

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

UPGRADE INTERNATIONAL CORP /FL/
Form 10QSB
August 19, 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 JUNE 30, 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 AUGUST 15, 2002, 44,248,400
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 D. SEE
FOOTNOTE C REGARDING OTHER SHARES WHICH HAVE BEEN CONTINGENTLY ISSUED.)

TRANSITIONAL SMALL BUSINESS DISCLOSURE FORMAT (CHECK ONE): YES NO

INDEX

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

Consolidated statements of operations for the three and nine months ended June 30, 2001 and 2002 (unaudited) and cumulative since inception (February 5, 1997) through June 30, 2002 (unaudited)

Consolidated statement of stockholders' equity (deficit) since September 30, 2001 and for the nine months ended June 30, 2002 (unaudited)

Consolidated statement of cash flows for the nine months ended June 30, 2001 and 2002 (unaudited) And Cumulative since inception (February 5, 1997) through June 30, 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

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

	September 30, 2001	June 30, 2002
		----- (unaudited)
CURRENT ASSETS		
Cash and cash equivalents	\$ 2,551,465	\$ 328,730
Restricted deposit	300,000	300,000
Subscriptions receivable	500,000	-0-
Note receivable from related party	135,243	143,021
Prepaid expenses, deposits and other	110,022	170,413
	-----	-----
Total current assets	3,596,730	942,164
PROPERTY AND EQUIPMENT - AT COST, less accumulated depreciation and amortization		
	2,071,663	1,669,590
SPUTTERING MACHINE, held for sale		
	2,000,000	800,000
ADVANCES TO ROCKSTER GROUP		
	1,084,000	1,630,000
OTHER ASSETS		
Intangible and deferred assets, net of accumulated Amortization	466,256	616,846
Acquisition deposits	1,820,715	1,820,715
Deposits	194,128	194,128
	-----	-----
Total assets	\$ 11,233,492	\$ 7,673,443
	=====	=====
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	\$ 3,853,950	\$ 4,845,269
Payable to related parties	5,503,022	2,388,105
Accrued liabilities	2,972,713	3,250,361
Notes payable	1,717,231	4,395,924
Equipment purchase contract payable	2,024,748	2,024,748
Royalty and license fee payable to CardTech, Inc.	1,161,873	1,939,524
	-----	-----
Total current liabilities	17,233,537	18,843,928
CONVERTIBLE DEBENTURES, net of unamortized discount		
	2,004,488	372,860
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	40,809
Stock subscriptions	2,742,586	4,719,993
Additional paid in capital	53,947,618	80,910,480
Deferred compensation	(498,559)	(366,139)
Receivable from stockholders of subsidiary	(266,621)	(266,621)
Accumulated development stage deficit	(65,427,260)	(97,791,867)
	-----	-----
	(9,477,712)	(12,753,345)
	-----	-----
Total liabilities and stockholders' deficit	\$ 11,233,492	\$ 7,673,443

=====

The accompanying notes are an integral part of these statements.

3

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

	Nine Month ended June 30,		Three months ended June 30,	
	2001	2002	2001	2002
Costs and expenses	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Research and development	\$ 5,030,133	\$ 3,365,431	\$ 1,490,718	\$ 755,962
Purchased in-process research & development	-	-	-	-
Sales and marketing	1,276,559	217,802	140,908	76,588
General and administrative	8,519,784	10,245,638	1,430,092	4,883,825
	14,826,476	13,828,871	3,061,718	5,716,375
Other expenses (income)				
Equity in losses of UltraCard	-	-	-	-
Interest expense and penalties	3,733,448	19,427,565	2,706,606	6,141,726
Loss on advances to Pathways	3,399,780	-	3,399,780	-
Other, net	193,290	(21,298)	106,504	(19,309)
	7,326,518	19,406,267	6,212,890	7,322,417
Minority interest in losses of subsidiaries	-	(870,531)	-	(125,000)
NET LOSS	\$ 22,152,994	\$32,364,607	\$ 9,274,608	\$11,713,792
LOSS PER COMMON SHARE-BASIC AND DILUTED	\$ 0.64	\$ 0.86	\$ 0.39	\$ 0.29

The accompanying notes are an integral part of these statements.

4

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

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)

Since September 30, 2001 through June 30, 2002 (unaudited)

	Voting common stock		Common stock subscribed		Additional paid-in capital	Def com
	Shares	Amount	Shares	Amount		
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	
Shares issued on October 20 and 21, 2001 at \$1.58 per share in 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, 200 1 at \$1.48 per share in lieu of penalties in connection with October 11, 2001 conversion of convertible debentures	51,743	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	

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

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 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					

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

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
	5				
	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		
Shares issued on October 20 and 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					

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

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 \$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 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

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT) - Con

Since September 30, 2001 through June 30, 2002 (unaudited)

	Voting common stock		Common stock subscribed		Additional paid-in capital	Def compe
	Shares	Amount	Shares	Amount		
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	562,171	562	-	-	443,184	
Shares issued on December 7, 2001 at \$1.09 per share in lie of fees and penalties in connection with October 10 through 12, 2001 conversion of convertible debentures	948,843	949	-	-	972,536	
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	

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

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 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 and warrants 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

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

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	-	-	-	-	-
---	---	---	---	---	---

7

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

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

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
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		

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

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

8

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)- Continued

Since September 30, 2001 through June 30, 2002 (unaudited)

	Voting common stock		Common stock subscribed		Additional paid-in capital	De
	Shares	Amount	Shares	Amount		
Warrants granted to consultants in settlement of fees, providing the warrant holder the right to acquire up to 1,730,000 shares at price ranging from \$1.00 to \$2.50	-	-	-	-	512,114	
Shares and warrants granted in April 2002 as a finders fee on loans extended in March 2002	55,000	55	61,875	66,825	273,433	
Shares and warrants issued in April 2002 at prices from \$0.85 To \$1.08 per share pursuant to loan inducements fees	212,500	213	150,000	45,000	142,674	
Shares and warrants granted during April 2002 as penalties and interest on promissory notes	-	-	771,173	668,610	1,121,715	
Shares issued April 5, 2002 as loan inducement fees for shares subscribed in March, 2002	350,000	350	(350,000)	(181,275)	180,925	
Shares subscribed on April 25,2002 As settlement of debts of subsidiary company at \$1.007 per share.	-	-	400,000	402,875	-	
Common Shares and warrants issued on April 5,2002 at a price of \$1.00 per share in connection with private placement	100,000	100	-	-	99,900	

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

Shares issued in April as a finders fee on September 2001 share issuance	25,000	25	-	-	(25)
Shares and warrants issued on April 10,2002 paid as a finders fee on April notes	6,875	7	-	-	3,383
Shares and warrants granted on April 10,2002 paid as a finder fee on April notes	-	-	73,219	56,109	144,608
Warrants issued on April 30,2002 in connection with convertible debenture providing to the holders the right acquire 362,200 shares at the price of \$0.75 for five years from the date of issuance	-	-	-	-	254,967
Warrants issued on April 30,2002 to officer of the Company in connection with \$775,000 convertible debenture agreement The warrants provide to the holer the right to acquire 1,200,000 at a price of \$.75 per share for a period of five years	-	-	-	-	896,166
Shares and warrants granted in May 2002 at \$0.80 per share pursuant to loan inducements fees	-	-	250,000	27,772	25,780
Shares and warrants granted during May 2002 as penalties and interest on promissory note	-	-	897,298	587,535	1,203,595
Shares and warrants granted on May 2002 paid as finder fees	-	-	110,000	71,445	183,177
Shares and warrants granted in June 2002 at the prices from \$0.38 to \$\$ 0.44 per shares pursuant to loan inducement fees from loans provided in June 2002	-	-	50,000	17,016	60,012
shares and warrants granted during June 2002 as penalties and interest on promissory notes	-	-	1,166,073	514,833	1,034,524
Shares subscribed at \$0.50 per share on May 29,2002 as partial payment to related party creditor and to secure deferral of amounts due to creditor of subsidiary company	-	-	1,300,000	650,000	-
Amortization of deferred compensation for the three months ended June 30, 2002	-	-	-	-	-
Net loss for the nine months ended June 30, 2002	-	-	-	-	-
-----	-----	-----	-----	-----	-----
Balances at June 30, 2002	40,808,401	\$40,809	6,089,784	\$ 4,719,993	\$80,910,480

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

=====

9

	Accumulated development stage deficit	Total
	-----	-----
Warrants granted to consultants in settlement of fees, providing the warrant holder the right to acquire up to 1,730,000 shares at price ranging from \$1.00 to \$2.50	-	512,114
Shares and warrants granted in April 2002 as a finders fee on loans extended in March 2002	-	340,313
Shares and warrants issued in April 2002 at prices from \$0.85 to \$1.08 per share pursuant to loan inducements fees	-	187,887
Shares and warrants granted during April 2002 as penalties and interest on promissory notes	-	1,790,325
Shares issued April 5, 2002 as loan inducement fees for shares subscribed in March, 2002	-	-
Shares subscribed on April 25, 2002 As settlement of debts of subsidiary company at \$1.007 per share.	-	402,875
Common Shares and warrants issued on April 5, 2002 at a price of \$1.00 per share in connection with private placement	-	100,000
Shares issued in April as a finders fee on September 2001 share issuance	-	-
Shares and warrants issued on April 10, 2002 paid as a finders fee on April notes	-	200,724
Warrants issued on April 30, 2002 in connection with convertible debenture providing to the holders the right acquire 362,200 shares at the price of \$0.75 for five years from the date of issuance	-	254,967
Warrants issued on April 30, 2002 to officer of the Company in connection with \$775,000 convertible debenture agreement The warrants provide to the holder the right to acquire 1,200,000 at a price of \$.75 per share for a		

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

period of five years	-	896,166
Shares and warrants granted in May 2002 at \$0.80 per share pursuant to loan inducements fees	-	53,552
Shares and warrants granted during May 2002 as penalties and interest on promissory note	-	1,791,130
Shares and warrants granted on May 2002 paid as finder fees	-	254,622
Shares and warrants granted in June 2002 at the prices from \$0.38 to \$\$ 0.44 per shares pursuant to loan inducement fees from loans provided in June 2002	-	77,028
Shares and warrants granted during June 2002 as penalties and interest on promissory notes	-	1,549,357
Shares subscribed at \$0.50 per share on May 29,2002 as partial payment to a related party creditor to secure deferral of amounts due to creditor of subsidiary company	-	650,000
Amortization of deferred compensation for the three months ended June 30, 2002	-	41,547
Net loss for the nine months ended June 30, 2002	(32,364,607)	(32,364,607)
-----	-----	-----
Balances at June 30, 2002	\$ (97,791,867)	\$ (12,753,345)
	=====	=====

The accompanying notes are an integral part of this statement.

10

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Nine months ended June 30,		Cumulativ
	2001	2002	since incep
	-----	-----	(February 5,
	-----	-----	-----
Increase (Decrease) in Cash and Cash Equivalents			
Cash flows from operating activities:			
Net loss	\$ (22,152,994)	\$ (32,364,607)	\$ (91,77
Adjustments to reconcile net loss to net			

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

cash used in operating activities			
Depreciation and amortization	531,544	278,534	1,46
Amortization of beneficial conversion feature and debt discount	1,884,151	3,797,826	7,59
Amortization of loan costs	-	651,849	65
Write off of leasehold improvements	-	210,805	21
Modification of loan agreements	-	232,922	23
Equity securities issued in lieu of interest and penalties on debt	-	16,175,500	18,85
Employee stock options issued below fair value	-	132,420	1,39
Adjustment to receivables from subsidiary's stockholders	-	-	13
Write off of uncollectible advances	3,399,780	-	3,54
Write off due to impairment of machine held for sale	-	1,200,000	2,25
Write off of option cost	-	-	7
Loss on sale of property and equipment	29,904	-	2
Common stock subscribed for financing fees	416,529	-	
Equity in loss of UltraCard	-	-	1,26
Purchased in-process research & development	-	-	5,97
Warrants and options issued for services	1,903,685	512,114	5,64
Warrants issued for financing fees	1,418,433	-	
Shares issued for services	-	-	48
Expenses incurred through loan assumption	-	-	47
Stock of subsidiary issued in exchange for contribution of intellectual property charged to expense	-	-	12
Minority interest	-	(870,531)	(3,43
Changes in assets and liabilities:			
Prepaid expenses, deposits and other	(274,976)	(63,012)	94
Accounts payable and accrued liabilities	4,400,180	4,257,269	12,56
Net cash used in operating activities	(8,443,764)	(5,848,911)	(31,28
Cash flows from investing activities			
Advances to The Pathways Group, Inc.	(1,498,955)	-	(3,53
Advances to Rockster, Inc.	(950,000)	(546,000)	(1,63
Advances to eCourier Corps	-	-	(13
Payments on equipment under construction	-	-	(1,20
Acquisition of property and equipment, net	(587,063)	(56,777)	(1,75
Acquisition of Centurion Technologies, Inc., net of cash acquired	-	-	(1,00
Acquisition of UltraCard, Inc., net of cash acquired	-	(379,164)	(5,95
Acquisition of equity interest in EforNet Corp. from a minority shareholder	-	-	(20
Additions to note receivable from related party	(130,000)	-	(6
Acquisition deposit	(15,000)	-	(6
Additions to intangible assets	(66,470)	(25,463)	(22
Net cash used in investing activities	(3,247,488)	(1,007,404)	(15,68
Cash flows from financing activities			
Proceeds from sale of common stock and stock subscriptions	6,255,614	1,071,746	36,80
Borrowings, net of loan costs	5,945,251	3,600,285	13,75
Principal payments on borrowings	(1,361,370)	(38,451)	(3,72
Purchase of collateral on subsidiary's LOC	-	-	(80
Release of restricted cash	505,687	-	50
Proceeds from exercise of options & warrants	55,000	-	76
Net cash provided by financing activities	11,400,182	4,633,580	47,30
Net increase(decrease)cash & cash equivalents	(291,070)	(2,222,735)	32

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

Cash & cash equivalents beginning of period	398,989	2,551,465	
Cash & cash equivalents end the period	\$ 107,919	\$ 328,730	\$ 32

The accompanying notes are an integral part of these statements.

11

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 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 March 31, 2001 and 2002.

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 June 30, 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 nine months ended June 30, 2001 and 2002 and for the period from inception (February 5, 1997) and the statements of cash flows for the nine months ended June 30, 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 significant inter-company balances and transactions have been eliminated in

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

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 nine and three months ended June 30, 2002 was 37,833,319 and 40,788,805, respectively and 21,829,283 and 18,323,267 for the nine and three months ended June 30, 2001, respectively, and 16,533,687 since inception (February 5, 1997) through June 30, 2002. 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 June 30, 2002, 48,365,000 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 for a future financing as described in note D. The shares were cancelled and are being returned to the Company subsequent to June 30, 2002.

12

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 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

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

substantial funds. The Company expects that its existing and expected financings will be adequate to satisfy the requirements of its current and planned operations until 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 June 30, 2002:

In April 2002, the Company borrowed \$575,000 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%-12.5% interest, 12.5% of the original loan amount payable in common stock and up to 30% of the original loan amount in warrants at an exercise price of the lowest average closing bid price for a period 120 days prior to the date of the loan maturity but not more than \$0.25 to \$0.80. In connection with these loans the Company issued 362,500 shares of common stock, and warrants entitling the holder to purchase 362,500 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. As a finders fee on these agreements the Company issued notes in the amount of \$30,250, 80,094 shares and 193,532 warrants to acquire common stock at an exercise price ranging from market to \$0.80 per share.

On April 30, 2002 the Company converted previously outstanding unsecured shareholders' advances in the amount of \$290,823 pursuant to the terms of two convertible debentures. The debentures bear interest at a rate of 10% per annum, are immediately convertible into common stock at \$0.75 per share, and mature on December 31, 2002. In addition, the Company issued 290,823 warrants to acquire common stock of the Company at a price of \$0.75 per share expiring five years from the date of issuance.

In April 2002, the Company settled debt to a creditor of its subsidiary in the amount of \$402,875 through the issuance of four hundred thousand shares in the common stock of the Company.

On April 5, 2002 the Company received proceeds of \$100,000 pursuant to the terms of a private placement of common stock of the Company at a price of \$1.00 per share. In conjunction with the offering the Company issued 100,000 warrants at a exercise price of \$1.00.

In April 2002 the Company issued warrants to acquire 1,730,000 shares in the Common stock of the Company to a group of consultants in settlement of amounts due those consultants. Of those warrants, 1,250,000 vest equally over a 12 month period. The warrants have exercise prices ranging from \$1.00 to \$2.50, are exercisable immediately and have a five year term. As of June 30, 2002, 395,831 warrants were vested and earned in connection with all warrants vested and earned as of June 30, 2002, the Company recognized \$512,114 in consulting fees.

In May 2002, the Company borrowed \$125,000 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 12.5% interest, 12.5% of the original loan amount payable in common stock and up to 30% of the original loan amount in warrants at an exercise price of market but not more than \$0.25 per share. In connection with these loans the Company issued 250,000 shares and 250,000 warrants to acquire shares of the Company at a price of \$0.75 per share.

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

The warrants have a five year term. In addition, the Company paid a financing fee comprised of a note payable in the amount of \$13,750, 110,000 shares in the capital stock of the Company and 275,000 warrants to acquire common shares of the Company at a price of \$0.25. The warrants are exercisable immediately and expire five years from the date of grant.

On May 29, 2002, the Company entered into a release and settlement agreement with CardTech, Inc., providing for the settlement of \$650,000 due and owing to CardTech by UltraCard. The amount of \$650,000 was settled by the issuance of 1,300,000 shares in the common stock of Upgrade International Corp.

In June 2002, the Company received \$90,000 from a group of private investors pursuant to the terms of certain promissory notes agreements. The promissory notes bear interest at the rate of 10%, regardless of the term of the note and mature in 60 days from the date of issuance. The company also granted 180,000 warrants in aggregate to the note holders to acquire common stock of the Company at a strike price of \$0.25 per share. The warrants are exercisable immediately and expire five years from the date of grant. Additional warrant coverage is made available in the amount of 1,000 warrants per day at a strike price of \$0.25 per share, on two notes each in the amount of \$25,000 if the loans are unpaid by maturity.

In June 2002, the Company received from an individual private investor proceeds of \$250,000 pursuant to a promissory note agreement. The promissory notes bears interest at the rate of 10% per annum and matures 60 days from the date of issuance and had 50,000 of detachable warrants. In addition, the Company granted 50,000 shares of the common stock of the Company and an additional 50,000 shares in the common stock of UltraCard, and 50,000 warrants with a exercise price of \$0.25 per share with a five-year term.

During the third quarter of 2002, the Company borrowed \$100,000 from an officer of the Company, which brought the total amount advanced by that officer to \$775,000. On April 30, 2002, that balance was rolled into a convertible debenture, bearing interest at a rate of 10% per annum and convertible into the common stock of the Company at \$0.75 per share. The convertible debenture has a maturity date of December 31, 2002, and had 750,000 detachable 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. As an inducement fee, the Company issued 450,000 warrants that bear the same terms and warrants issued with debt.

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 Subsidiaries. The debt instrument planned for is a seven-year term with the principal due at maturity, and interest payable quarterly commencing in year three of the financing. The loan is to be 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. This transaction never funded, and the Company has requested the return of the stock and cancelled the shares subsequent to the end of the quarter.

The Company is actively pursuing new investment into the Company, including a significant bond transaction. Future financings may take the form of equity, convertible debentures and other types of debt instruments.

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2001 and 2002

NOTE E - SPUTTERING MACHINE

On February 28, 2000, a subsidiary of the Company entered into an agreement with an unrelated company (the Supplier) to build a sputtering machine originally for use in its research and development activities. During the year ended September 30, 2000, the subsidiary paid \$1,200,000 to the Supplier and recorded a liability for the amounts billed but unpaid as of September 30, 2000 equaling \$2,307,025. The liability also included applicable sales tax, rent payments allocation, and amounts due under a development contract with the Supplier requiring \$50,000 monthly payments, which expired prior to September 30, 2000 but was then orally extended to January 12, 2001. During the year 2001, the Company's management changed its intent of the use of the machine for internal purposes which resulted in the Supplier's removing the tax liability of \$247,500. As of September 30, 2001 and June 30, 2002, amounts billed but the unpaid relating to the machine, rent allocations, and the development contract totaled \$2,024,748.

During fiscal year 2001, management decided to subcontract some of the manufacturing for the UltraCard technology products. The Company believes the most likely disposition of the sputtering machine will be to sell it to the manufacturer of the component that the machine is designed for. As result of this decision, the sputtering machine is classified as held for sale. Accordingly, the Company has written down its carrying amount to the estimated fair value of \$2,000,000 at September 30, 2001. Fair value was determined based on management's estimate of the asset's method and likelihood of disposition. The Company recognized a \$1,054,125 impairment loss during the year ended September 30, 2001.

Because of the special purpose nature of this piece of equipment, and in the event that the machine is not used for its intend and designed use, the Company decided to write down the value of the equipment to its estimated liquidated value of \$800,000. As a result the Company recorded a \$1,200,000 impairment loss during the quarter ended June 30, 2002.

NOTE F - COMMITMENTS AND CONTINGENCIES

The Company is in default on its payments on its ten-year lease for office space located in Los Angeles, California. 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 expected to be completed during the current fiscal year. 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 granted the landlord 250,000 warrants on May 5, 2002 to purchase common stock at \$.50 per share, which are refundable upon successful conclusion of the negotiations, which is planned to be completed during September 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 September 30, 2002. If the Company is unable to do this, it may have to

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

write-off as much as \$1,820,715 in acquisition deposits recorded at June 30, 2002.

During the quarter, the Company and Cardtech agreed to defer all licensing and royalty payments currently due. Under the terms of the amendment, CardTech has agreed to defer approximately \$2.25 million, and any additional monies due, by way of minimum royalty payments, until the sooner of (i) the commercialization of the intellectual property (revenues from product sales of same) that is the subject of the License, or (ii) the completion of an initial public offering with net proceeds to UltraCard of not less than Fifty Million dollars (\$50,000,000).

In addition, CardTech has agreed to exchange the required \$650,000.00 payment under an exchange of debt-for-equity agreement with Upgrade International, for 1.3 million shares of Upgrade International Corporation common stock. Among the provisions of this agreement is the right for CardTech to put back the shares for a one year period. As of June 30, 2002, these shares are classified as common shares subscribed on the Consolidated Statement of Stockholders' Equity (Deficit).

NOTE G - SUBSEQUENT EVENTS

During July and August 2002, the Company borrowed in the aggregate \$70,000 from existing shareholders pursuant to certain 60-day note agreements. Interest under the terms of the notes payable upon maturity varied between 10% - 12%. In addition, as a cost of the financing, the Company granted the noteholders warrants to purchase in the aggregate 190,000 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.

During July 2002, the Company received advances from an existing shareholder in the amount of \$45,000.

During August 2002, the Company received an advance totaling \$138,720.

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

Upgrade and its companies continues to focus on two significant initiatives. One is closing a significant financing which will provide adequate working capital to fund the final phase of commercializing its products. Upgrade management is spending a significant time and effort in this regard. The Company has retained an investment advisor who is directing an effort to consummate a significant bond transaction which, if successful, will provide the Company with adequate working capital to complete commercialization. The necessary documentation to bring this transaction is currently being drafted and

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

marketing is expected to take place in late August and September.

Second are the steps necessary to complete the commercialization 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 provide functionality to the UltraCard.

The Company intends to align 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. 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 along with other potential partners 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.

14

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 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.

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.

The previously announced pilot project in China is still in place, awaiting delivery of our product. It is anticipated that delivery will take place within six months after receipt of the capital necessary to complete commercialized product. The receipt of sufficient capital is expected during the first quarter of fiscal year 2003.

Additionally, the Company is in discussions regarding a significant joint-venture opportunity in China which would involve significant distribution of cards to support a number of applications.

Finally, the Company plans to fund cQue and Rockster to complete its software to a commercialized state.

FINANCIAL RESULTS

Net losses aggregated \$11.7 million in the three months ended June 30, 2002 compared with a \$9.3 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 \$5.3 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, compared to \$2.7 million during the comparable quarter the previous year.

During the quarter, the Company wrote down its carrying amount of its sputtering machine by \$1.2 million, to record its new carrying amount at the estimated net liquidation value. The Company does believe that it will recognize the new carrying amount upon Sale. However since the machine is designed specifically for part of the manufacturing process of the UltraCard, this may not occur or occur in a timely manner. The Company will continue to assess the carrying amount of this asset. Further impairment write downs are possible in the future. The Company's general and administrative costs of \$3.7 million in the current quarter represents an increase over the previous year, but consistent with the previous quarter recognizing the Company's desire 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 group's 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 \$77,000 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.

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

The Company did record an allowance regarding the potential uncollectibility of advances to The Pathways Group of \$3.4 million during the quarter ended June 30, 2001.

For the first nine months of fiscal year 2002, net losses incurred were \$32.4 million, of which \$16.9 million of the nine month loss related to the costs of capital, compared to \$3.7 million during nine months ending June 30, 2001. During fiscal 2002, the Company has found it difficult and expensive to raise capital in the current capital markets. As a result, the Company has had to pay higher costs to obtain operating capital, including the additional debt financing costs including the issuance of its capital stock and warrants to purchase stock. 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. As of a result of tighter cash flows, the Company's investment in research and development was \$3.4 million for the first nine months compared to \$5.0 million the previous years' comparable period. However, in spite of the tight cash position, this does 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 comparable to the previous year period.

15

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2001 the Company had available cash balances of approximately \$329,000. The Company is managing very tight cash flows but still providing funding for its research and development program at UltraCard. During the nine months ended June 30, 2002, the Company raised approximately \$3,600,000 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 June 30, 2002, the Company had total indebtedness of approximately \$3,500,000 under these arrangements.

Other funds were raised in the forms of convertible debentures from a related party of the Company and short-term notes from existing shareholders. The Company's cash used in operations was \$ 5.8 million, which represents a \$2.6 million decrease (31%) compared to the comparable period the prior year of \$8.4 million. This decrease results from the increase in accounts payable and accrued liability levels.

Cash flows from financing activities of \$4.6 million in the nine month period ended June 30, 2002 represents a level consistent with the last three 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. It is expected that upon receipt of funding necessary to complete commercialization, the Company will make the required investments either internally by way of capital expenditure and personnel or by way of available outsourced resources to complete all required tasks.

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

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

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.

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 currently in discovery.

Item 2. Changes in Securities and Use of Proceeds

During the three months ended June 30, 2002 the Company made the following sales of unregistered securities;

In April 2002, the Company borrowed \$575,000 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%-12.5% interest, 12.5% of the original loan amount payable in common stock and up to 30% of the original loan amount in warrants at an exercise price of the lowest average closing bid price for a period 120 days prior to the date of the loan maturity but not more than \$0.25 to \$0.80. In addition, as an inducement to enter into the financing the Company issued 362,500 shares of common stock, and warrants entitling the holder to purchase 362,500 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. As a finders fee on these agreements the Company issued notes in the amount of \$30,250, 80,094 shares and 193,532 warrants to acquire common stock at an exercise price ranging from market to \$0.80 per share.

In April 2002, the Company issued 55,000 shares pursuant to the terms of certain loan extension inducement fees for March notes in the amount of \$110,000.

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

On April 30, 2002 the Company received \$290,823 pursuant to the terms of two convertible debentures. The debentures bear interest at a rate of 10% per annum, are immediately convertible into common stock at \$0.75 per share, and mature on December 31, 2002. In addition, the company issued 225,823 warrants to acquire common stock of the Company at a price of \$0.75 per share expiring five years from the date of issuance.

In April 2002, the Company entered into a debt settlement agreement with a creditor of UltraCard Inc. to settle \$402,875 due to the creditor by the issuance of four hundred thousand shares in the capital stock of the Company.

On April 5, 2002 the Company received proceeds of \$100,000 pursuant to the terms of a private placement of common stock of the Company at a price of \$1.00 per share. In conjunction with the offering the Company issued 100,000 warrants at a strike price of \$1.00. In addition to the warrants issued in conjunction with the financing an additional 50,000 warrants were issued at a \$1.00 strike price and 230,000 warrants were issued at a strike price of \$2.50 both for consulting fees, paid to the investor. All warrants are exercisable immediately and have a five year term from the date of issuance.

In April 2002 the Company issued warrants to acquire 1,730,000 shares in the capital stock of the Company to a group of consultants in settlement of amounts due those consultants. 1,250,000 of those warrants vest equally over a 12 month period. The warrants have strike prices ranging from \$1.00 to \$2.50, are exercisable immediately and have a five year term.

In May 2002, the Company borrowed \$125,000 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 12.5% interest, 12.5% of the original loan amount payable in common stock and up to 30% of the original loan amount in warrants at an exercise price of market but not more than \$0.25 per share. As an inducement to enter into the loan agreement the Company issued 250,000 shares and 250,000 warrants to acquire shares of the Company at a price of \$0.75 per share. The warrants have a five year term. In addition, the Company paid a financing fee comprised of a note payable in the amount of \$13,750, 110,000 shares in the capital stock of the Company and 275,000 warrants to acquire common shares of the Company at a price of \$0.25. The warrants are exercisable immediately and expire five years from the date of grant.

On May 29, 2002, the Company entered into a release and settlement agreement with CardTech, Inc., providing for the settlement of \$650,000.00 due and owing to CardTech by UltraCard. The amount of \$650,000.00 was settled by the issuance of 1,300,000 shares in the capital stock of Upgrade International Corp.

In June 2002, the Company received \$90,000 from a group of private investors pursuant to the terms of certain promissory notes agreements. The promissory notes bear interest at the rate of 10%, regardless of the term of the note and mature in 60 days from the date of issuance. The company also granted 180,000 warrants in aggregate to the note holders to acquire common stock of the Company at a strike price of \$0.25 per share. The warrants are exercisable immediately and expire five years from the date of grant.

Additional warrant coverage is made available in the amount of 1,000 warrants per day at a strike price of \$0.25 per share, on two notes each in the amount of \$25,000 if the loans are unpaid by maturity.

In June 2002, the Company received from an individual private investor proceeds of \$250,000 pursuant to a promissory note agreement. The promissory notes bears interest at the rate of 10% per annum and matures 60 days from the date of

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

issuance. In addition the company granted 50,000 shares of the capital stock of the company and an additional 50,000 shares in the capital stock of UltraCard. The company also granted 100,000 warrants with a strike price of \$0.25 per share with a five-year term.

During the quarter, the Company borrowed \$37,500 from an officer of the Company, which brought the total amount advanced by that officer to \$775,000. On April 30, 2002 that balance was rolled into a convertible debenture, bearing interest at a rate of 10% per annum and convertible into the common stock of the Company at \$0.75 per share. The convertible debenture has a maturity date of December 31, 2002. In addition, on April 30, 2002, the Company granted 1,200,000 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.

17

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. This transaction has not as yet funded. The Company has cancelled this transaction and have requested the return of its shares which were to collateralize the financing.

During the quarter, citing various conflicting business issues and other commitments, C. Rowland Hanson resigned as a director of the Company. The Company plans to continue its relationship with Mr. Hanson's consulting company regarding communication and branding strategies.

Item 6. Exhibits

Exhibit No.	Description
99.1	Certification of the Chief Executive Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certification of the Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

18

SIGNATURES

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

Upgrade International Corporation

Date: August 19, 2002

/s/ Daniel S. Bland

Daniel S. Bland, President and Chief
Executive Officer, and Secretary

Date: August 19, 2002

/s/ Howard A. Jaffe

Howard A. Jaffe, Executive Vice President
Chief Operating and Financial Officer

19