in settlement of liabilities due to that Company. The share issuance was valued at \$1,100,000. The share issuances were issued pursuant to exemptions from registration under Regulation S, and Section 4(2) of the securities act. In addition the Company issued 500,000 common stock warrants as part of the the same settlement agreement.

In March 2002, the Company issued 12,000 shares pursuant to a private placement for aggregate proceeds of \$24,000. The offer and sale of 12,000 shares was made pursuant to an exemption from registration under Regulation S, and Section 4(2).

In March 2002, the Company borrowed \$700,000 from existing debt holders pursuant to 30-day note agreements. Interest and penalties are required under the terms

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

of the notes payable every 30 days comprised of 10% interest, 10% to 12.5% of the original loan amount payable in common stock and up to 37.5% of the original loan amount in warrants at an exercise price of market but not more than \$.80. In addition, as a cost of the financing, the Company granted a \$77,000 note payable, 494,375 shares of common stock, and warrants entitling holder to purchase 783,125 shares of common stock at \$.80 per share. The warrants are exercisable immediately and expire five years from the date of grant. The note, share and warrant issuances were issued pursuant to exemptions from registration under Regulation S, Rule 506 and Section 4(2).

During the three month period ended March 31, 2002, the Company borrowed \$587,500 from an officer. On April 30, 2002 this balance, combined with then outstanding \$150,000 loan due to the officer, and increased by further advances to \$775,000, was rolled into a convertible note payable bearing interest at a rate of 8% per annum and convertible into the common stock of the Company at \$0.75 per share. The convertible debenture is due December 31, 2002. In addition, on April 30, 2002 the Company granted 750,000 warrants to acquire common stock at a price of \$0.75 per share with a cashless exercise provision and a five-year term. In connection with this transaction, the Company recognized \$150,000 in debt discount, with \$87,500 being expensed in the first quarter of the year ending March 31, 2002. The convertible debenture issuance was issued pursuant to exemptions from registration under Rule 506 and Section 4(2).

15

Item 5. Other Information

In February 2002, the Company entered into a debt financing agreement with an institutional syndicator to obtain up to \$15 million in working capital for Upgrade and its group of Companies. The debt instrument is for a seven-year term with the principal due at maturity, and interest payable quarterly commencing in year three of the financing. The loan is secured by the issuance of 40 million shares of Company Stock, which will be issued under Rule 144A. These shares will carry a different CUSIP number from the Company's Common Stock. Additionally, 5 million restricted shares under Rule 506D were also deposited into the custody account. All shares are restricted, and can only be traded among qualified institutional investors. Upon repayment of the credit facility, the shares are to be returned to the Company. Contained in the agreement is the stipulation that the voting rights of the 45 million shares by way of proxy will be voted in proportion with the existing shareholder base. The Company also retains the right to substitute collateral 18 months after closing of the transaction. This transaction has not as yet funded.

Item 6. Exhibits

Exhibit No.	Description
-------------	-------------

Upgrade International Corporation

/s/ Daniel Bland

Date: May 20, 2002

Daniel Bland, President and Chief
Executive Officer, and Secretary

Edgar Filing: UPGRADE INTERNATIONAL CORP /FL/ - Form 10QSB

Date: May 20, 2002

/s/ Howard A. Jaffe

Howard A. Jaffe, Chief Operating
and Financial Officer