

CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD
Form 10-Q
May 20, 2002

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2002

Commission File Number 0-31729

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD.

(Exact name of registrant as specified in its charter)

Delaware

23-2498715

(State or other jurisdiction
of incorporation or organization)

(IRS Employer Identification No.)

1341 N. Delaware Avenue, Suite 300, Philadelphia, PA 19125

(Address of principal executive offices)

Telephone: (215) 425-9635

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

Yes (X) No ()

As of May 15, 2002, there were 38,529,565 shares outstanding of the Registrant's \$.001 par value common stock.

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD.

INDEX TO FORM 10-Q

	PAGE(S)
PART I. FINANCIAL INFORMATION	
Item 1. Consolidated Balance Sheets at March 31, 2002 (unaudited) and June 30, 2001 (audited)	3
Consolidated Statements of Operations for the three months and nine months ended March 31, 2002 and 2001 (unaudited)	4-5
Consolidated Statement of Stockholders' Equity (Deficit) for the nine months ended March 31, 2002 (unaudited)	6
Consolidated Statements of Cash Flows for the nine months ended March 31, 2002 and 2001 (unaudited)	7-8
Notes to Consolidated Financial Statements (unaudited)	9-18
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	19-23
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	24-25
Item 2. Changes in Securities and Use of Proceeds	26
Item 3. Defaults Upon Senior Securities	26
Item 4. Submission of Matters to a Vote of Security Holders	26
Item 5. Other Information	26
Item 6. Exhibits and Reports on Form 8-K	26
SIGNATURES	27

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

PART I. - FINANCIAL STATEMENTS.

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Dollars and Shares in Thousands)

	Mar. 31, 2002	June 30, 2001
	----- (Unaudited)	----- (Audited)
CURRENT ASSETS		
Cash and cash equivalents	\$ 2	\$ 124
Inventory	107	107
Prepaid expenses and other current assets	-	105
	-----	-----
	109	336
PROPERTY AND EQUIPMENT, NET	609	814
INTANGIBLE ASSETS, NET	92	148
OTHER NON-CURRENT ASSETS	8	-
	-----	-----
TOTAL ASSETS	\$ 818	\$ 1,298
	=====	=====
CURRENT LIABILITIES		
Accounts payable - trade	\$ 791	\$ 1,828
Accrued expenses and other current liabilities	3,475	637
Short-term borrowings from related party	854	762
Convertible short-term borrowings	316	63
	-----	-----
	5,436	3,290
	-----	-----
COMMITMENTS AND CONTINGENCIES		
COMMON STOCK		
\$.001 par value; authorized 300,000 shares; issued and outstanding, 38,530 shares at March 31, 2002 and 35,380 shares at June 30, 2001		
	38	35
WARRANTS OUTSTANDING	6,309	9,865
ADDITIONAL PAID-IN-CAPITAL	270,607	266,626
ACCUMULATED DEFICIT	(281,572)	(278,518)
	-----	-----
TOTAL STOCKHOLDERS' DEFICIT	(4,618)	(1,992)
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 818	\$ 1,298
	=====	=====

See accompanying notes

3

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(Dollars and Shares in Thousands, Except Per Share Amounts)

THREE MONTHS ENDED NINE MONTHS ENDED

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

	MARCH 31,		MARCH 31,	
	2002	2001 (Note 5)	2002	2001 (Note 5)
REVENUE	\$ -	\$ -	\$ -	\$ -
COST OF REVENUE	-	-	-	-
GROSS PROFIT	-	-	-	-
Depreciation and amortization	149	22	238	66
General and administrative expenses	846	1,928	4,209	6,234
LOSS FROM OPERATIONS	(995)	(1,950)	(4,447)	(6,300)
OTHER INCOME (EXPENSE)				
Interest income	-	33	-	336
Interest expense	(20)	-	(75)	-
	(20)	33	(75)	336
NET LOSS FROM CONTINUING OPERATIONS	(1,015)	(1,917)	(4,522)	(5,964)
DISCONTINUED OPERATIONS				
Net loss from operations	-	(3,765)	-	(11,982)
Loss on disposal	-	(2,520)	(100)	(3,035)
NET LOSS BEFORE EXTRAORDINARY GAIN	(1,015)	(8,202)	(4,622)	(20,981)
EXTRAORDINARY GAIN ON DISCHARGE OF INDEBTEDNESS	1,568	-	1,568	-
NET INCOME (LOSS)	\$ 553	\$ (8,202)	\$ (3,054)	\$ (20,981)

4

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(Dollars and Shares in Thousands, Except Per Share Amounts)

WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	38,530	35,764	38,004	35,820
--	--------	--------	--------	--------

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

BASIC AND DILUTED EARNINGS (LOSS)				
PER COMMON SHARE				
Net loss from continuing operations	\$ (0.03)	\$ (0.05)	\$ (0.12)	\$ (0.17)
Discontinued operations:				
Net gain (loss) from operations	-	(0.11)	-	(0.33)
Loss on disposal	-	(0.07)	-	(0.09)
	-----	-----	-----	-----
Net loss before extraordinary gain	(0.03)	(0.23)	(0.12)	(0.59)
Extraordinary gain on discharge of indebtedness	0.04	-	0.04	-
	-----	-----	-----	-----
Net income (loss) per common Share	\$ 0.01	\$ (0.23)	\$ (0.08)	\$ (0.59)
	=====	=====	=====	=====

See accompanying notes

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
NINE MONTHS ENDED MARCH 31, 2002
(Dollars and Shares in Thousands)

COMMON STOCK		COMMON STOCK	ADD'L.	ACCUMULATED
NUMBER OF SHARES	AMOUNT	WARRANTS OUTSTANDING, NET	PAID-IN CAPITAL	DEFICIT

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

BALANCES, JUNE 30, 2001	35,380	\$ 35	\$ 9,865	\$ 266,626	\$ (278,518)
Nine months ended					
March 31, 2002					
(unaudited):					
Common stock issued for cash	3,000	3	-	147	-
Commission on issuance of common stock	-	-	-	(15)	-
Common stock issued for expenses	150	-	-	10	-
Common stock warrants issued, net of change in unearned consulting fees of \$(235)	-	-	283	-	-
Common stock warrants expired	-	-	(3,839)	3,839	-
Net loss	-	-	-	-	(3,054)
BALANCES, MARCH 31, 2002 (unaudited)	38,530	\$ 38	\$ 6,309	\$ 270,607	\$ (281,572)

See accompanying notes

6

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(Dollars in Thousands)

	NINE MONTHS ENDED MARCH 31,	
	2002	2001 (Note 5)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (3,054)	\$ (20,981)
Adjustments to reconcile net loss to net		

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

cash flows used in operating activities:		
Extraordinary gain on discharge of indebtedness	(1,568)	-
Loss from discontinued operations	100	15,017
Depreciation and amortization	238	66
Issuance of common stock and common stock warrants for expenses	80	1,329
Other	(70)	(60)
Change in current assets and liabilities which increase cash		
Inventory	-	-
Prepaid expenses and other current assets	105	207
Accounts payable - trade	66	355
Accrued expenses and other current liabilities	3,555	77
	-----	-----
Net cash used in operating activities	(548)	(3,990)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of fixed assets	19	-
Investment in discontinued operations	-	(9,003)
Investment in long-lived assets	-	(14)
	-----	-----
Net cash provided by (used) in investing activities	19	(9,017)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Sale of common stock for cash	150	-
Commission on sale of common stock	(15)	-
Short-term borrowings	272	-
	-----	-----
Net cash received from financing activities	407	-
	-----	-----
NET CHANGE IN CASH AND EQUIVALENTS	(122)	(13,007)
CASH AND EQUIVALENTS, BEGINNING OF PERIOD	124	13,652
	-----	-----
CASH AND EQUIVALENTS, END OF PERIOD	\$ 2	\$ 645
	=====	=====

7

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(Dollars in Thousands)

	NINE MONTHS ENDED	
	MARCH 31,	

		2001
	2002	(Note 5)
	-----	-----
SUPPLEMENTAL DISCLOSURES OF		
CASH FLOW INFORMATION		
Cash paid during the period:		
Interest	\$ -	\$ -
Income taxes	\$ -	\$ -

SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND
FINANCING ACTIVITIES
None

See accompanying notes

8

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2002 AND 2001

NOTE 1 - BASIS OF INTERIM PRESENTATION

The accompanying interim period financial statements of Clariti Telecommunications International, Ltd. ("Clariti" or the "Company") are unaudited, pursuant to certain rules and regulations of the Securities and Exchange Commission, and include, in the opinion of management, all adjustments (consisting of only normal recurring accruals) necessary for a fair statement of the results for the periods indicated, which, however, are not necessarily indicative of results that may be expected for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. The financial statements should be read in conjunction with the financial statements and the notes thereto included in Clariti's June 30, 2001

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

Form 10-K, Clariti's September 30, 2001 Form 10-Q, Clariti's December 31, 2001 Form 10-Q and other information included in Clariti's Forms 8-K and amendments thereto as filed with the Securities and Exchange Commission.

NOTE 2 - DESCRIPTION OF THE BUSINESS

Clariti Telecommunications International, Ltd. ("Clariti" or the "Company") is an international wireless communications technology company with proprietary technology for transmitting digital data utilizing radio frequencies transmitted by FM radio stations.

During the period from December 1998 to May 2001, the Company was also a significant provider of wire-line telecommunication services through its interest in several businesses with operations in the United States, United Kingdom, Europe and Australia. During the year ended June 30, 2001, the Company discontinued its wire-line telecommunication operations (see Note 5).

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

Fiscal Year End

The Company's fiscal year ends on June 30. In these financial statements, the three-month periods ended March 31, 2002 and 2001 are referred to as Fiscal 3Q02 and Fiscal 3Q01, respectively, and the nine-month periods ended March 31, 2002 and 2001 are referred to as Fiscal Nine Months 2002 and Fiscal Nine Months 2001, respectively.

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and all wholly-owned subsidiaries where management control is not deemed to be temporary. All significant intercompany transactions have been eliminated in consolidation.

9

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2002 AND 2001

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (continued)

Income Taxes

There is no income tax benefit for operating losses for the nine-month period ended March 31, 2002 due to the following:

- Current tax benefit - the operating losses cannot be carried back to earlier years.
- Deferred tax benefit - the deferred tax assets were offset by a valuation allowance required by FASB Statement 109, "Accounting for Income Taxes." The valuation allowance is necessary because, according to criteria established by FASB Statement 109, it is more likely than not that the deferred tax asset will not be realized through future taxable income.

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and equivalents, accounts payable, accrued expenses, and short-term borrowings. These balances, as presented in the balance sheet as of March 31, 2002 and June 30, 2001 approximate their fair value because of their short maturities.

Net Income (Loss) Per Common Share

Net income (loss) per common share is based upon the weighted average number of common shares outstanding during the period. The treasury stock method is used to calculate dilutive shares. Such method reduces the number of dilutive shares by the number of shares purchasable from the proceeds of the options and warrants assumed to be exercised. Basic and diluted weighted average shares outstanding for Fiscal 3Q02, Fiscal 3Q01, Fiscal Nine Months 2002 and Fiscal Nine Months 2001 were the same because the effect of using the treasury stock method would be antidilutive.

Recent Accounting Pronouncements

In August 2001, FASB Statement 142, "Goodwill and Other Intangible Assets" was issued, which is effective for fiscal years beginning after December 15, 2001. Statement 142 addresses how intangible assets that are acquired individually or with a group of assets should be accounted for upon their acquisition and also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. Also, for previously recognized non-goodwill intangible assets, the useful lives must be reassessed with remaining amortization periods adjusted accordingly, and reflected as a change in accounting principle. Based on the Company's policy for accounting for intangible assets, management does not anticipate the adoption of this standard will result in any significant impact on earnings or financial position of the Company.

10

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2002 AND 2001

NOTE 4 - MANAGEMENT'S PLANS

The Company's consolidated financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

The Company has historically relied on equity and debt financing to meet its cash requirements. However, adverse market conditions for telecommunications companies during the last 24 months have made it extremely difficult for the Company to obtain additional financing. The Company has substantially exhausted its cash reserves and has no firm commitments for near-term funding. Therefore, On April 18, 2002, the Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. The Company will continue to manage its properties and operate the business as "debtor-in-possession" under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code. During the Chapter 11 process, the Company is being funded for limited expenses by Anstead Investment, Ltd., a secured creditor and largest shareholder. The Company

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

intends to submit a Plan of Reorganization to the Court in the near future. These matters raise substantial doubt about the Company's ability to continue as a going concern.

The Company will continue to focus its future efforts on development and commercialization of its patented ClariCAST(TM) wireless datacasting technology. Because the Company's technology is still under development, the Company expects no revenues or operating cash flows in the near term. Due to its severe cash shortage, the Company has temporarily suspended its wireless technology development activities; however, the Company plans to restart such activities as the Company comes out of the Chapter 11 process.

The Company is also actively pursuing opportunities to secure additional financing in order to meet operating cash requirements through the remainder of the current fiscal year. The Company also plans to search for strategic alternatives in order to advance the business, create synergies and/or secure financing. There can be no assurances that funding will be generated or available, or if available, on terms acceptable to the Company. Failure to secure additional financing will have a material adverse impact on the Company.

The consolidated financial statements do not include any adjustments relating to the recoverability of recorded asset amounts or the amounts of liabilities that might be necessary should the Company be unable to continue as a going concern.

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2002 AND 2001

NOTE 5 - DISCONTINUED OPERATIONS

During the period from December 1998 to May 2001, the Company was a significant provider of wire-line telecommunication services through its interest in several businesses with operations in the United States, United Kingdom, Europe and Australia. The Company previously referred to these operations as the Telephony/Internet Services business segment. As further described below, the Company has divested substantially all of its interests in the Telephony/Internet Services business segment, representing the disposal of a business segment under Accounting Principals Board Opinion No. 30. Accordingly, the accompanying statement of operations and statement of cash flows for Fiscal 3Q01 and Fiscal Nine Months 2001 have been restated to conform to discontinued operations treatment. These divestments consist of the following:

- In October 1999, the Company's wire-line operations in the United Kingdom and Europe (the "UK Telecommunications Group") filed for voluntary liquidation and ceased operation of its businesses. Through such liquidation proceedings, the Company received certain operating assets of the UK Telecommunications Group consisting principally of telephone switching equipment in the United Kingdom. In March 2001, the

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

Company sold such operating assets in the United Kingdom.

- In January and March of 2001, the Company sold a total of 91% of its interest in NKA Communications Pty Ltd. ("NKA"), an Australian provider of telephony to corporate clients. The estimated net realizable value of the remaining 9% of NKA still held by the Company is -0-.
- In May 2001, the Company sold all of the common stock of Tekbilt World Communications, Inc. ("TWC") a/k/a Clariti Telecom, Inc. for an unsecured note for \$250,000 (the "TWC Note") and in a separate transaction, the Company also sold all of the common stock of MegaHertz-NKO, Inc. ("M-NKO") for an unsecured note for \$250,000 (the "M-NKO Note"). The TWC Note carries a fixed interest rate of 6% and is payable on May 9, 2003. The M-NKO Note carries a fixed interest rate of 6% and is payable on May 23, 2003. The estimated net realizable value of both notes is -0-.

12

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2002 AND 2001

NOTE 5 - DISCONTINUED OPERATIONS (continued)

The operating results from these discontinued operations are as follows (in thousands):

	THREE MONTHS ENDED MARCH 31,		NINE MONTHS ENDED MARCH 31,	
	2002	2001	2002	2001
Revenues	\$ -	\$ 4,008	\$ -	\$ 11,004
Expenses	-	(7,773)	-	(22,986)
Net gain (loss) from discontinued operations	\$ -	\$(3,765)	\$ -	\$(11,982)

Loss on disposal of discontinued operations consists of the following (in thousands):

	THREE MONTHS ENDED MARCH 31,		NINE MONTHS ENDED MARCH 31,	
	2002	2001	2002	2001
Sale of TWC	\$ -	\$(1,007)	\$ (100)	\$(1,007)
Sale of UK operating assets	-	(844)	-	(844)

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

Sale of 91% of NKA	-	(669)	-	(1,184)
	-----	-----	-----	-----
Net (loss) from discontinued operations	\$ -	\$(2,520)	\$ (100)	\$(3,035)
	=====	=====	=====	=====

During Fiscal Nine Months 2002, the Company recognized an additional loss of \$100,000 on the disposal of TWC. The Company recognized losses on the disposal of discontinued operations of TWC, UK and NKA in Fiscal 3Q01 and Fiscal Nine Months 2001.

NOTE 6 - SHORT-TERM BORROWINGS FROM RELATED PARTY

On May 3, 2001, the Company borrowed \$750,000 from Anstead Investment, Ltd. ("Anstead"), a greater than 5% shareholder, for a period of 61 days. The note carries interest at the rate of 10% per annum and is secured by substantially all of the Company's assets. The amount shown on the Company's consolidated balance sheet as of March 31, 2002 includes \$70,000 of accrued interest. In connection with this loan, the Company granted to Anstead warrants to purchase 400,000 shares of the Company's common stock at an exercise price of \$0.95 per share. Such warrants expire on May 3, 2003.

13

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 MARCH 31, 2002 AND 2001

NOTE 6 - SHORT-TERM BORROWINGS FROM RELATED PARTY (continued)

On November 30, 2001, the Company and Anstead Investment, Ltd. executed a Forbearance and Amendment Agreement whereby extending the terms of the repayment of the \$750,000 loan amount to March 31, 2002. In addition, the Forbearance and Amendment Agreement allowed for Anstead to advance an additional \$20,500 to the Company for legal fees associated with the agreement. The additional \$20,500 also carries interest at the rate of 10% annum and is due by March 31, 2002. On March 3, 2002, the Company borrowed an additional \$13,519 from Anstead Investment, Ltd. for certain expenses, carrying the same terms as the original note. Also, In April 2002, the Company borrowed an additional \$5,000 from Anstead Investment, Ltd. for certain expenses, also carrying the same terms as the original note. The Company is in default of this loan.

NOTE 7 - CONVERTIBLE SHORT-TERM BORROWINGS

On June 28, 2001, the Company borrowed \$62,500 from a third party. The unsecured note was due on November 1, 2001 and carries interest at the rate of 8% per annum. The note is convertible into shares of the Company's common stock at the option of the lender at a conversion price of \$0.075 per share. The amount shown on the Company's consolidated balance sheet as of March 31, 2002 includes \$3,750 of accrued interest. In connection with this loan, the Company granted to the third party warrants to purchase a total of 125,000 shares of the Company's common stock, 62,500 of which are exercisable at \$0.25 per share and 62,500 of which are exercisable at \$0.50 per share. Such warrants expire on June 28, 2002. The Company was unable to repay the loan by the November 1, 2001 due date, and is therefore in default of the loan agreement.

On July 2, 2001, the Company entered into a Funding Agreement with a third

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

party pursuant to which Clariti borrowed \$250,000 (the "Outstanding Balance"). The Outstanding Balance is secured by a second position security interest in substantially the same assets as those securing the \$750,000 loan from Anstead (see Note 6). The Outstanding Balance must be repaid on or before July 2, 2002, and no interest accrues on the Outstanding Balance. The third party may convert the Outstanding Balance into shares of the Company's common stock at a conversion price of \$0.50 per share. In connection with this Funding Agreement, the Company granted to the third party warrants to purchase a total of 1,000,000 shares of the Company's common stock exercisable at \$0.50 per share. Such warrants expire on July 2, 2002.

NOTE 8 - COMMITMENTS AND CONTINGENCIES

France Telecom SA ("France Telecom") initiated a complaint against the Company on May 12, 2000 before the Tribunal de Commerce de Paris (Paris Commercial Court) in Paris, France. France Telecom's claim relates to a debt it claims it is owed by GlobalFirst Communications SA, a former French subsidiary of the UK Telecommunications Group, for long-distance telephone services. France Telecom seeks payment from Clariti of 20,000,000 French Francs (approximately

14

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2002 AND 2001

NOTE 8 - COMMITMENTS AND CONTINGENCIES (continued)

\$2,700,000). France Telecom further claims unspecified damages corresponding to the loss of revenue resulting from the ceasing of commercial relations with GlobalFirst Communications SA. The Company has vigorously defended the claims asserted by France Telecom. Clariti believes that it did not verbally or in writing make a promise to pay any obligations of GlobalFirst Communications SA, and that it caused no damages to France Telecom because commercial relations with GlobalFirst Communications SA had ceased before Clariti held any negotiations with France Telecom. On April 10, 2002, The Tribunal de Commerce de Paris made a decision on the case and France Telecom was not awarded any damages. The Company does not know if France Telecom will appeal the decision.

On November 30, 1999, IDT Corporation ("IDT") filed a complaint in the Court of Common Pleas in Philadelphia, Pennsylvania against the Company and Clariti Carrier Services Limited, an inactive United Kingdom subsidiary of the Company, seeking payment for long-distance telephone services pursuant to a contract between IDT and GlobalFirst Communications Limited, a former subsidiary of the UK Telecommunications Group. The complaint seeks damages in the amount of \$690,163 plus interest, costs and attorneys fees. On March 20, 2000, the Court of Common Pleas dismissed the complaint on the basis of jurisdiction, provided that proper jurisdiction lies in England. On or about April 15, 2000, IDT filed an appeal with the Superior Court of Pennsylvania appealing the decision of the Court of Common Pleas. On or about April 19, 2001, the Superior Court sustained the decision of the Court of Common Pleas regarding jurisdiction. To date, the Company is not aware of any further action taken by IDT in this matter. The Company believes that neither the Company nor Clariti Carrier Services Limited has any liability with respect to IDT's claim.

On or about September 28, 2000, Michael P. McAndrews filed a Demand for Arbitration with the American Arbitration Association against the Company and Clariti Wireless concerning obligations arising under Mr. McAndrews' Employment Agreement. Mr. McAndrews has alleged that the Company had guaranteed and assumed the obligation due Mr. McAndrews pursuant to an Assignment and Guaranty

Agreement. Mr. McAndrews claimed that as a result of a material change in his duties, he resigned from employment for "good reason" (as defined in the Employment Agreement), therefore entitling him to a severance package in an amount in excess of \$294,000. Additionally, Mr. McAndrews requested reasonable attorney fees and other costs and fees, together with interest thereon. Clariti Wireless and the Company disputed Mr. McAndrews' allegations, asserting that Mr. McAndrews was not entitled to any payments and/or damages under the Employment Agreement. The Arbitrators held a hearing on June 14 and 15, 2001 regarding the matter. On October 18, 2001, the Arbitrators ruled that the Company and Clariti Wireless are jointly and severally liable to pay Mr. McAndrews \$290,500, plus reasonable attorney's fees and costs. On December 17, 2001, the Arbitrators awarded Mr. McAndrews \$83,219 for attorney's fees and costs, bringing the total award for Mr. McAndrews to \$373,219. The Company continues to believe that Mr. McAndrews was not entitled to any payments and/or damages under the Employment Agreement and is considering its options in response to this ruling. On or about November 19, 2001, Clariti Telecommunications International and Michael P. McAndrews executed a Settlement Agreement and General Release whereby the Company shall pay Mr. McAndrews a

15

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2002 AND 2001

NOTE 8 - COMMITMENTS AND CONTINGENCIES (continued)

settlement amount of \$90,000 in order to settle the above claim. The settlement amount was to be paid by January 19, 2002. Subsequently, on January 21, 2002, the Company and Mr. McAndrews amended the Settlement Agreement and General Release whereby increasing the settlement amount to \$100,000 plus \$750 per day for each day increasing the settlement amount to \$100,000 plus \$750 per day for each day after January 21, 2002 and extended the settlement payment date to February 28, 2002. This settlement payment was not made and therefore, the Company's liability remains \$373,219.

On June 12, 2001, M&T Bank filed an action against Clariti Telecommunications International, Ltd. in the Court of Common Pleas of Montgomery County, Pennsylvania. M&T Bank seeks to hold Clariti responsible under the terms of a guaranty agreement pursuant to which Clariti allegedly guaranteed certain obligations of its former subsidiary, Clariti Telecom, Inc. M&T Bank seeks damages in the amount of \$368,000. This case is in the early stages of discovery with no case management scheduled or trial date set.

On October 17, 2001, Nine Penn Center Associates filed a complaint against the Company in the Court of Common Pleas of Montgomery County, Pennsylvania. Nine Penn Center Associates is the landlord and owner of real property known as the Mellon Bank Center, 1735 Market Street, Philadelphia, PA 19103, a former address of the Company's headquarters. Nine Penn Center Associates is seeking damages associated with the remainder of the lease agreement. On April 2, 2002, the Court entered a judgment by default in favor of Nine Penn Center Associates in the amount of \$1,203,493. This amount has been accrued and recorded in general and administrative expenses.

As further described in Note 4, the Company has been experiencing a severe cash shortage. As a result, on April 18, 2002, the Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. The Company will continue to manage its properties and operate the business as "debtor-in-possession" under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code.

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

During the Chapter 11 process, the Company is being funded by Anstead Investment, Ltd., a secured creditor and largest shareholder. The Company intends to submit a Plan of Reorganization to the Court in the near future.

The Company is, from time to time, during the normal course of its business operations, subject to various other litigation claims and legal disputes. The Company expects none to have a material adverse impact on its operations, however, no assurance can be given that an adverse determination of any claim or dispute would not have an adverse impact on its operations during any given period.

16

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2002 AND 2001

NOTE 9 - COMMON STOCK

During Fiscal Nine Months 2002 the Company sold 3,000,000 shares of its common stock to a third party investor for proceeds, net of commissions, of \$135,000. In addition, the Company issued 150,000 shares of its common stock to a third party for consulting services valued at \$10,500.

NOTE 10 - STOCK OPTIONS

During Fiscal Nine Months 2002, 1,777,000 stock options with exercise prices between \$.24 and \$12.38 per share (weighted average price of \$5.07 per share) expired without being exercised. There were no new stock options issued during Fiscal Nine Months 2002.

NOTE 11 - WARRANTS

From time to time, the Company may issue warrants to purchase its common stock to parties other than employees and directors. Warrants may be issued as a unit with shares of common stock, in connection with borrowings, as an incentive to help the Company achieve its goals, or in consideration for cash or services rendered to the Company, or a combination of the above. Cost associated with warrants issued to other than employees is valued based on the fair value of the warrants as estimated using the Black-Scholes model with the following assumptions: no dividend yield, expected volatility of 80%, and a risk-free interest rate of 5.0%.

During Fiscal Nine Months 2002 the Company issued warrants to purchase a total of 1,062,500 shares of the Company's common stock at prices ranging from \$0.25 per share to \$0.50 per share (weighted average price of \$0.49 per share). The warrants were issued for services rendered and expire 1 year from the date of grant. The Black-Scholes model valued these warrants at a total of \$12,145.

During Fiscal Nine Months 2002 the Company also amended the terms of certain outstanding warrants. The expiration date of 31,250 warrants was extended for one additional year and the exercise price of such warrants was reduced from \$7.00 per share to \$3.56 per share. In addition, the exercise price of a total of 347,500 warrants was reduced from between \$1.00 per share and \$6.00 per

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

share to \$0.07 per share. Finally, the expiration date of 75,000 warrants was extended for three additional years and the exercise price of such warrants was reduced from \$8.00 per share to \$0.05 per share.

Also during Fiscal Nine Months 2002, 787,500 warrants with exercise prices between \$4.40 and \$9.52 per share expired without being exercised. The book value of such expired warrants (approximately \$3,839,000) was reclassified from warrants outstanding to additional paid-in capital.

17

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2002 AND 2001

NOTE 12 - SEGMENT INFORMATION

The Company has determined that segment information is not required to be presented because the Company's former segment known as Telephony/Internet Services was discontinued during Fiscal 2001 (see Note 5).

NOTE 13 - EXTRAORDINARY GAIN ON DISCHARGE OF INDEBTEDNESS

On October 24, 2001, the Company's wholly-owned subsidiary, Clariti Wireless Messaging, Inc. ("Clariti Wireless"), filed a voluntary petition for bankruptcy under Chapter 7 of the U.S. Bankruptcy Code. The bankruptcy proceedings have since been declared closed by the bankruptcy judge. As a result, all of Clariti Wireless' debts have been discharged, resulting in an extraordinary gain on discharge of indebtedness of \$1,568,000 for Fiscal 3Q02.

NOTE 14 - SUBSEQUENT EVENTS

On May 3, 2002, RadioNet International, Inc. ("RadioNet"), a wholly owned subsidiary of the Company, filed a voluntary petition for bankruptcy under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. The operations of RadioNet have ceased. There are no significant assets of RadioNet.

On April 18, 2002, the Parent Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. The Company continues to manage its properties and operate the business as "debtor-in-possession" under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code. During the Chapter 11 process, the Company is being funded for limited expenses by Anstead Investment, Ltd., a secured creditor and largest shareholder. The Company intends to submit a Plan of Reorganization to the Court in the near future.

18

PART I. ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

Certain information included in this quarterly report may be deemed to include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that involve risk and uncertainty, such as our ability to successfully do any or all of the following:

- Obtain financing for operations and expansion
- Achieve our goal of launching a commercial wireless voicemail system or other applications in Italy during calendar 2002
- Lease SCA channels from FM radio stations
- Develop commercially viable applications for the ClariCAST(TM) technology in addition to the Wireless Voicemail System
- Develop partnerships with local companies domestically or in foreign markets to help market, sell and distribute our wireless products and services
- Select partners who will be used to help market, sell and distribute our wireless products and services
- Develop a marketing strategy of our wireless products and services
- Make our wireless products and services affordable and appealing to our target markets
- Address multiple markets simultaneously to market our wireless products and services
- Develop manufacturing and distribution channels of our wireless products and services
- Manage the progress and costs of additional research and development of our wireless products and services and the ClariCAST(TM) technology
- Manage the risks, restrictions and barriers of conducting business internationally
- Reduce future operating losses and negative cash flow
- Compete effectively in the markets we choose to enter
- Develop new products and services and enhance current products and services
- Stimulate demand for our wireless products and services
- Obtain approval for the Plan of Reorganization from the United States Bankruptcy Court

In addition, certain statements may involve risk and uncertainty if they are preceded by, followed by, or that include the words "intends," "estimates," "believes," "expects," "anticipates," "should," "could," or similar expressions, and other statements contained herein regarding matters that are not historical facts. Although we believe that our expectations are based on reasonable assumptions, we can give no assurance that our expectations will be achieved. The important factors that could cause actual results to differ materially from those in the forward-looking statements herein (the "Cautionary Statements") include, without limitation, risks related to our ability to obtain funding, risks relating to our significant capital requirements, risks relating to the bankruptcy of the Parent Company, Clariti Telecommunications International, Ltd., risks associated with our operating losses, risks relating to our development, risks relating to competition and

regulatory developments, as well as the other risks referenced from time to time in our filings with the Securities and Exchange Commission. All subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements. We do not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect

19

events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. The following discussion should be read in conjunction with our consolidated financial statements appearing elsewhere in this report.

General Operations

The current focus of our business is the development and commercialization of ClariCAST(TM), our proprietary wireless technology that will support voice messaging (including wireless voicemail and text-to-speech), data and information services to a high-speed digital wireless device.

Recent Events

On May 3, 2002, RadioNet International, Inc. ("RadioNet"), a wholly owned subsidiary of the Company, filed a voluntary petition for bankruptcy under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. The operations of RadioNet have ceased. There are no significant assets of RadioNet.

On April 18, 2002, the Parent Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. The Company continues to manage its properties and operate the business as "debtor-in-possession" under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code. During the Chapter 11 process, the Company is being funded for limited expenses by Anstead Investment, Ltd., a secured creditor and largest shareholder. The Company intends to submit a Plan of Reorganization to the Court in the near future.

On April 15, 2002, Peter S. Pelullo resigned as President and Chief Executive Officer as well as a member of the Board of Directors of Clariti Telecommunications International, Ltd. ("the Company"). Also, On April 15, 2002, Ernest J. Cimadamore resigned as Secretary and Senior Vice President of the Company. Abraham Carmel was appointed as Chairman of the Board of Directors of the Company. Mr. Carmel has been a Director of the Company since October 1999 and will also assume the title of President, Chief Executive Officer and Treasurer. The Company also appointed Stuart W. Settle, Esq. and Ian Tromans to its Board of Directors. Mr. Settle also serves as Secretary of the Company. Mr. Settle has served as legal counsel to Anstead Investments, Ltd., a secured creditor and largest shareholder of the Company, on certain matters in the past. The Board of Directors now includes the following members: Stuart W. Settle, Esq., Ian Tromans and Abraham Carmel as the Chairman.

On March 6, 2002, the following members of the Board of Directors of Clariti Telecommunications International, Ltd. resigned as Directors and members of any committees of the Board of Directors: Michael Jordan, Robert Sannelli, John D'Anastasio, Chester Hunt and Dr. H.G. Hinderling, LL.M.

On October 24, 2001, our wholly-owned subsidiary, Clariti Wireless Messaging, Inc. ("Clariti Wireless"), filed a voluntary petition for bankruptcy under Chapter 7 of the United States Bankruptcy Code. Clariti Wireless' operations have ceased. The bankruptcy proceedings have since been declared closed by the bankruptcy judge. As a result, all of Clariti Wireless' debts

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

have been discharged, resulting in an extraordinary gain on discharge of indebtedness of \$1,568,000 for Fiscal 3Q02.

20

Results of Operations

Three Months Ended March 31, 2002 ("Fiscal 3Q02")
vs. Three Months Ended March 31, 2001 ("Fiscal 3Q01")

For Fiscal 3Q02, the Company generated net income of \$553,000, or \$0.01 per share, on no revenue as compared to a net loss of \$8,202,000, or \$0.23 per share, on no revenue in Fiscal 3Q01. Net loss from continuing operations was \$1,015,000, or \$0.03 per share, on no revenue in Fiscal 3Q02 as compared to a net loss from continuing operations of \$1,917,000, or \$0.05 per share, on no revenue in Fiscal 3Q01.

The \$902,000 decrease in the loss from continuing operations was primarily a result of a \$302,000 decrease in salary expense due to the reduction in corporate staff as well as a decrease in consulting expense of \$720,000.

General and administrative expenses decreased \$1,082,000, from \$1,928,000 to \$846,000 primarily due to the decrease in salary and consulting expenses as mentioned above.

During the period from December 1998 to May 2001, we were also a significant provider of wire-line telecommunication services through our interest in several businesses with operations in the United States, United Kingdom, Europe and Australia. During the year ended June 30, 2001, we divested these business operations, which formed our former business segment, Telephony/Internet Services. Therefore, the results of operations for Fiscal 3Q01 reflect \$3,765,000 of losses from such discontinued operations and we recognized an additional \$2,520,000 loss on the disposal of three of those businesses. Also, on October 24, 2001, our wholly-owned subsidiary, Clariti Wireless, filed a voluntary petition for bankruptcy under Chapter 7 of the United States Bankruptcy Code. Clariti Wireless' operations have ceased and the bankruptcy proceedings have since been declared closed by the bankruptcy judge. As a result, all of Clariti Wireless' debts have been discharged, resulting in an extraordinary gain on discharge of indebtedness of \$1,568,000 for Fiscal 3Q02.

Nine Months Ended March 31, 2002 ("Fiscal Nine Months 2002")
v. Nine Months Ended March 31, 2001 ("Fiscal Nine Months 2001")

For the Fiscal Nine Months 2002, the Company incurred a net loss of \$3,054,000, or \$0.08 per share, on no revenue as compared to a net loss of \$20,981,000, or \$0.59 per share, on no revenue for the Fiscal Nine Months 2001. Net loss from continuing operations was \$4,522,000, or \$0.12 per share, on no revenue in Fiscal Nine Months 2002 as compared to a net loss from continuing operations of \$5,964,000, or \$0.17 per share, on no revenue in Fiscal Nine Months 2001.

The \$1,442,000 reduction in loss from continuing operations was primarily due to a decrease in general and administrative expenses.

General and administrative expenses decreased \$2,025,000, from \$6,234,000 to \$4,209,000 for the Fiscal Nine Months 2002. This decrease was a result of a decline in consulting expense of \$1,905,000, a decline in salary expense of \$464,000, a decline in professional fees of \$608,000 and a decline in other general and administrative expenses of \$651,000. However, these decreases were offset by accruals of \$1,603,000 for certain leases in default and legal

proceedings for Fiscal Nine Months 2002. During the period from December 1998 to May 2001, the Company was also a significant provider of wire-line telecommunication services through our interest in several businesses with operations in the United States, United Kingdom, Europe and Australia. During the year ended June 30, 2001, we divested these business operations, which formed our former business segment, Telephony/Internet Services. Therefore, the results of operations for Fiscal Nine Months 2001 reflect \$11,982,000 of losses from such discontinued operations and we recognized an additional \$3,035,000 loss on the disposal of three of those businesses. Also, on October 24, 2001, our wholly-owned subsidiary, Clariti Wireless, filed a voluntary petition for bankruptcy under Chapter 7 of the United States Bankruptcy Code. Clariti Wireless' operations have ceased and the bankruptcy proceedings have since been declared closed by the bankruptcy judge. As a result, all of Clariti Wireless' debts have been discharged, resulting in an extraordinary gain on discharge of indebtedness of \$1,568,000 for Fiscal Nine Months 2002. Also, during Fiscal Nine Months 2002 we recognized an additional \$100,000 loss on the disposal of one of the divested businesses mentioned above.

Liquidity and Capital Resources

At March 31, 2002, the Company had a working capital deficit of \$5,327,000 (including a cash balance of \$2,000) as compared to a working capital deficit of \$2,954,000 (including a cash balance of \$124,000) at June 30, 2001. The working capital decrease of \$2,373,000 is primarily due to a \$1,603,000 increase in accruals for leases in default and legal proceedings as well as an increase in accrued payroll of \$981,000 and an increase in accrued consulting fees of \$275,000. These working capital decreases were partially offset by \$250,000 of short-term borrowings made during Fiscal 1Q02, \$135,000 proceeds (net of commissions) from the sale of common stock during Fiscal 1Q02.

We have historically relied principally on equity financing to meet our cash requirements. Adverse market conditions for telecommunications companies during the last 24 months have made it extremely difficult for the Company to raise additional equity financing. A major factor in our recent inability to raise equity funding has been the rapid and precipitous fall in the market price of our common stock, from \$5.25 per share in January 2001 to recent prices of approximately \$0.01 per share, resulting in a reduction of our market capitalization from \$187.7 million to less than \$1 million. We have substantially exhausted our cash reserves, we have no credit lines, and we have no firm commitments for near-term funding. Therefore, on April 18, 2002, the Parent Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. The Company continues to manage its properties and operate the business as "debtor-in-possession" under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code. During the Chapter 11 process, the Company is being funded for limited expenses by Anstead Investment, Ltd., a secured creditor and largest shareholder. The Company intends to submit a Plan of Reorganization to the Court in the near future.

On May 3, 2001, the Company borrowed \$750,000 from Anstead Investment, Ltd. ("Anstead"), a greater than 5% shareholder, for a period of 61 days. The note carries interest at the rate of 10% per annum and is secured by substantially all of the Company's assets. The amount shown on the Company's consolidated

balance sheet as of March 31, 2002 includes \$70,000 of accrued interest.

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

On November 30, 2001, the Company and Anstead Investment, Ltd. executed a Forbearance and Amendment Agreement whereby extending the terms of the repayment of the \$750,000 loan amount to March 31, 2002. In addition, the Forbearance and Amendment Agreement allowed for Anstead to advance an additional \$20,500 to the Company for legal fees associated with the agreement. The additional \$20,500 also carries interest at the rate of 10% annum and is due by March 31, 2002. On March 3, 2002, the Company borrowed an additional \$13,519 from Anstead Investment, Ltd. for certain expenses, carrying the same terms as the original note. Also, In April 2002, the Company borrowed an additional \$5,000 from Anstead Investment, Ltd. for certain expenses, also carrying the same terms as the original note. The Company is in default of this loan.

On July 2, 2001, the Company entered into a Funding Agreement with a third party pursuant to which Clariti borrowed \$250,000 (the "Outstanding Balance"). The Outstanding Balance is secured by a second position security interest in substantially the same assets as those securing the \$750,000 loan from Anstead (see Note 6). The Outstanding Balance must be repaid on or before July 2, 2002, and no interest accrues on the Outstanding Balance. The third party may convert the Outstanding Balance into shares of the Company's common stock at a conversion price of \$0.50 per share.

We have chosen to focus our future efforts on development and commercialization of our patented ClariCAST(TM) wireless datacasting technology. Because our technology is still under development, we expect no revenues or positive operating cash flow in the near term. Future cash expenditure requirements have been significantly reduced through the discontinuance of the Telephony/Internet Services businesses and through major reductions in wireless technology development and corporate overhead expenses.

The Company is also actively pursuing opportunities to secure additional financing in order to meet operating cash requirements through the remainder of the current fiscal year. The Company also plans to search for strategic alternatives in order to advance the business, create synergies and/or secure financing. There can be no assurances that funding will be generated or available, or if available, on terms acceptable to the Company. Failure to secure additional financing will have a material adverse impact on the Company.

Significant additional funding will be required beyond 2002 to launch the ClariCAST(TM) System in Italy and other specified target markets and to meet expected negative operating cash flows and capital expenditure plans. There can be no assurances that such funding will be generated or available, or if available, on terms acceptable to us.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

On May 3, 2002, RadioNet International, Inc. ("RadioNet"), a wholly owned subsidiary of the Company, filed a voluntary petition for bankruptcy under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. The operations of RadioNet have ceased. There are no significant assets of RadioNet.

On April 18, 2002, the Parent Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. The Company continues to manage its properties and operate the business as "debtor-in-possession" under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code. During the Chapter 11 process, the Company is being funded by Anstead Investment, Ltd., a secured creditor and largest shareholder. The Company intends to submit a Plan of Reorganization to the Court in the near future.

On October 24, 2001, Clariti Wireless Messaging, Inc., a wholly owned subsidiary of the Company, filed a voluntary petition for bankruptcy under Chapter 7 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Eastern District of Pennsylvania. Clariti Wireless' operations have ceased. The case has been closed.

France Telecom SA ("France Telecom") initiated a complaint against the Company on May 12, 2000 before the Tribunal de Commerce de Paris (Paris Commercial Court) in Paris, France. France Telecom's claim relates to a debt it claims it is owed by GlobalFirst Communications SA, a former French subsidiary of the UK Telecommunications Group, for long-distance telephone services. France Telecom seeks payment from Clariti of 20,000,000 French Francs (approximately \$2,600,000). France Telecom further claims unspecified damages corresponding to the loss of revenue resulting from the ceasing of commercial relations with GlobalFirst Communications SA. The Company has vigorously defended the claims asserted by France Telecom. Clariti believes that it did not verbally or in writing make a promise to pay any obligations of GlobalFirst Communications SA, and that it caused no damages to France Telecom because commercial relations with GlobalFirst Communications SA had ceased before Clariti held any negotiations with France Telecom. On April 10, 2002, The Tribunal de Commerce de Paris made a decision on the case and France Telecom was not awarded any damages. The Company does not know if France Telecom will appeal the decision.

On November 30, 1999, IDT Corporation ("IDT") filed a complaint in the Court of Common Pleas in Philadelphia, Pennsylvania against the Company and Clariti Carrier Services Limited, an inactive United Kingdom subsidiary of the Company, seeking payment for long-distance telephone services pursuant to a contract between IDT and GlobalFirst Communications Limited, a former subsidiary of the UK Telecommunications Group. The complaint seeks damages in the amount of \$690,163 plus interest, costs and attorneys fees. On March 20, 2000, the Court of Common Pleas dismissed the complaint on the basis of jurisdiction, provided that proper jurisdiction lies in England. On or about April 15, 2000, IDT filed an appeal with the Superior Court of Pennsylvania appealing the decision of the Court of Common Pleas. On or about April 19, 2001, the Superior Court sustained the decision of the Court of Common Pleas regarding jurisdiction. To date, the Company is not aware of any further action taken by IDT in this matter. The Company believes that neither the

24

Company nor Clariti Carrier Services Limited has any liability with respect to IDT's claim.

On or about September 28, 2000, Michael P. McAndrews filed a Demand for Arbitration with the American Arbitration Association against the Company and Clariti Wireless concerning obligations arising under Mr. McAndrews' Employment Agreement. Mr. McAndrews has alleged that the Company had guaranteed and

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

assumed the obligation due Mr. McAndrews pursuant to an Assignment and Guaranty Agreement. Mr. McAndrews claimed that as a result of a material change in his duties, he resigned from employment for "good reason" (as defined in the Employment Agreement), therefore entitling him to a severance package in an amount in excess of \$294,000. Additionally, Mr. McAndrews requested reasonable attorney fees and other costs and fees, together with interest thereon. Clariti Wireless and the Company disputed Mr. McAndrews' allegations, asserting that Mr. McAndrews was not entitled to any payments and/or damages under the Employment Agreement. The Arbitrators held a hearing on June 14 and 15, 2001 regarding the matter. On October 18, 2001, the Arbitrators ruled that the Company and Clariti Wireless are jointly and severally liable to pay Mr. McAndrews \$290,500 plus reasonable attorney's fees and costs. On December 17, 2001, the Arbitrators awarded Mr. McAndrews \$83,219 for attorney's fees and costs, bringing the total award for Mr. McAndrews to \$373,219. The Company continues to believe that Mr. McAndrews was not entitled to any payments and/or damages under the Employment Agreement and is considering its options in response to this ruling. On or about November 19, 2001, Clariti Telecommunications International and Michael P. McAndrews executed a Settlement Agreement and General Release whereby the Company shall pay Mr. McAndrews a total of \$90,000 in order to settle the above claim. The settlement amount was to be paid by January 19, 2002. Subsequently, on January 21, 2002, the Company and Mr. McAndrews amended the Settlement Agreement and General Release by increasing the settlement amount to \$100,000 plus \$750 per day for each day after January 21, 2002 and extended the settlement payment date to February 28, 2002. This settlement payment was not made and therefore, the Company's liability remains \$373,219.

On June 12, 2001, M&T Bank filed an action against Clariti Telecommunications International, Ltd. in the Court of Common Pleas of Montgomery County, Pennsylvania. M&T Bank seeks to hold Clariti responsible under the terms of a guaranty agreement pursuant to which Clariti allegedly guaranteed certain obligations of its former subsidiary, Clariti Telecom, Inc. M&T Bank seeks damages in the amount of \$368,000. This case is in the early stages of discovery with no case management scheduled or trial date set.

On October 17, 2001, Nine Penn Center Associates filed a complaint against the Company in the Court of Common Pleas of Montgomery County, Pennsylvania. Nine Penn Center Associates is the landlord and owner of real property known as the Mellon Bank Center, 1735 Market Street, Philadelphia, PA 19103, a former address of the Company's headquarters. Nine Penn Center Associates is seeking damages associated with the remainder of the lease agreement. On April 2, 2002, the Court entered a judgment by default in favor of Nine Penn Center Associates in the amount of \$1,203,493. This amount has been accrued and recorded in general and administrative expenses.

The Company is, from time to time, during the normal course of its business operations, subject to various other litigation claims and legal disputes. The Company expects none to have a material adverse impact on its operations, however, no assurance can be given that an adverse determination of any claim or dispute would not have an adverse impact on its operations during any given period.

25

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

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

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

None

Item 5. Other Events

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

None

(b) Reports on Form 8-K:

On April 18, 2002, Clariti Telecommunications International, Ltd. ("the Company") filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania.

On April 15, 2002, Peter S. Pelullo resigned as President and Chief Executive Officer as well as a member of the Board of Directors of Clariti Telecommunications International, Ltd. ("the Company"). Also, On April 15, 2002, Ernest J. Cimadamore resigned as Secretary and Senior Vice President of the Company. Abraham Carmel was appointed as Chairman of the Board of Directors of the Company. Mr. Carmel has been a Director of the Company since October 1999 and will also assume the title of President, Chief Executive Officer and Treasurer. The Company also appointed Stuart W. Settle, Esq. and Ian Tromans to its Board of Directors. Mr. Settle also serves as Secretary of the Company. Mr. Settle has served as legal counsel to Anstead Investments, Ltd., a secured creditor and largest shareholder of the Company, on certain matters in the past. The Board of Directors now includes the following members: Stuart W. Settle, Esq., Ian Tromans and Abraham Carmel as the Chairman.

On March 6, 2002, the following members of the Board of Directors of Clariti Telecommunications International, Ltd. resigned as Directors and members of any committees of the Board of Directors: Michael Jordan, Robert Sannelli, John D'Anastasio, Chester Hunt and Dr. H.G. Hinderling, LL.M.

On October 24, 2001 the Company filed a Form 8-K disclosing that Clariti Wireless Messaging, Inc., a wholly owned subsidiary of Clariti Telecommunications International, Ltd., filed a voluntary petition for bankruptcy under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania.

26

SIGNATURES

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

Dated: May 20, 2002

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD.

(REGISTRANT)

By: s/Michael McNulty

Michael McNulty
Vice President of Finance