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ION NETWORKS INC
Form 10QSB/A
June 21, 2002

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

FORM 10-QSB/A

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

For the quarterly period ended December 31, 2001

OR

/ / TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
---- EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File No.: 0-13117

ION NETWORKS, INC.
(Exact Name of Small Business Issuer in Its Charter)

Delaware 22-2413505
(State or Other Jurisdiction of (IRS Employer Identification Number)
Incorporation or Organization)

1551 South Washington Avenue Piscataway, New Jersey 08854

(Address of Principal Executive Offices)

(732) 529-0100

(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 ___

There were 21,138,001 shares of Common Stock outstanding as of January 22, 2002.

Transitional Small Business Disclosure Format:

Yes ___ No X

FORM 10-QSB

FOR THE QUARTER ENDED DECEMBER 31, 2001

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The condensed consolidated financial statements included herein have been prepared by the registrant without audit pursuant to the rules and regulations of the Securities and Exchange Commission. Although the registrant believes that the disclosures are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. It is suggested that these condensed financial statements be read in conjunction with the audited financial statements and the notes thereto included in the registrant's Annual Report on Form 10-KSB for the year ended March 31, 2001.

ION NETWORKS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

	December 31 2001 -----
ASSETS	
Current assets:	
Cash and cash equivalents	\$ 1,746
Accounts receivable, net of allowance for doubtful accounts of \$148,781 and \$161,000 respectively	1,475

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Other receivables	
Inventory, net	1,436
Prepaid expenses and other current assets	255
Related party notes receivable	98

Total current assets	5,011
Restricted cash	375
Property and equipment at cost, net of accumulated depreciation of \$2,612,357 and \$2,095,564 respectively	948
Capitalized software, less accumulated amortization of \$3,197,791 and \$2,585,607, respectively	967
Goodwill and other acquisition - related intangibles, less accumulated amortization of \$963,021 and \$694,444 respectively	63
Other assets	19

Total assets	\$ 7,385
	=====
 LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Current portion of capital leases	\$ 74
Current portion of long-term debt	61
Accounts payable	1,128
Accrued expenses	397
Accrued payroll and related liabilities	668
Deferred income	179
Other current liabilities	296

Total current liabilities	2,805
Long-term portion of capital leases	165
Long-term debt, net of current portion	8
Commitments and contingencies (Note 10)	
Stockholders' equity:	
Preferred stock, par value \$.001 per share; authorized 1,000,000 shares, none issued	
Common stock, par value \$.001 per share; authorized 50,000,000 shares, issued and outstanding 21,124,801 at December 31, 2001; issued and outstanding 18,203,301 shares at March 31, 2001	21
Additional paid-in capital	40,764
Notes receivable from officers	(536)
Accumulated deficit	(35,876)
Accumulated other comprehensive income	32

Total stockholders' equity	4,405

Total liabilities and stockholders' equity	\$ 7,385
	=====

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

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	For the Three Months Ended December 31,		For
	2001	2000	20
	----	----	--
Revenue	\$ 2,214,216	\$ 3,432,572	\$ 5,23
Cost of sales	1,092,872	1,610,796	2,52
	-----	-----	-----
Gross margin	1,121,344	1,821,776	2,71
Research and development expenses	211,929	468,539	72
Selling, general and administration	1,870,157	2,450,863	6,40
Restructuring, asset impairments and other charges	217,467	2,961,125	21
Depreciation and amortization	468,830	949,787	1,41
	-----	-----	-----
Loss from operations	(1,647,039)	(5,008,538)	(6,04
Other income	264,725	--	26
Interest income	17,932	91,756	9
Interest expense	(7,510)	(12,289)	(2
	-----	-----	-----
Loss before income tax expense	(1,371,892)	(4,929,071)	(5,71
Income tax expense	--	11,291	
	-----	-----	-----
Net loss	\$ (1,371,892)	\$ (4,940,362)	\$ (5,71
	=====	=====	=====
PER SHARE DATA			
Net loss per share			
Basic	\$ (0.07)	\$ (0.27)	\$
Diluted	\$ (0.07)	\$ (0.27)	\$
Weighted average number of common shares outstanding:			
Basic	18,542,991	18,077,210	18,31
Diluted	18,542,991	18,077,210	18,31

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

ION NETWORKS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED DECEMBER 31, 2001
(Unaudited)

	Shares	Par Value	Additional Paid-in Capital	Accumulated Deficit	Accumu Oth Compre Inco
	-----	-----	-----	-----	-----
Balance March 31, 2001	18,203,301	\$ 18,203	\$ 40,191,346	\$ (30,165,045)	\$ 46,
Net loss				(5,711,833)	
Exercise of stock options and warrants	21,500	22	4,386		

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Issuance of restricted shares	2,900,000	2,900	536,100		
Notes receivable from officers					
Noncash stock-based compensation			32,999		
Translation adjustments					(14,000)
Balance December 31, 2001	21,124,801	\$ 21,125	\$ 40,764,831	\$ (35,876,878)	\$ 32,999

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

ION NETWORKS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)

	FOR THE NINE MONTHS ENDING DECEMBER 31, 2001
CASH FLOWS FROM OPERATING ACTIVITIES	
Net loss	\$ (5,711,833)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	1,412,794
Provision for inventory obsolescence	75,953
Other charges	(9,052)
Noncash stock-based compensation charges	32,999
Changes in operating assets and liabilities:	
(Increase) decrease in	
Accounts receivable	1,321,510
Other receivables	13,497
Inventory	(372,607)
Prepaid expenses and other assets	(46,685)
Increase (decrease) in	
Accounts payable and accrued expenses	(753,892)
Accrued payroll and related liabilities	252,532
Deferred income	644
Other current liabilities	(13,195)
Net cash used in operating activities	(3,797,335)
CASH FLOWS FROM INVESTING ACTIVITIES	
Acquisition of property and equipment	(30,776)
Capitalized software	(334,140)
Related party notes receivable, net of repayments	798,713
Increase in restricted cash	--
Net cash provided by (used in) investing activities	433,797

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CASH FLOWS FROM FINANCING ACTIVITIES	
Principal payments on debt and capital leases	(110,927)
Proceeds from sales of common stock / exercise of stock options and warrants	4,408

Net cash (used in) provided by financing activities	(106,519)
Effects of exchange rates on cash	(14,144)

Net decrease in cash	(3,484,201)
Cash and cash equivalents, beginning of year	5,230,833

Cash and cash equivalents, end of period	\$ 1,746,632
	=====

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

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ION NETWORKS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS
DECEMBER 31, 2001
(Unaudited)

Note 1 - Condensed Consolidated Financial Statements:

The condensed consolidated balance sheets as of December 31, 2001 and March 31, 2001, the condensed consolidated statements of operations for the three and nine month periods ended December 31, 2001 and 2000, the condensed consolidated statements of cash flows for the nine month periods ended December 31, 2001 and 2000 and the condensed consolidated statement of stockholders' equity for the nine month period ended December 31, 2001, have been prepared by the Company without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary for the fair presentation of the Company's financial position, results of operations and cash flows at December 31, 2001 and 2000 have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited financial statements and notes thereto included in the annual report on Form 10-KSB for the year ended March 31, 2001.

During the second quarter of fiscal 2002, the Company initiated an aggressive plan to increase its revenue and reduce its expenditures and operating costs significantly. The Company's operating plan included certain assumptions, the most important of which is the attainment of future revenues in the twelve months ending September 30, 2002 equivalent to those attained in fiscal year 2001 of approximately \$11 million. Based on its performance in the quarter ending December 31, 2001, analysis of its sales pipeline and the Company's expectation of sequential continued growth, the Company believes it is on target to achieve such revenues. As a result, the Company believes that it will have sufficient cash to fund its operations for the next twelve months. However, to the extent that revenues in the next 12 months fall below those achieved in all of fiscal year 2001, the Company may have to (i) modify its operating plan and scale back its expenditures for personnel and other operating costs in order to preserve cash; and/or (ii) raise additional funds through equity and/or debt

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financing. In addition, the Company is presently evaluating the need to raise additional funds through debt or equity financing to grow its business through expansion and/or through acquisitions. There can be no assurance that the Company will be able to obtain any such financing, or that such additional financing can be obtained on terms acceptable to the Company.

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Note 2 - Restricted Cash:

Due to the expiration of the Company's \$1.5 million line of credit on September 30, 2000, the Company pledged \$375,000 on September 7, 2000 as collateral on an outstanding letter of credit related to the required security deposit for the Company's Piscataway, New Jersey facility. Accordingly, \$375,000 has been reflected as restricted cash and is classified as a non-current asset at December 31, 2001 and March 31, 2001.

Note 3 - Inventory:

Inventory, net of allowance for obsolescence of \$1,647,342 and \$1,571,388 at December 31, 2001 and March 31, 2001, respectively, consists of the following:

	December 31, 2001 -----	March 31, 2001 -----
Raw materials	\$ 341,039	\$ 690,566
Work in process	4,107	18,440
Finished goods	1,090,956	430,442
	-----	-----
Total	\$1,436,102	\$1,139,448
	=====	=====

Note 4 - Earnings Per Share:

The computation of Basic Earnings Per Share is based on the weighted average number of common shares outstanding for the period. Diluted Earnings Per Share is based on the weighted average number of common shares outstanding for the period plus the dilutive effect of common stock equivalents, comprised of outstanding stock options and warrants.

The following is a reconciliation of the denominator used in the calculation of basic and diluted earnings per share:

	Three Months Ended 12/31/01 -----	Three Months Ended 12/31/00 -----	Nine Months Ended 12/31/01 -----	Nine En 12/31 -----
Weighted Average No. of Shares Outstanding	18,542,991	18,077,210	18,316,943	16,59
Incremental Shares for Common Equivalents	643,046	132,310	220,302	1,28
	-----	-----	-----	-----
Diluted Shares Outstanding	19,186,037	18,209,520	18,537,245	17,88

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The potential incremental common shares above were excluded from the computation of diluted earnings per share for all periods presented, because their inclusion would have had an antidilutive effect on earnings per share due to the Company's net loss for each respective period.

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Note 5- Comprehensive Income:

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income". The following table reflects the reconciliation between net loss per the financial statements and comprehensive loss.

	Three Months Ended 12/31/01	Three Months Ended 12/31/00	Nine Months Ended 12/31/01
	-----	-----	-----
Net loss	\$ (1,371,892)	\$ (4,940,362)	\$ (5,711,833)
Effect of foreign currency translation	(1,267)	(27,923)	(14,144)
	-----	-----	-----
Comprehensive loss	\$ (1,373,159)	\$ (4,968,285)	\$ (5,725,977)
	=====	=====	=====

Note 6 - Restructuring, asset impairments and other charges

During the year ended March 31, 2001, the Company recorded \$3,763,612 of restructuring, asset impairments and other charges.

As a result of the Company's operating performance during the first six months of fiscal 2001 as compared to the prior year, the Company's management evaluated the Company's business and product strategy and, in the Company's third fiscal quarter of fiscal 2001, implemented a business restructuring plan which was intended to enable the Company to reach a position of positive operating cash flows and focus its product offerings on those believed to have the greatest potential to generate further, near-term market penetration and positive operating contribution.

Included in the exit costs were approximately \$353,000 of cash severance and termination benefits associated with the separation of approximately 38 employees. All of these affected employees left the company as of March 31, 2001. All termination benefits were paid as of June 30, 2001.

In addition, the Company made strategic decisions to abandon certain products and technologies including those which were acquired in the acquisition of SolCom Systems, Ltd. on March 31, 1999. The Company also closed down the research and development efforts at SolCom Systems, Ltd. and centralized the research and development functions at its New Jersey headquarters. As a result of the above decisions, the Company recorded an impairment charge of approximately \$2,332,000 primarily relating to the abandonment of the

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capitalized core technology from this acquisition and other existing capitalized software. An additional impairment charge of approximately \$870,000 was recorded to write-off the remaining goodwill from the Company's acquisition of SolCom Systems, Ltd. in March 1999 which was being amortized over a three year period. Additionally, the Company recorded an impairment in the amount of approximately \$209,000 on fixed assets previously used in the manufacturing process at SolCom Systems, Ltd. As of March 31, 2001, all of the restructuring activities described above were completed.

In addition to the implementation of the above restructuring plan, in early October 2001, the Company announced the layoff of 17 employees in order to bring its expenses in line with its anticipated revenues. The Company recorded \$217,467 of severance and termination related

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costs. Termination benefits of \$178,624 were paid during the third quarter of fiscal 2002 with the balance to be paid in the fourth quarter of fiscal 2002.

Note 7 - Income Taxes:

The Company has recorded a full valuation allowance against the federal and state net operating loss carryforwards and a full valuation allowance against the foreign net operating loss carryforwards and the research and development credit because management currently believes that it is more likely than not that substantially all of the net operating loss carryforwards and credits will expire unutilized.

Note 8 - New Accounting Pronouncements:

In June 1998, The Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." Among other provisions, it requires that entities recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Gains and losses resulting from changes in the fair values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. This standard, as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133, and Amendment of FASB Statement No. 133", is effective for the Company as of April 1, 2001. The Company has no transition adjustment as a result of adopting the standard.

In July 2001, the Financial Accounting Standards Board ("FASB"), issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets". Statement No. 141 requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method of accounting. In addition, it further clarifies the criteria for recognition of intangible assets separately from goodwill. Statement No. 142 establishes new standards for goodwill acquired in a business combination and eliminates the amortization of goodwill over its estimated useful life. Rather, goodwill will now be tested for impairment annually, or more frequently if circumstances indicate potential impairment, by applying a fair value based test. The Company expects to adopt these statements during the first quarter of fiscal 2003. Management does not believe that the adoption of these standards will have a material impact on the Company's financial position or results of operations.

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The Company is currently evaluating the impact of adopting SFAS Nos. 143, "Accounting for Asset Retirement Obligations" and 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" which were recently issued by the FASB. These pronouncements will be adopted by the Company during fiscal year 2003.

Note 9 - Related Party Transactions:

During April 2000, the Company issued a loan to the former Chief Executive Officer (the "Former CEO") of the Company in the amount of \$750,000. The loan accrued interest at a rate of LIBOR plus 1%. This loan had an original maturity date of the earlier of April 2005 or thirty days after the Company for any reason no longer employed the Former CEO.

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The Former CEO resigned his position at the Company effective September 29, 2000. On October 5, 2000, the Company entered into an agreement with the Former CEO pursuant to which the \$750,000 promissory note was amended to extend the due date to April 30, 2001, and to provide that interest on the note shall accrue through September 29, 2000. The loan was collateralized by the receipt of a first mortgage interest on the personal residence of the Former CEO. Pursuant to this agreement, the Former CEO also agreed to reimburse the Company for certain expenses totaling \$200,000, to be paid over a period of six months ending March 31, 2001. During the fiscal year ended March 31, 2001, \$50,000 was repaid and \$22,000 was recorded as a non-cash offset as a result of earned but unpaid vacation owed to the Former CEO. During the quarter ended June 30, 2001, an additional \$15,000 was repaid. On August 3, 2001, the Company received a cash payment of \$777,713 from the Former CEO, in partial payment of the promissory notes. The Company received two additional payments of \$3,000 each in September and October 2001.

On June 29, 2000, the Company made an advance of \$135,000 to the Former CEO. The advance was repaid in full on July 26, 2000.

Note 10 - Commitments:

On October 5, 2000, the Company entered into a consulting agreement with Venture Consulting Group, Inc. ("VCGI") whereby VCGI provided the services of Ronald C. Sacks as Chief Executive Officer of the Company, and the services of three additional consultants. The fees for the consultants' services were \$500,000 over a one-year period. In addition, the individual consultants were issued options to purchase 240,000 shares of common stock at the fair market value on the date of grant. Such options vested 25% during December 2000 with the remaining vesting ratably monthly from January 2001 through September 2001. The Company recorded compensation expense based upon the fair value of the options during each reporting period beginning in October 2000 in connection with the one-year vesting period. The Company recorded compensation expense of \$19,800 for the nine months ended December 31, 2001 based upon the fair value of the vested options as of September 30, 2001 as determined using the Black Scholes option pricing model.

Note 11 - Equity:

Effective October 2001, the Company approved and granted 2,900,000 shares of restricted stock to three executives at fair value. The restricted shares are subject to a repurchase right which will permit the Company to repurchase any

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shares which have not yet vested at the effective date of termination of the employees' employment, as defined in their employment agreements, for an amount equal to the purchase price per share paid by the employees. The Company will receive a series of interest bearing promissory notes for the value of the shares to be repaid by the employees. The notes are to be repaid by the employees at the earlier of ten years or the date upon which the employees dispose of their shares. The issuance of the restricted shares and the notes receivable due from the employees is recorded in the Company's financial statements during the quarter ended December 31, 2002. Only the vested portion of the shares has been included in earnings per share at December 31, 2001.

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Note 12 - Subsequent Events:

On November 9, 2001, the Company entered into an agreement with the landlord for its Piscataway, NJ facility to amend the Lease Agreement dated February 18, 1999 as follows:

The Company will use \$250,000 of its restricted cash from the letter of credit (see Note 2) towards the rent payments for 10 months starting January 2002. The Company will pay the remaining 50% of its rent from its general cash reserves on a monthly basis for this 10 month period. On January 10, 2002, the Landlord received the \$250,000 from the letter of credit per the above mentioned lease amendment. The Company agreed to replenish the letter of credit by November 2003.

As of January 1, 2002, the Company entered into a memorandum of understanding to sublease approximately 5,400 square feet of its facility to a third party tenant for a period of 24 months. The rent will be \$5,200 per month for the first nine months and \$10,400 per month for the last fifteen months, but with a 100% abatement for the first three months. As part of the rental payment, the third party tenant will issue to the Company warrants to purchase approximately \$77,400 worth of its common stock at an exercise price equivalent to the price of the common stock in its first round of financing.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

A number of statements contained in this report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the applicable statements. These risks and uncertainties include, but are not limited to, those described in the Company's filings with the Securities and Exchange Commission included in its annual report Form 10-KSB, for the fiscal year ended March 31, 2001.

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RESULTS OF OPERATIONS

FOR THE THREE MONTHS ENDED DECEMBER 31, 2001 COMPARED TO THE SAME PERIOD IN 2000

Revenue for the three months ended December 31, 2001, was \$2,214,216 compared to revenue of \$3,432,572 for the same period in 2000, a decrease of \$1,218,356 or 35.5%. The decrease in revenue was due to reduced order activity in part attributable to the severe economic downturn impacting the telecommunications

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industry as well as continuing residual affects of the September 11, 2001 tragedy. In response to this decline in revenue, the Company continues to take steps to strengthen its sales force, build sales momentum and improve its sales pipeline. Although the Company cannot guarantee that the opportunities identified in the pipeline will translate to increased revenue in the future, it believes the current level of activity in the three months ended December 31, 2001 is a positive sign.

Cost of sales for the three months ended December 31, 2001 was \$1,092,872 compared to \$1,610,796 for the same period in 2000. Cost of sales as a percentage of revenue for the three months ended December 31, 2001 increased to 49.4% from 46.9% for the same period in 2000 due to an increase of approximately \$127,000 (net of write-offs) to the reserve for obsolete inventory.

Research and development ("R&D") expense, net of capitalized software development, for the three months ended December 31, 2001 was \$211,929 compared to \$468,539 for the same period in 2000. As a percentage of revenue, R&D expenses were 9.6% compared to 13.6% for the same period in 2000. The decrease in the percentage of R&D to revenue primarily reflects the completed development of the Company's next scheduled product release and a reduction of the R&D staff as a result of the Company's restructuring activities.

Selling, general and administrative expenses ("SG&A") for the three months ended December 31, 2001 were \$1,870,157 compared to \$2,450,863 for the same period in 2000. As a percentage of revenue, SG&A is higher at 84.5% from 71.4% experienced in the same period in 2000, primarily due to reduced sales volumes. This reduction in expenses in dollar terms is primarily the result of the Company's restructuring efforts implemented during fiscal 2001.

Depreciation and amortization expenses - amortization of capitalized software, goodwill and other acquisition related intangibles, and depreciation on equipment, furniture and fixtures - was \$468,830 for the three months ended December 31, 2001 compared to \$949,787 in the same period in 2000. The decreased expense was primarily the result of management's decision during fiscal 2001 to abandon certain of the products and technology associated with the SolCom acquisition.

Net loss for the three months ended December 31, 2001 was \$1,371,892 compared to a loss of \$4,940,362 for the same period in 2000. This represents a significant year over year improvement despite the reduction in revenue seen this quarter. This is attributable to the Company's focused efforts to reduce expenses, improve operating margins and stabilize the business environment in line with current market conditions.

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FOR THE NINE MONTHS ENDED DECEMBER 31, 2001 COMPARED TO THE SAME PERIOD IN 2000

Revenue for the nine months ended December 31, 2001, was \$5,236,038 compared to revenue of \$8,304,574 for the same period in 2000, a decrease of \$3,068,536 or 37.0%. The decrease in revenue was due to reduced order activity primarily attributable to the severe economic downturn impacting the telecommunications industry compounded by the September 11, 2001 tragedy. In response to this decline in revenue, the Company continues to take steps to strengthen its sales force, build sales momentum and improve its sales pipeline. Although the Company cannot guarantee that the opportunities identified in the pipeline will translate to increased revenue in the future, it believes the current level of activity in the three months ended December 31, 2001 is a positive sign.

Cost of sales for the nine months ended December 31, 2001 was \$2,523,047

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compared to \$4,738,864 for the same period in 2000. Cost of sales as a percentage of revenue for the nine months ended December 31, 2001 decreased to 48.2% from 57.1% for the same period in 2000 due to ongoing improvements in inventory management and general cost containment strategies implemented during the past 12 months. Included in cost of sales for the nine months ended December 31, 2001 was approximately \$127,000 (net of write-offs) to the reserve for obsolete inventory.

Research and development ("R&D") expense, net of capitalized software development, for the nine months ended December 31, 2001 was \$720,426 compared to \$1,987,673 for the same period in 2000. As a percentage of revenue, R&D expenses were 13.8% compared to 23.9% for the same period in 2000. The decrease in the percentage of R&D to revenue primarily reflects the completed development of the Company's next scheduled product release and a reduction of the R&D staff as a result of the Company's restructuring activities.

Selling, general and administrative expenses ("SG&A") for the nine months ended December 31, 2001 were \$6,405,442 compared to \$9,532,008 for the same period in 2000. As a percentage of revenue, SG&A is higher at 122.3% from 114.8% experienced in the same period in 2000, primarily due to reduced sales volumes. This reduction in expenses in dollar terms is primarily the result of the Company's restructuring efforts implemented during fiscal 2001.

Depreciation and amortization expenses - amortization of capitalized software, goodwill and other acquisition related intangibles, and depreciation on equipment, furniture and fixtures - was \$1,412,794 for the nine months ended December 31, 2001 compared to \$3,175,999 in the same period in 2000. The decreased expense was primarily the result of management's decision during fiscal 2001 to abandon certain of the products and technology associated with the SolCom acquisition.

Net loss for the nine months ended December 31, 2001 was \$5,711,833 compared to a loss of \$14,361,858 for the same period in 2000. This represents a significant year over year improvement despite the reduction in revenue seen this quarter. This is attributable to the Company's focused efforts to reduce expenses, improve operating margins and stabilize the business environment in line with current market conditions.

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FINANCIAL CONDITION AND CAPITAL RESOURCES

Net cash used in operating activities during the nine months ended December 31, 2001 was \$3,797,335 compared to net cash used during the same period in 2000 of \$6,765,523. The net cash used for the nine months ended December 31, 2001 resulted primarily from the build-up of inventory due to lower than expected revenues, the payment of accounts payable, and the net loss incurred during the quarter.

Net cash provided by investing activities during the nine months ended December 31, 2001 was \$433,797 compared to net cash used during the same period in 2000 of (\$2,786,069). The majority of this was the collection of the related party receivable.

Net cash used in financing activities during the nine months ended December 31, 2001 was (\$106,519) compared to net cash provided during the same period in 2000 of \$5,202,829.

During the second quarter of fiscal 2002, the Company initiated an aggressive

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plan to increase its revenue and reduce its expenditures and operating costs significantly. The Company's operating plan included certain assumptions, the most important of which is the attainment of future revenues in the twelve months ending September 30, 2002 equivalent to those attained in fiscal year 2001 of approximately \$11 million. Based on its performance in the quarter ending December 31, 2001, analysis of its sales pipeline and the Company's expectation of sequential continued growth, the Company believes it is on target to achieve such revenues. As a result, the Company believes that it will have sufficient cash to fund its operations for the next twelve months. However, to the extent that revenues in the next 12 months fall below those achieved in all of fiscal year 2001, the Company may have to (i) modify its operating plan and scale back its expenditures for personnel and other operating costs in order to preserve cash; and/or (ii) raise additional funds through equity and/or debt financing. In addition, the Company is presently evaluating the need to raise additional funds through debt or equity financing to grow its business through expansion and/or through acquisitions. There can be no assurance that the Company will be able to obtain any such financing, or that such additional financing can be obtained on terms acceptable to the Company.

SIGNIFICANT ACCOUNTING POLICIES - The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting policies are limited to those described below.

REVENUE RECOGNITION - The Company recognizes revenue from product sales at the time of shipment and passage of title. We do not offer our customers the right to return products, however the Company records warranty costs at the time revenue is recognized. Management estimates the anticipated warranty costs but actual results could differ from those estimates. Maintenance contracts are sold separately and maintenance revenue is recognized on a straight-line basis over the period the service is provided, generally one year.

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ALLOWANCE FOR DOUBTFUL ACCOUNTS RECEIVABLE - Accounts receivable are reduced by an allowance to estimate the amount that will actually be collected from our customers. Many of our customers have been adversely affected by economic downturn in the telecommunications industry. If the financial condition of our customers were to materially deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

INVENTORY OBSOLESCENCE RESERVES - Inventories are stated at the lower of cost (average cost) or market. Reserves for slow moving and obsolete inventories are provided based on historical experience and current product demand. If our estimate of future demand is not correct or if our customers place significant order cancellations, inventory reserves could increase from our estimate. We may also receive orders for inventory that has been fully or partially reserved. To the extent that the sale of reserved inventory has a material impact on our financial results, we will appropriately disclose such effects. Our inventory carrying costs are not material; thus we may not physically dispose of reserved inventory immediately.

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IMPAIRMENT OF SOFTWARE DEVELOPMENT AND PURCHASED SOFTWARE COSTS - The Company capitalizes computer software development costs in accordance with the provisions of Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS 86"). SFAS 86 requires that the Company capitalize computer software development costs upon the establishment of the technological feasibility of a product, to the extent that such costs are expected to be recovered through future sales of the product. Management is required to use professional judgment in determining whether development costs meet the criteria for immediate expense or capitalization. These costs are amortized by the greater of the amount computed using (i) the ratio that current gross revenues from the sales of software bear to the total of current and anticipated future gross revenues from the sales of that software, or (ii) the straight-line method over the estimated useful life of the product, or both, may be reduced significantly in the near term (due to competitive pressures). As a result, the carrying amount of the capitalized software costs may be reduced materially in the near term.

We record impairment losses on capitalized software and other long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. While we believe that our estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect our estimates.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, The Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." Among other provisions, it requires that entities recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Gains and losses resulting from changes in the fair values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. This standard, as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133, and Amendment of FASB Statement No. 133", is effective for the Company as of April 1, 2001. The Company has no transition adjustment as a result of adopting the standard.

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In July 2001, the Financial Accounting Standards Board ("FASB"), issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets". Statement No. 141 requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method of accounting. In addition, it further clarifies the criteria for recognition of intangible assets separately from goodwill. Statement No. 142 establishes new standards for goodwill acquired in a business combination and eliminates the amortization of goodwill over its estimated useful life. Rather, goodwill will now be tested for impairment annually, or more frequently if circumstances indicate potential impairment, by applying a fair value based test. The Company expects to adopt these statements during the first quarter of fiscal 2003. Management does not believe that the adoption of these standards will have a material impact on the Company's financial position or results of operations.

The Company is currently evaluating the impact of adopting SFAS Nos. 143,

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"Accounting for Asset Retirement Obligations" and 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" which were recently issued by the FASB. These pronouncements will be adopted by the Company during fiscal year 2003.

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PART II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

(c) On October 8, 2001, the Company issued 2,000,000 shares of Common Stock to its CEO at a price of \$.13 per share, in connection with the CEO's employment agreement and pursuant to a restricted stock grant. The total aggregate purchase price was \$340,000, and was paid through the issuance of promissory notes by the Company's CEO in favor of the Company. The issuance of these shares was exempt from registration pursuant to Rule 506 promulgated under Section 4(2) of the Securities Act of 1933, as amended (the "Act").

On October 17, 2001, the Company issued 600,000 and 300,000 shares of Common Stock to its COO and CTO, respectively, at a price of \$.31 per share, in connection with their respective employment agreements and pursuant to restricted stock grants. The total aggregate purchase price was \$186,000 and \$93,000, respectively, and was paid through the issuance of promissory notes by the Company's COO and CTO, respectively, in favor of the Company. The issuance of these shares was exempt from registration pursuant to Rule 506 promulgated under Section 4(2) of the Act.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

- (a) Exhibits: None.
- (b) Reports on Form 8-K:
 - (i) On October 23, 2001, the Company filed a current report on Form 8-K, reporting the issuance of a press release relating to the hiring of Kam Saifi as its new President and CEO.
 - (ii) On October 24, 2001, the Company filed a current report on Form 8-K, reporting the issuance of a press release relating to the hiring of Cameron Saifi and David Arbeitel, as the Company's COO and CTO, respectively.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DATE: June 20, 2002

ION NETWORKS, INC.

/s/ Kam Saifi

Kam Saifi, Director, Chief Executive Officer,
President and Interim Principal Financial
Officer