APPIANT TECHNOLOGIES INC
Form 10-Q
August 20, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2001

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

For the transition period from __________to ___________

COMMISSION FILE NUMBER 0-21999

APPIANT TECHNOLOGIES INC.
(Exact name of registrant as specified in its charter)

DELAWARE	84-1360852
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6663 OWENS DRIVE
PLEASANTON, CALIFORNIA 94588
(Address of principal executive offices)

(925) 251-3200
(Registrant's telephone number)

Check whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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 [ ]

As of August 20, 2001, there were 14,267,475 shares of Common Stock outstanding.

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PART I. FINANCIAL STATEMENTS
ITEM 1. Condensed Consolidated Financial Statements

APPIANT TECHNOLOGIES INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2001 (unaudited)	September 30, 2000
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 3,977,000	$ 5,603,000
Restricted cash	113,000	116,000
Accounts receivable, net of allowance for doubtful accounts of $344,000 and $402,000	3,368,000	3,907,000
Inventory	160,000	550,000
Equipment at customers under integration	1,368,000	1,708,000
Prepaid expenses and other	625,000	313,000
TOTAL CURRENT ASSETS	9,611,000	12,197,000
Property and equipment, net	5,924,000	3,395,000
Capitalized software, net	23,494,000	18,366,000

Goodwill and other intangible assets, net	11,111,000	2,443,000
Other assets	1,971,000	2,384,000
TOTAL ASSETS	$ 52,111,000	$ 38,785,000
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Lines of credit	$ --	$ 343,000
Accounts payable	11,907,000	5,269,000
Accrued liabilities	3,889,000	2,478,000
Deferred revenue	2,179,000	2,919,000
Income tax payable	285,000	280,000
Advances for preferred stock	--	3,500,000
Accrued liability related to warrants	2,402,000	--
Convertible notes payable	5,771,000	--
Capital lease obligations, current portion	5,612,000	3,072,000
TOTAL CURRENT LIABILITIES	32,045,000	17,861,000
Capital lease obligations, net of current portion	4,435,000	4,717,000
TOTAL LIABILITIES	36,480,000	22,578,000
REDEEMABLE CONVERTIBLE PREFERRED STOCK	253,000	--
STOCKHOLDERS' EQUITY		
Common stock	157,000	123,000
Additional paid-in capital	80,039,000	49,261,000
Unearned stock-based compensation	(288,000)	(2,012,000)
Accumulated deficit	(63,904,000)	(30,809,000)
Accumulated other comprehensive loss	(626,000)	(356,000)
TOTAL STOCKHOLDERS' EQUITY	15,378,000	16,207,000
TOTAL LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY	$ 52,111,000	$ 38,785,000

See notes to condensed consolidated financial statements.

APPIANT TECHNOLOGIES INC.
AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(UNAUDITED)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2001	2000	2001	2000

NET REVENUES:				
Products and integration services.	$ 1,852,000	$ 1,132,000	$ 5,236,000	$10,347,0
Other services	4,272,000	3,142,000	13,503,000	11,269,0
TOTAL NET REVENUES	6,124,000	4,274,000	18,739,000	21,616,0
Cost of revenues:				
Products and integration services.	1,609,000	1,190,000	4,790,000	7,181,0
Other services	3,950,000	1,905,000	10,204,000	7,477,0
TOTAL COST OF REVENUES	5,559,000	3,095,000	14,994,000	14,658,0
GROSS PROFIT	565,000	1,179,000	3,745,000	6,958,0
OPERATING EXPENSES				
Selling, general and administrative. . . .	3,746,000	2,497,000	13,766,000	9,255,0
Research and development	965,000	36,000	2,175,000	134,0
Amortization of goodwill and other intangibles.	558,000	159,000	960,000	478,0
Impairment of equipment and capitalized software	3,699,000	--	3,699,000	
TOTAL OPERATING EXPENSES	8,968,000	2,692,000	20,600,000	9,867,0
LOSS FROM OPERATIONS	(8,403,000)	(1,513,000)	(16,855,000)	(2,909,0
OTHER INCOME (EXPENSE)				
Interest income.	39,000	45,000	219,000	159,0
Interest expense	(7,576,000)	(1,837,000)	(8,929,000)	(2,122,0
Other.	417,000	(167,000)	376,000	(169,0
Total other expense	(7,120,000)	(1,959,000)	(8,334,000)	(2,132,0
Loss from operations before income tax	(15,523,000)	(3,472,000)	(25,189,000)	(5,041,0
Provision for income tax	54,000	147,000	280,000	271,0
NET LOSS	(15,577,000)	(3,619,000)	(25,469,000)	(5,312,0
Preferred dividends.	--	--	(7,626,000)	(2,0
NET LOSS AVAILABLE TO COMMON STOCKHOLDERS.	$(15,577,000)	$(3,619,000)	$(33,095,000)	$(5,314,0
BASIC AND DILUTED NET LOSS PER COMMON SHARE	$ (1.05)	$ (0.33)	$ (2.42)	$ (0.
SHARES USED IN PER SHARE CALCUATIONS - BASIC AND DILUTED	14,854,000	10,834,000	13,684,000	9,900,0
COMPREHENSIVE LOSS				
Net loss	$(15,577,000)	$(3,619,000)	$(25,469,000)	$(5,312,0
Other comprehensive (loss)				
Translation (loss)	(11,000)	(30,000)	(74,000)	(28,0
COMPREHENSIVE LOSS	$(15,588,000)	$(3,649,000)	$(25,543,000)	$(5,340,0

See notes to condensed consolidated financial statements.

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APPIANT TECHNOLOGIES INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months Ended June 30,	
	2001	2000
CASH FLOWS FROM OPERATING ACTIVITES		
Net loss.	$(25,469,000)	$ (5,312,000)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Provision for (reduction in) doubtful accounts.	(59,000)	(167,000)
Depreciation and amortization	1,755,000	380,000
Amortization of goodwill.	960,000	478,000
Gain on sale of fixed assets.	--	1,000
Gain on cancellation of equipment lease	(157,000)	--
Impairment of equipment and capitalized software.	3,699,000	
Stock-based compensation.	(2,015,000)	1,814,000
Deemed interest expense related to notes payable convertible at a discount.	190,000	--
Deemed interest expense related to notes payable to related Party convertible at a discount.	1,274,000	47,000
Amortization of discount on notes payable to related party.	950,000	--
Cost of additional warrants issued to related party	3,799,000	--
Amortization of discount on notes payable	171,000	1,596,000
Amortization of issuance costs on notes payable	17,000	--
Remeasurement of warrant due to registration requirement. . .	1,120,000	--
Changes in operating assets and liabilities:		
Accounts receivable	1,121,000	2,351,000
Inventory and equipment at customers under integration. . .	729,000	(880,000)
Prepaid expenses and other.	(812,000)	(91,000)
Other assets.	(337,000)	(135,000)
Income tax payable.	5,000	214,000
Accounts payable and other current liabilities.	3,491,000	(767,000)
Accrued liability related to warrants	2,402,000	
Deferred revenue.	(741,000)	761,000
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	(7,907,000)	290,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Restricted cash	3,000	70,000
Proceeds on sale of property and equipment.	--	17,000
Cash acquired in connection with purchase of Trimark, Inc.. .	--	45,000
Cash acquired in connection with purchase of Quaartz Inc. . .	22,000	--
Acquired software assets.	--	(2,000,000)
Capitalization of software development costs.	(2,198,000)	(354,000)
Purchase of property and equipment.	(1,582,000)	(727,000)

NET CASH USED IN INVESTING ACTIVITIES	(3,755,000)	(2,949,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Funds in escrow	--	(791,000)
Borrowings under line of credit	--	13,673,000
Repayments under line of credit	(343,000)	(14,213,000)
Borrowing of notes receivable from related party	(250,000)	--
Repayment of notes receivable from related party	250,000	297,000
Proceeds from draw on equity line	1,745,000	--
Proceeds from notes payable and sale of warrants	5,100,000	--
Repayment of note payable to related party	(100,000)	(150,000)
Proceeds from issuance of Series B preferred stock, net of issuance costs	4,959,000	--
Proceeds from issuance of convertible debentures, net of issuance costs of $403,000		5,397,000
Proceeds from warrants and options exercised for common stock	1,746,000	574,000
Principal payments on capital lease	(2,798,000)	(120,000)
Principal payment on notes payable	--	(119,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	10,309,000	4,548,000
Effect of exchange rate changes on cash	(273,000)	14,000
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,626,000)	1,903,000
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 5,603,000	$ 2,329,000
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 3,977,000	$ 4,232,000

See notes to condensed consolidated financial statements.

APPIANT TECHNOLOGIES INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

Supplemental disclosures for cash flow information:		
Cash paid during the period for:		
Interest	$ 647,000	$ 135,000
Income taxes	$ 88,950	$ 6,000
NON-CASH TRANSACTIONS:		
Property and equipment acquired under capital leases	$ 3,654,000	$ 351,000
Accounts payable for purchases of property and equipment	$ 2,643,000	$ --
Accounts payable written-off for purchases of property and equipment returned during third quarter	$ 1,564,000	
Software assets acquired under capital leases	$ 563,000	$ --
Payable for purchases of software asset financed under capital leases during first quarter	$ 1,503,000	$ --
Accounts payable for purchase of software assets	$ 767,000	$ --
Deemed dividend on beneficial conversion feature of Series B Preferred Stock	$ 7,626,000	$ --

Recognition of beneficial conversion feature on notes payable	$ 2,548,000	$ --
Allocation of proceeds to fair value of warrants issued on notes payable	$ 5,330,000	$ --
Issuance of warrants to strategic partner in conjunction with convertible debentures	$ 546,000	
Issuance of warrants to underwriters in conjunction with sale of Series B Preferred Stock	$ 1,107,000	$ --
Modification of warrant exercise price in conjunction with sale of Series B Preferred Stock	$ 1,847,000	$ --
Issuance of common stock to underwriters in conjunction with sale of Series B Preferred Stock	$ 573,000	$ --
Costs of financing on Equity line	$ 1,745,000	$ --
Conversion of Series B Preferred Stock into Common Stock	$ 4,678,000	$ --
Conversion of advances to Series B Preferred Stock	$ 3,500,000	$ --
Issuance of common stock in Quaartz acquisition	$ 8,310,000	$ --

See notes to condensed consolidated financial statements.

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APPIANT TECHNOLOGIES INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. The balance sheet as of September 30, 2000 is derived from the Company's audited financial statements included in its Form 10-KSB for the fiscal year ended September 30, 2000 but does not include all disclosures required by generally accepted accounting principles in the United States of America. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the fiscal year ended September 30, 2000.

The unaudited condensed consolidated financial statements included herein reflect all adjustments (which include only normal recurring adjustments)which are, in the opinion of management, necessary to state fairly the results for the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for the fiscal year ending September 30, 2001.

The consolidated financial statements include our results as well as the results of our significant operating subsidiaries: NHancement Technologies North America, Inc., doing business as Appiant Technologies North America ("APPIANT NA") and Infotel Technologies (Pte) Ltd ("Infotel").

APPIANT NA revenues were 41% and 58% of consolidated net revenues for the nine months ended June 30, 2001 and 2000. Infotel revenues were 59% and 42% of consolidated net revenues for the nine months ended June 30, 2001 and 2000. No revenues have been recorded through June 30, 2001 from the Company's hosted internet inUnison(TM) unified communication and unified information portal

services.

2. NET LOSS PER SHARE

Basic net loss per share is computed based on the weighted average number of shares outstanding during the period. Diluted net loss per share is also computed based on the weighted average number of shares outstanding during the period. Diluted net loss per share does not include the weighted average effect of dilutive potential common shares including convertible preferred stock, convertible debentures and options and warrants to purchase common stock in any period presented because the effect is anti-dilutive.

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The following table presents information necessary to reconcile basic and diluted net loss per common and common equivalent share:

	Three Months Ended June 30,		Nine Months June 3	
	2001	2000	2001	
Net loss	$(15,577,000)	($3,619,000)	$(25,469,000)	(
Preferred stock dividends	--	--	(7,626,000)	
Net loss available to common stockholders - basic	(15,577,000)	($3,619,000)	(33,095,000)	(
Weighted average shares used in net loss per share - basic and diluted	14,854,000	10,834,000	13,684,000	
Anti-dilutive securities:				
Convertible preferred stock	36,000	--	36,000	
Convertible notes and debentures	2,380,000	--	2,380,000	
Options and warrants to purchase common stock	8,579,000	3,057,000	8,579,000	
Anti-dilutive securities not included in net loss per share calculation	10,995,000	3,057,000	10,995,000	

3. INVENTORY

Inventory consists of systems and system components and is valued at the lower of cost (first-in, first-out method) or market.

4. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations." SFAS 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. The Company believes that the adoption of SFAS 141 will not have a significant impact on its financial statements.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," which is effective for fiscal years beginning after December 15, 2001. SFAS 142 requires, among other

things, the discontinuance of goodwill amortization. In addition, the Standard includes provisions upon adoption for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and testing for impairment of existing goodwill and other intangibles. The Company is currently assessing but has not yet determined the impact of SFAS 142 on its financial position and results of operations.

In December 1999, the SEC issued Staff Accounting Bulletin No. 101 ("SAB 101"), Revenue Recognition in Financial Statements." SAB 101 summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements. The Company adopted SAB 101 in the first quarter of fiscal 2001. The adoption of SAB 101 did not have a material effect on the Company's financial position or results of operations.

5. ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

On October 1, 2000, the Company adopted Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 requires that all derivatives be recorded on the balance sheet at fair value. Changes in the fair value of derivatives that do not qualify for hedge treatment, as well as the ineffective portion of a particular hedge, must be recognized currently in earnings.

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The Company has significant international sales transactions generated by it's Singapore subsidiary, Infotel. The Company has used forward exchange contracts to hedge firm purchase commitments that expose the Company to risk as a result of fluctuations in foreign currency exchange rates. Gains and losses of forward exchange contracts that were designated as hedges of firm purchase commitments were deferred in other current liabilities and were included in the measurement of the underlying transaction. Hedge accounting was only applied if the derivative reduced the risk of the underlying hedged item and was designated at inception as a hedge. Derivatives are measured for effectiveness both at inception and on an ongoing basis. There were no exchange contracts outstanding at June 30, 2001.

6. WRITE-OFF OF COMPUTER EQUIPMENT AND SOFTWARE ASSETS

In the nine months ended June 30, 2001, the Company entered into lease financing arrangements with a hardware vendor, under which approximately $1.3 million related to hardware and related product costs and $2.5 million related to consulting services were acquired for its first data center in Atlanta, Georgia. The Company relocated its data center to Sunnyvale, California in June 2001 and intends to relocate the hardware and related costs of $1,500,000 to this location and wrote off the remaining net book value of $2.5 million related to consulting services for the first data center to operating expenses. The capitalized consulting services related to the installation of the hardware and the Company determined that they had no future value following the relocation. The Company is in discussions with the hardware vendor regarding the balance due under the lease, including revised payment terms and possible forgiveness of a part or all of the lease payments. On June 29, 2001, the Company returned various items of computer equipment and related goods related to the first data center to the vendor for an aggregate purchase price of $1.6 million. The vendor forgave the balance due under the capital lease of $1.6 million and the equipment and payable was written off in the three months ended June 30, 2001.

In addition, the Company had capitalized $1.2 million as part of its software asset related to software and services obtained for billing and provisioning. In June 2001, the Company concluded that other software would be used as the

primary billing application and that the software did not have any other alternative future use, and therefore, $1.2 million was written off in the three months ended June 30, 2001. The Company is in discussions with the vendor regarding settlement of the related account payable.

7. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases its principal office facilities pursuant to non-cancelable operating leases in Pleasanton, California, which expires in 2007. Quaartz leases office space in Santa Clara, California pursuant to non-cancelable leases, which expire in 2002 and 2007. NHAN India leases office space that expires in February 2003. Infotel leases office space in Singapore with the lease expiring in December 2002.

Future minimum rental payments under operating leases as of June 30, 2001 are as follows (in thousands):

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FISCAL YEAR	
2001	$ 503,000
2002	1,928,000
2003	1,627,000
2004	743,000
2005	345,000
Thereafter	970,000
	$6,116,000

Capital Leases

In the nine months ended June 30, 2001, the Company entered into additional financing transactions with a hardware vendor, financing approximately $1.3 million related to hardware and other product costs and $2.5 million related to consulting services (See Note 6).

The Company also leases computer equipment and other software under capital leases. These leases extend for varying periods through 2004. On July 27, 2001, the Company entered into a settlement and release agreement with a software vendor which the Company has a leasing arrangement for the non-exclusive license of certain software with a remaining balance of $7.4 million (see Note 14).

Equipment and software under capital leases included in property and equipment and capitalized software are as follows:

	June 30, 2001	September 30, 2000
Equipment	$ 5,107,000	$ 1,047,000
Software	10,573,000	10,010,000
	15,680,000	11,057,000
Less: accumulated amortization	(975,000)	(144,000)

	$14,705,000	$ 10,913,000

Future capital lease payments are as follows:

FISCAL YEAR

	June 30, 2001
Remainder of 2001	$ 2,885,000
2002	4,972,000
2003	2,697,000
2004	31,000
	10,585,000
Less amount representing interest	(538,000)
Present value of minimum future Payments	10,047,000
Less current maturities	5,612,000
	$ 4,435,000

Contingencies

In January 2001, a software vendor (the "vendor") filed a complaint against Quaartz, a wholly owned subsidiary located in Santa Clara, California (see note 13) for damages for breach of contract in the amount of $130,000 plus interest and attorneys fees. The vendor alleged that Quaartz breached a software licensing agreement for the vendor's Intellisync software development engine wherein Quaartz failed to make 2 payments totaling $65,000 each. In March 2001, Quaartz filed a cross complaint for breach of contract in the amount of at least $70,000 plus interest and attorneys fees. These cross-claims are based on allegations that the software the vendor provided to Quaartz did not include key synchronization features, which the vendor represented to the Quaartz were included in the software. Moreover, Quaartz alleges that the software did not function in accordance with the terms of the licensing agreement. Both parties have answered to each complaint. In addition the parties have agreed to mediate the matter and have agreed upon October 19, 2001 to conduct mediation. The Company has recorded a contingent liability of $130,000 but has not recorded any contingent assets in relation the cross complaint or any additional costs related to the defense of the claim.

In order to adapt the office space to the Quaartz's requirements, Quaartz vacated Suite 101 at their existing premises and moved to Suite 203 in the same premises. Quaartz did not formally cancel the lease for Suite 101 and is currently in negotiation with the landlord to settle claims for alleged breach of the leasehold agreement. In July 2001, the landlord sent a proposal to Quaartz's management to settle this litigation. This proposal stated an amount due of $2,580,000. The landlord offered to provide a complete release of all obligations to the lease for the sum of $559,000. This offer was available until July 12, 2001 and was not accepted by the Company. Quaartz is currently in negotiations with the landlord. The vacant office space has been subleased to another tenant. No amount has been accrued in relation to this contingency.

In December 2000, a former employee filed suit for wrongful termination in the Superior Court of Alameda County, State of California. The Company believes the suit is without merit and is defending it vigorously. No amount has been accrued in relation to this contingency.

The Company remains in discussions with two former employees who believe they were wrongfully denied severance by the Company. The Company disputes these

allegations and has claims regarding the failure of such employees to properly perform their duties and obligations to the Company.

From time to time, we are also involved in other legal actions arising in the ordinary course of business. While management intends to defend vigorously, there can be no assurance that any of these complaints or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flow. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies.

On April 24, 2001 a vendor filed suit against the Company in the Superior Court of California, County of San Diego, claiming breach of contract and anticipatory breach of contract. The first cause of action sought a principal sum of $164,000, alleging that the Company failed to fully pay the vendor for public relations services rendered. The second cause of action sought a principal sum of $348,000, alleging that the Company failed to pay the vendor for marketing and advertising services rendered. The final cause of action claimed a principal sum of $93,000, alleging that the Company did not provide the requisite advance notice for termination of both the Public Relations Agreement and Marketing Agreement. During the third fiscal quarter of 2001, the Company has settled the suit with the vendor for $380,000. The Company had previously established an accrual of $300,000 for this contingency and recorded an additional accrual of $80,000 in the three month period ended June 30, 2001.

8. CONVERTIBLE NOTES PAYABLE

In 2000, the Company instituted arbitration proceedings against one of our customers for breach of contract totaling approximately $610,000, of which the customer had paid us approximately $276,000. In the three month period ended June 30, of 2001, the Company settled with the customer for $164,000. The Company will recognize revenue for the settled amount when cash is received.

Convertible Promissory Notes Payable

On March 21, 2001, the Company entered into Convertible Promissory Notes Payable with a related party in the principal amount of $2,500,000 (the "$2,500,000 Notes"). The $2,500,000 Notes accrues interest at 10% per annum and becomes fully due and payable on May 31, 2001 (the "Maturity Date"). Upon approval by the Company's shareholders, the principal and accrued interest under the $2,500,000 Note converts into shares of the Company's common stock at any time on or after the Maturity Date. The conversion price is equal to 80% of the average of the five days lowest closing market price of the common stock during the period beginning on March 16, 2001 and ending on the Maturity Date. If the principal and accrued interest on the $2,500,000 Note is not paid in full or converted into Common Stock for any reason other than awaiting shareholder approval, and otherwise in accordance with the terms on or before the Maturity Date, then the conversion price shall be reduced 20% for each full week that this note is not paid or converted, provided that the conversion price shall not in any event be reduced to less than $1.00. If the shareholders fail to approve the issuance of equity, the related party may receive cash in the amount of

$250,000 in addition to the repayment of the principal and unpaid accrued interest at 25% per annum. The $2,500,000 Note is past due and was not converted to common stock as of June 30, 2001 as it has to be approved by the Company's shareholders.

In conjunction with the $2,500,000 Note, the Company issued a warrant to purchase 462,963 shares of its common stock at an exercise price of $2.70 per share with a term of 7 years (See Note 10). The warrants were valued using the Black-Scholes option pricing model and the following assumptions: contractual term of seven years, a risk free interest rate of 5.80%, a dividend yield of 0% and volatility of 141%. The allocation of note proceeds to the fair value of the warrant of $950,000 was recorded as a discount on the $2,500,000 Note and recorded as additional paid in capital. The discount on the $2,500,000 Notes was amortized over the note maturity period and, as a result, $147,000 was recorded as non-cash interest expense in the three month period ended March 31, 2001 and the remaining $803,000 was recorded as non-cash interest expense in the three months ended June 30, 2001.

As a result of the beneficial conversion feature described above for the $2,500,000 Note, the Company recorded a charge to additional paid in capital of $1,274,000, which was recorded as a discount on the note payable. The discount on the note payable is amortized over its maturity period and, as a result, $197,000 was recorded as non-cash interest expense in the three month period

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ended March 31, 2001 and the remaining $1,077,000 was recorded as non-cash interest expense in the three months June 30, 2001 (See Note 10).

In addition, the Company issued 1,500,000 additional warrants to the same related party to purchase shares of the Company's common stock at an exercise price of $2.70 per share due to the failure of the Company's completion of an equity investment of at least $6 million on or before May 31, 2001. The warrants were valued using the Black-Scholes option pricing model and the following assumptions: contractual term of 7 years, a risk free interest rate of 4.775%, a dividend yield of 0% and volatility of 147%. The fair value of $3,799,000 was recorded non-cash interest expense in the three months ended June 30, 2001.

On May 31, 2001, the Company entered into Convertible Promissory Notes Payable with two related parties, the Company's Chief Executive Officer and the Vice President of Sales, in the principal amount of $100,000 each (the $200,000 Notes"). The $200,000 Notes accrue interest at 14% per annum and became fully due and payable on June 21, 2001 ("maturity date"). The $200,000 Notes were also convertible on the maturity date into shares of the Company's common stock at 90% of the conversion price applicable to any security received in any interim financing subsequent to the date of the notes. If no interim financing was obtained on or before the maturity date, the $200,000 Notes were convertible into shares of the Company's common stock at 90% of the closing price on the trading day immediately preceding the maturity date.

In addition, the Company issued warrants to the same related party's to purchase 20,000 shares each of the Company's common stock at an exercise price of $1.57 per share (See Note 10). The Black-Scholes option pricing model was used to value the warrants and the following assumptions: contractual term of 5 years, a risk free interest rate of 4.625%, a dividend yield of 0% and volatility of 147%. The allocation of the $200,000 Note proceeds to the fair value of the warrants of $44,000 was recorded as a discount on the notes payable and recorded as additional paid-in capital. The discount on the notes payable was amortized over the note maturity period and, as a result, $44,000 was recorded as non-cash interest expense in the three months ended June 30, 2001.

As a result of the beneficial conversion feature described above for the $200,000 Notes, the Company recorded a charge to additional paid-in capital of $67,000, which was recorded as a discount on the notes payable. The discount was amortized over the maturity period and, as a result, the Company recorded non-cash deemed interest expense of $67,000 in the three month period ended June 30, 2001. The Chief Executive Officer's note was repaid in full on June 21, 2001. The Vice President of Sales' note has not been converted into common stock and remained outstanding at June 30, 2001.

On May 31, 2001, the Company also entered into Convertible Promissory Notes Payable with the same terms as the $200,000 Notes, with a related party in the principal amount of $150,000 and a non-related party in the principal amount of $250,000 (the "$400,000 Notes"). These $400,000 Notes were rolled into the convertible debentures payable issued on June 8, 2001 (the "June 8, 2001 Debentures").

In addition, the Company issued warrants to purchase 30,000 and 50,000, respectively, shares of the Company's common stock at an exercise price of $1.57 per share (See Note 10). The Black-Scholes option pricing model was used to value the warrants and the following assumptions: contractual term of 5 years, a

risk free interest rate of 4.625%, a dividend yield of 0% and volatility of 147%. The allocation of the $400,000 Note proceeds to the fair value of the warrants of $88,000 was recorded as a discount on the notes payable and recorded as additional paid-in capital. The discount on the notes payable was fully amortized and, as a result, $88,000 was recorded as non-cash interest expense in the three month period ended June 30, 2001.

As a result of the beneficial conversion feature described above, the Company recorded a charge to additional paid-in capital of $133,000, which was recorded as a discount on the $400,000 Notes. The discount on the $400,000 Notes payable was amortized to the note extinguishment date and, as a result, $51,000 was recorded as non-cash interest expense in the three months ended June 30, 2001. On the extinguishment date, the Company calculated the intrinsic value of the beneficial conversion feature of $44,000, reversed the beneficial conversion charge previously recorded and recorded additional non-cash interest expense of $39,000.

June 8, 2001 Convertible Debentures Payable

On June 8, 2001, the Company entered into a Convertible Debentures purchase agreement with certain investors in the aggregate principal amount of $2,400,000. The investors were obtained through a strategic partnering agreement. The June 8, 2001 Debentures accrue interest at 8% per annum, payable in common stock at the time of conversion. The conversion price is equal to lower of 110% of the average of any three closing bid prices selected by the investor during the 15 trading days prior to conversion or $2.44.

In connection with the June 8, 2001 Debentures, the Company issued warrants to purchase 1,081,000 shares of the Company's common stock at an exercise price of $2.89 per share (See Note 10). The Black-Scholes option pricing model was used to value the warrants and the following assumptions: contractual term of 5 years, a risk free interest rate of 4.625%, a dividend yield of 0% and volatility of 147%. The allocation of the June 8, 2001 Debenture proceeds to the fair value of the warrants of $1,282,000 was recorded as a discount on the Debenture and recorded as a warrant liability due to the Company's requirement to register the common stock. The common stock issuable pursuant to the conversion and exercise of the Debenture and warrant respectively must be registered within 30 days after the closing date of the next round of financing.

The discount on the Debentures is amortized over the note maturity period and, as a result, $39,000 was recorded as non-cash interest expense in the three month period ended June 30, 2001. In addition, due to the registration requirement the warrants need to be remeasured to their estimated value each reporting period until they are registered. As a result, the Company has recorded $1,120,000 of non-cash deemed interest expense during the three months ended June 30, 2001. The warrants were remeasured at June 30, 2001 using the Black-Scholes option pricing model using the following assumptions: contractual term of 5 years, a risk-free interest rate of 4.63%, a dividend yield of 0% and volatility of 147%. The liability related to the warrants total $2,402,000 at June 30, 2001.

As a result of the beneficial conversion feature described above for the June 8, 2001 Debentures, the Company recorded a charge to additional paid-in capital of $1,118,000, which was recorded as a discount on the notes payable. The discount on the notes payable is amortized over the note maturity period and, as a result, $34,000 was recorded as non-cash interest expense in the three month period ended June 30, 2001.

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At any time until August 30, 2001, if the Company raises at least $25 million, the Company shall have the right to redeem all outstanding debentures at a price equal to 115% of par plus accrued dividends. If the debentures are redeemed, the investor shall retain 60% of all issued warrants. Within 30 days after the closing date of the interim financing, the Company is required to file a registration statement for resale of all common stock issuable pursuant to the funding.

The Company issued warrants to purchase 200,000 shares of the Company's common stock to its strategic partner for finding investors for the June 8, 2001 Debentures at an exercise price of $1.60 per share (See Note 10). The Black-Scholes option pricing model was used to value the warrants and the following assumptions: contractual term of 5 years, a risk free interest rate of 4.63%, a dividend yield of 0% and volatility of 147%. The fair value of $546,000 was accounted for as a convertible debentures issuance costs and recorded as a deferred charge. The issuance cost is amortized over the note maturity period and, as a result, $17,000 was recorded as a non-cash interest expense in the three month period ended June 30, 2001.

9. REDEEMABLE CONVERTIBLE PREFERRED STOCK

In October 2000, the Company sold 87,620 shares of Series B Preferred Stock to domestic "accredited investors" for aggregate gross proceeds of $8,762,000, including $3.5 million received in advance. In connection with this issuance, the Company also issued to its investment bankers a fully exercisable warrant to acquire 75,000 shares of its Common Stock at an exercise price of $13.50 per share and paid a placement fee of 10% of the proceeds, 35% in cash and 65% paid in common stock issued in the second quarter of 2001. Holders of the Series B Preferred Stock are entitled to a non-cumulative 5% per annum dividend, payable quarterly in arrears, when, if and as declared by the Company's Board of Directors, which may be paid in cash or shares of the Company's Common Stock, in the Company's sole discretion. Each share of Series B Preferred Stock is immediately convertible into shares of our Common Stock at the lesser of (i) $13.50 per share or (ii) 90% of the average closing bid prices for the 10 trading days immediately preceding the date of conversion, provided, that such conversion price shall not be less than $10.00. At any time after the third anniversary of the Closing, the Company may require the holders of the Series B Preferred Stock to convert.

Upon voluntary or involuntary liquidation, dissolution or winding up of the Company, the investors will be entitled to receive, on a pari passu basis with holders of other shares of Preferred Stock, if any, an amount equal to such investors investment in the Offering and any declared but unpaid dividends. As a result, the net proceeds from the sale of the Series B Preferred Stock has been classified outside of stockholders' equity.

As a result of the beneficial conversion feature described above, the Company recorded a deemed dividend of $7,626,000 during the three months ended December 31, 2000. In addition, the Company estimated the value of the warrant at $1,107,000 issued to its investment bankers using the Black-Scholes option pricing model with the assumptions that follow: expected volatility of 135%, weighted average risk free interest rate of 5.8%, term of 1 year, and no expected dividend. The Company recorded this warrant as a cost of financing.

As of June 30, 2001, 83,120 preferred shares have been converted into 831,200 shares of the Company's common stock and 4,500 preferred shares remain outstanding.

10. STOCKHOLDERS' EQUITY

WARRANTS

On November 15, 2000, the Company adjusted the exercise price of warrants to purchase 120,000 shares of its common stock from $20.82 to 13.50 to obtain a waiver allowing us to issue Series B preferred stock to other investors, as well as engage in other financing transactions. The warrants were originally issued in conjunction with a stock purchase agreement (See "Stock Purchase Agreement"). The modification to the warrants was valued using the Black-Scholes option pricing model and the following assumptions: term of 2.54 years, a risk free interest rate of 6.2%, a dividend of 0% and a volatility of 135%. The fair value of the warrant of $1,847,000 was accounted for as a cost of the Series B preferred stock financing.

On November 28, 2000, the Company issued a warrant to purchase 30,000 shares to a professional services firm in consideration for certain services rendered to us at an exercise price of $8.34 per share. The warrants are immediately exercisable and expire in November 2005. The warrants were valued using the Black-Scholes option pricing model and the following assumptions: contractual term of five years, a risk free interest rate of 5.08%, a dividend yield of 0% and volatility of 135%. The fair value of $413,000 was expensed during the three months ended December 31, 2000.

On March 21, 2001, the Company issued a warrant, subject to adjustments pursuant to the terms of the Warrant, to purchase 462,963 shares of its common stock with an exercise price of $2.70 per share to a related party in conjunction with a Convertible Promissory Note (See Note 8). The warrant is immediately exercisable and expires in 7 years. As of May 31, 2001, the Company had not completed an equity investment in the Company in the aggregate principal amount of at least $6 million, and the Company had not prepaid the note payable and accrued interest in cash or common shares. As a result, the Company issued an additional warrant on May 31, 2001 to purchase 1,500,000 shares of Common Stock with an exercise price of $2.70. The warrant is immediately exercisable and expires in 7 years.

On April 9, 2001, the Company issued a warrant to purchase 200,000 shares of its common stock with an exercise price of $2.00 to a customer in connection with a Master Service Agreement. The warrant is immediately exercisable and expires in

5 years. The warrants were valued using the Black-Scholes option pricing model and the following assumptions: contractual term of 5 years, a risk free interest rate of 4.625%, a dividend yield of 0% and volatility of 147%. The fair value of $449,000 was accounted for as a deferred cost of sales and recorded as an "other asset." The deferred cost of sales is amortized over the Master Service Agreement term and, as a result, $34,000 was recorded as non-cash cost of sales in the three months ended June 30, 2001.

On May 31, 2001, the Company issued warrants to purchase 120,000 shares of its common stock with an exercise price of $1.57 per share to certain investors in conjunction with the $200,000 Notes and $400,000 Notes (See Note 8). The warrants are exercisable immediately and expire in 5 years.

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On June 8, 2001, the Company issued warrants to purchase 1,081,000 shares of its common stock with an exercise price of $2.89 per share to certain investors in conjunction with June 8, 2001 Debentures (See Note 8). The warrants are exercisable immediately and expire in 5 years.

On June 8, 2001, the Company issued warrants to purchase 200,000 shares of its common stock to its strategic partner at an exercise price of $1.60 (See Note 8). The warrants are immediately exercisable and expire in 5 years.

COMMON STOCK

On May 23, 2001, the Company acquired all of the outstanding stock of Quaartz Inc. and issued 1,500,00 shares of its common stock with an estimated value of $8.3 million to former Quaartz shareholders (See Note 12).

STOCK PURCHASE AGREEMENT

In fiscal year 2000 the Company entered into a common stock purchase agreement (the "equity line agreement"), dated May 24, 2000 and amended as of June 30, 2000 with an investment corporation under which the Company may require the investment corporation to purchase up to $50 million of its common stock. Under the terms of the equity line agreement, the Company is under no obligation to sell its common stock to the investment corporation. However, the Company may make up to a maximum of twelve requests for the purchase of its common stock with no single purchase exceeding $4 million unless otherwise agreed to by the investment corporation. In addition, the equity line agreement does not require the investment corporation to purchase the Company's common stock if it would result in the investment corporation owning more than 9.9% of the Company's outstanding common stock. The purchase price of the common stock is 92% of the volume weighted average price per share of the Company's common stock over the eighteen-day period prior to the date the Company requests the investment corporation to purchase its common stock. In addition, the investment corporation will receive a 2% placement fee and an escrow agent fee from the proceeds due to the Company. In conjunction with the stock purchase agreement, the Company issued a warrant to purchase 120,000 shares of its common stock. The warrant exercise price was subsequently adjusted to $13.50 per share on November 15, 2000 in exchange for securing a waiver from the investment corporation allowing us to issue Series B preferred stock to other investors, as well as engage in other financing transactions (see "Warrants" above). The Black-Scholes option pricing model was used to value the warrants and the following assumptions: contractual term of 3 years, a risk free interest rate of 5,8%, a dividend yield of 0% and a volatility of 135%. The fair value of $2,144,000 was accounted for as a non-current asset. As and when stock is purchased under the equity line agreement, the costs will be reclassified from "Other assets" to "Additional paid in capital", on a dollar for dollar basis with the amount of proceeds received from the sale of common stock.

During the second quarter, the Company requested that the investment corporation purchase $1.745 million of stock under the equity line agreement. Accordingly, the Company received net proceeds of $1.745 million under the equity line and, accordingly, reclassified $1.745 million from "Other Non-Current Assets" to "Additional paid-in capital" upon receipt of the proceeds and issuance of the stock. If at termination of the agreement the proceeds received from the sale of common stock are less than the costs associated with this agreement, then the residual costs remaining in "Other Assets" will be charged to expense.

11. SEGMENT REPORTING

The Company defines operating segments as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The operating segments disclosed are managed separately, and each represents a strategic business unit that offers different products and serves different markets.

The Company's reportable operating segments include APPIANT NA, Infotel, and other, which includes corporate operations. APPIANT NA, includes the Company's enterprise operations, Triad and NHAN SWG. APPIANT NA enterprise operations include systems integration and distribution of voice processing and multimedia messaging equipment, technical support and ongoing maintenance. Triad, which provides profile selling services to corporate and credit union clients, has been classified as part of APPIANT NA for internal reporting purposes rather than as a separate segment. The Company acquired Quaartz on May 23, 2001, an application and service provider primarily involved in software development projects for the Company. The results of Quaartz have been included with those of Appiant NA since the date of acquisition. The periods ended June 30, 2000 have been reclassified to conform to the current fiscal year presentation. Triad derives substantially all of its revenue from sales in the U.S. NHAN SWG was formed late in fiscal 1999 to design, develop, market and sell the inUnison(TM) portal services. NHAN SWG did not generate revenue in 2001 or 2000. The following table presents APPIANT NA's net revenue by country and is attributed to countries based on location of the customer:

	For the three months ended June 30,		For the nine months ended June 30,	
	2001	2000	2001	2000
United States	$ 1,964,000	$ 1,825,000	$ 4,673,000	$ 12,606,000
India	567,000	--	3,038,000	--
	$ 2,531,000	$ 1,825,000	$ 7,711,000	$ 12,606,000

Infotel is a distributor and integrator of telecommunications and other electronics products operating in Singapore and provides radar system integration, turnkey project management, networking and test instrumentation services. Infotel derives substantially all of its revenue from sales in Singapore. There are no intersegment revenues.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies in the Company's Annual Report on Form 10-KSB for our fiscal year ended September 30, 2000.

	APPIANT NA	INFOTEL	OTHER(1)	TOTAL
THREE MONTHS ENDED June 30, 2001				
Net revenue to external customers	$ 2,531,000	$ 3,593,000	$ --	$ 6,124,000
Net Income (loss)	(8,260,000)	158,000	(7,475,000)	(15,577,000)
Total assets	25,323,000	10,014,000	16,774,000	52,111,000
THREE MONTHS ENDED June 30, 2000				
Net revenue to external customers	$ 1,826,000	$ 2,448,000	$ --	$ 4,274,000
Net Income (loss)	(2,236,000)	347,000	(1,730,000)	(3,619,000)
Total assets	9,645,000	8,778,000	18,045,000	36,468,000
NINE MONTHS ENDED June 30, 2001				
Net revenue to external customers	$ 7,711,000	$11,028,000	$ --	$ 18,739,000
Net Income (loss)	(18,332,000)	771,000	(7,908,000)	(25,469,000)
Total assets	12,888,000	10,014,000	16,774,000	52,111,000

NINE MONTHS ENDED June 30, 2000				
Net revenue to external customers	$ 12,606,000	$ 9,010,000	$ --	$ 21,616,000
Net Income (loss)	(1,441,000)	919,000	(4,790,000)	(5,312,000)
Total assets	9,645,000	8,778,000	18,045,000	36,468,000