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BOUNDLESS CORP
Form 10-Q
August 14, 2001

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C.

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2001

Commission File Number 0-17977

BOUNDLESS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other Jurisdiction of Incorporation or Organization)

13-3469637
(I.R.S. Employer Identification No.)

100 Marcus Blvd.
Hauppauge, NY
(Address of principal executive offices)

11788
(Zip Code)

(631) 342-7400
(Registrant's telephone number, including area code)

Indicate by check mark 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 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 No
--- ---

As of June 30, 2001, the Registrant had approximately 5,688,037 shares of Common Stock, \$.01 par value per share outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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BOUNDLESS CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (in thousands)

	June 30	
	2001	

Current assets:		(unaudited)
Cash and cash equivalents	\$	
Trade accounts receivable, net	8,2	
Income tax refund	3	
Inventories	9,2	
Deferred income taxes	2,2	
Prepaid software license fees		
Prepaid expenses and other current assets	2	

Total current assets	20,4	
Property and equipment, net	10,5	
Goodwill, net	4,0	
Prepaid software license fees		
Other assets	4	

	\$ 35,5	
	=====	
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Current portion of long-term debt	\$ 9	
Accounts payable	11,7	
Accrued expenses and other current liabilities	7,5	
Deferred revenue	3	
Net liabilities of discontinued operations	1,9	

Total current liabilities	22,4	
Long-term liabilities:		
Long-term debt, less current maturities	12,6	
Other	6	

Total long-term liabilities	13,2	

Total liabilities	35,6	
Minority interest		

Stockholders' equity (deficit):		

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Common stock	
Additional paid-in capital	35,2
Accumulated deficit	(35,3
Accumulated other comprehensive loss	(1

Total stockholders' equity (deficit)	(1

	\$ 35,5
	=====

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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BOUNDLESS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2001	2000	2001	2000
	-----		-----	
	(unaudited)		(unaudited)	
	-----	-----	-----	-----
Revenue	\$ 27,886	\$ 34,212	\$ 14,897	\$ 17,480
Cost of revenue	25,296	25,815	13,855	12,986
	-----	-----	-----	-----
Gross margin	2,590	8,397	1,042	4,494
	-----	-----	-----	-----
Operating expenses:				
Sales and marketing	3,645	3,778	1,873	2,119
General and administrative	3,588	4,296	1,741	2,130
Research and development	753	738	352	387
Other (credits)	(1,765)	(267)	(1,787)	(273)
	-----	-----	-----	-----
Total operating expenses	6,221	8,545	2,179	4,363
	-----	-----	-----	-----
Operating income (loss)	(3,631)	(148)	(1,137)	131
Interest expense, net	874	518	448	363
	-----	-----	-----	-----
Loss before income taxes	(4,505)	(666)	(1,585)	(232)
Income tax expense	--	--	--	--
	-----	-----	-----	-----
Loss before discontinued operations	(4,505)	(666)	(1,585)	(232)
Loss from discontinued operations	(2,466)	(5,855)	--	(3,569)
	-----	-----	-----	-----
Net loss	\$ (6,971)	\$ (6,521)	\$ (1,585)	\$ (3,801)
	=====	=====	=====	=====
Other comprehensive loss:				
Cumulative effect of adoption of FAS 133 .	(30)	--	--	--
Cash flow hedges	(77)	--	(2)	--
	-----	-----	-----	-----
Other comprehensive loss	(107)	--	(2)	--
	-----	-----	-----	-----

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Total comprehensive loss	\$ (7,078)	\$ (6,521)	\$ (1,587)	\$ (3,801)
	=====	=====	=====	=====
Weighted average common shares outstanding ..	4,880	4,524	4,995	4,535
	=====	=====	=====	=====
Basic net (loss) per common share:				
Continuing operations	(0.92)	(0.15)	(0.32)	(0.05)
Discontinued operations	(0.51)	(1.29)	--	(0.79)
	-----	-----	-----	-----
Basic net loss per common share	\$ (1.43)	\$ (1.44)	\$ (0.32)	\$ (0.84)
	=====	=====	=====	=====
Weighted average dilutive shares outstanding	4,880	4,524	4,995	4,535
	=====	=====	=====	=====
Diluted net loss per common share:				
Continuing operations	(0.92)	(0.15)	(0.32)	(0.05)
Discontinued operations	(0.51)	(1.29)	--	(0.79)
	-----	-----	-----	-----
Diluted net loss per common share	\$ (1.43)	\$ (1.44)	\$ (0.32)	\$ (0.84)
	=====	=====	=====	=====

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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BOUNDLESS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
For the Six Months Ended June 30,

	2001	2000
	-----	-----
	(unaudited)	(unaudited)
Cash flows from operating activities:		
Net (loss)	\$ (6,971)	\$ (6,521)
Adjustments to reconcile net (loss) to net cash (used in) operating activities:		
Net loss from discontinued operations	2,466	5,855
Depreciation and amortization	1,806	1,375
(Gain) on the disposition of assets	(1,504)	(240)
Deferred revenue	(8)	(342)
Provision for doubtful accounts	222	309
Provision for excess and obsolete inventory	524	115
Options and warrants issued for services	--	184
Changes in assets and liabilities:		
Trade accounts receivable	793	(2,059)
Income tax refunds	--	833
Inventories	171	1,886
Other assets	309	(1,664)
Accounts payable and accrued expenses	1,902	841
Net change in assets and liabilities of discontinued operations	(3,538)	(5,855)
	-----	-----
Net cash (used in) operating activities	(3,828)	(5,283)
	-----	-----
Cash flows from investing activities:		
Capital expenditures	(251)	(1,195)
Proceeds from the sale of assets	1,600	1,538

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	-----	-----
Net cash provided by investing activities	1,349	343
	-----	-----
Cash flows from financing activities:		
Proceeds from exercise of stock options	--	1,383
Net proceeds from issuance of debt	--	4,400
Payments on loans payable and capital leases	(2,308)	(1,477)
Proceeds from issuance of common stock	1,189	--
	-----	-----
Net cash provided by (used in) financing activities	(1,119)	4,306
	-----	-----
Net (decrease) in cash and cash equivalents	(3,598)	(634)
Cash and cash equivalents at beginning of year	3,697	1,285
	-----	-----
Cash and cash equivalents at end of period	\$.99	\$ 651
	=====	=====
Non-cash transactions:		
Options, warrants and common stock issued for services	\$ --	\$ 184
Equipment acquisitions funded through debt	234	1,636
Cash paid for:		
Interest	732	671
Taxes	12	91

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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BOUNDLESS CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data)
(unaudited)

1. Condensed Consolidated Financial Statements

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three-month period ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. For further information refer to the consolidated financial statements and footnotes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

2. Background

Boundless Corporation (the "Company") was incorporated in 1988 under the laws of the State of Delaware. The Company through its subsidiaries- Boundless Technologies, Inc. ("Boundless Technologies"), Boundless Manufacturing Services, Inc. ("Boundless Manufacturing"), and Merinta Inc. ("Merinta")- is a provider of text and thin client terminals, manufacturing services, and software for the Internet appliances ("IA") market.

Boundless Technologies, a wholly-owned subsidiary, is engaged in supplying

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computer terminals for commercial use. The Company's general strategy is to provide fast, easy-to-use, and cost-effective products that enable access to applications and data in commercial environments, including Windows-based applications, as well as older "legacy" applications, running on mainframes, mid-range, and Unix systems.

Boundless Technologies principally designs, sells and supports (i) desktop computer display terminals, which generally do not have graphics capabilities, ("General Display Terminals"); (ii) thin client desktop display devices which enable access to Windows(R) computing environments ("Windows(R)-based Terminals" or "WBTs") and supporting software; and (iii) other products that are used in multi-user computing environments.

Boundless Technologies offers standard and custom models of its General Display Terminals primarily to retail, financial, telecommunications and wholesale distribution businesses requiring them for data entry and point of sale activities. Standard and custom model thin clients and Windows(R)-based Terminals are being marketed by Boundless primarily to manufacturing, healthcare and social assistance, financial and insurance, wholesale trade, educational services and public administration businesses with light processing requirements and the need to provide concurrent information to customers on a variety of topics, such as billing and current and historical product and service information.

Boundless Manufacturing is pursuing opportunities in the electronic manufacturing services ("EMS") marketplace. As of June 30, 2001, the Company owned approximately 55% of the outstanding shares of common stock of this subsidiary. Boundless Manufacturing operates from state-of-the-art ISO 9002 certified manufacturing facilities in Hauppauge, NY, and Boca Raton, FL, and will acquire additional manufacturing facilities as the business expands. Services include supply chain optimization, global supply base management, PCBA assembly and test, systems assembly and test, distribution and logistics, repair centers and end-of-life management. Boundless Manufacturing also offers in-house engineering expertise- product design, test development, product development- to significantly reduce time-to-market for original equipment manufacturers ("OEM") customers. Boundless Manufacturing provides a complete supply chain that is designed and built to each customer's specifications. Boundless Manufacturing also has post-manufacturing support capability in Chicago, Atlanta, Los Angeles and the Netherlands.

Boundless Manufacturing is focused on delivering a level of service and commitment, to both middle-market OEMs, and start-up companies, that is currently only available to top tier customers from the larger EMS companies. Boundless Manufacturing will develop relationships with those OEMs and ODMs whose supply chains can be completed or

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complemented by the company's unique capabilities, and diversify revenue risk by winning customers in several vertical markets including data storage, public and premise telco, office technology products, industrial controls and custom or embedded "PC" applications.

On May 11, 2001, management decided to discontinue Merinta. See Note 8.

3. Inventories

Inventories are stated at the lower of cost or market. Cost is determined on a first-in first-out basis. The major components of inventories are as follows:

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	June 30, 2001	December 31, 2000
	-----	-----
Raw materials and purchased components	\$7,271	\$8,006
Finished goods	1,244	1,233
Service parts	715	686
	-----	-----
Total inventories	\$9,230	\$9,925
	=====	=====

4. Equity

At June 30, 2001 and December 31, 2000 stockholders' equity (deficit) consisted of the following:

	June 30, 2001	December 31, 2000
	-----	-----
Common stock, \$0.01 par value, 25,000,000 shares authorized, 5,688,037 and 4,630,160 shares issued at June 30, 2001 and December 31, 2000, respectively	\$ 57	\$ 46
Additional paid-in capital	35,280	34,102
Accumulated deficit	(35,368)	(28,397)
Accumulated other comprehensive loss	(107)	--
	-----	-----
Total stockholders' equity (deficit)	\$ (138)	\$ 5,751
	=====	=====

5. Major Customers

The Company markets its terminal products through original equipment manufacturers ("OEMs") and reseller distribution channels. Customers can buy Boundless' products from an international network of value-added resellers (VARs) and regional distributors. Through its sales force, the Company sells directly to large VARs and regional distributors and also sells to major national and international distributors. For the second quarter ended June 30, 2001 sales to two major OEMs as a percentage of total revenues were 37%, with no one OEM exceeding 10% for the quarter ended June 30, 2000.

6. Business Segments

The Company's manufacturing is conducted at its New York and Florida facilities and its sales force operates from six geographically dispersed locations in the United States and European offices in the Netherlands and United Kingdom.

Operating segments are identified as components of an enterprise about which separate financial information is available for evaluation by its decision making group. In line with the formation of its two new subsidiaries, effective in 2000 the Company began managing its operations and reporting its financial results as three business segments. However, due to the decision to discontinue Merinta (see Note 8), only two continuing business segments remain. The results of the reportable segments are derived from Boundless' management reporting system. These results are based on Boundless' method of internal reporting and

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are not necessarily in conformity with generally accepted accounting principles. These results are used to evaluate the performance of each segment and determine the appropriate resource allocation mix.

Information for the current and prior year by business segment is presented below (in thousands):

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Three Months Ended June 30, 2001	Total	Elimi- nations	Boundless Technol- ogies/Corp.	Boundless Manufact- uring
Customer Revenue	\$ 14,897		\$ 8,801	\$ 6,096
Intercompany Revenue		\$ (6,738)		6,738
Total Revenue	\$ 14,897	\$ (6,738)	\$ 8,801	\$ 12,834
Gross Margin	\$ 1,042	\$ (413)	\$ 1,574	\$ (119)
Gross Margin percent	7.0%		17.9%	-0.9%
Operating income (loss)	\$ (1,137)		\$ 488	\$ (1,625)

Three Months Ended June 30, 2000	Total	Elimi- nations	Boundless Technol- ogies/Corp.	Boundless Manufact- uring
Customer Revenue	\$ 17,480		\$ 14,505	\$ 2,975
Intercompany Revenue		\$ (15,241)		15,241
Total Revenue	\$ 17,480	\$ (15,241)	\$ 14,505	\$ 18,216
Gross Margin	\$ 4,494		\$ 4,648	\$ (154)
Gross Margin percent	25.7%		32.0%	-0.8%
Operating income (loss)	\$ 131		\$ 1,583	\$ (1,452)

Six Months Ended June 30, 2001	Total	Elimi- nations	Boundless Technol- ogies/Corp.	Boundless Manufact- uring
Customer Revenue	\$ 27,886		\$ 18,273	\$ 9,613
Intercompany Revenue		\$ (13,294)		13,294

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Total Revenue	\$ 27,886 =====	\$(13,294) =====	\$ 18,273 =====	\$ 22,907 =====
Gross Margin	\$ 2,590 =====	\$ (699) =====	\$ 3,739 =====	\$ (450) =====
Gross Margin percent	9.3%		20.5%	-2.0%

Operating income (loss)	\$ (3,631) =====		\$ 29 =====	\$ (3,660) =====
Total assets by business segment	\$ 35,548 =====		\$ 15,202 =====	\$ 20,346 =====

Six Months Ended June 30, 2000	Total	Elimi- nations	Boundless Technol- ogies/Corp.	Boundless Manufact- uring
-----	-----	-----	-----	-----
Customer Revenue	\$ 34,212		\$ 29,833	\$ 4,379
Intercompany Revenue		\$(24,617)		24,617
Total Revenue	\$ 34,212 =====	\$(24,617) =====	\$ 29,833 =====	\$ 28,996 =====
Gross Margin	\$ 7,226 =====		\$ 8,834 =====	\$ (1,608) =====
Gross Margin percent	21.1%		29.6%	-5.5%

Operating income (loss)	\$ (148) =====		\$ 2,737 =====	\$ (2,885) =====
Total assets by business segment	\$ 46,278 =====		\$ 22,906 =====	\$ 23,372 =====

Pertinent financial data by major geographic segments for the second quarter ended June 30, 2001 and 2000 are:

	June 30, 2001	June 30, 2000
	-----	-----
Net sales to unaffiliated customers:		
United States	\$11,828	\$12,147
United Kingdom	929	868
Germany	1,002	358
Other European countries	587	2,140
Other foreign areas	551	1,967
Total sales	\$14,897 =====	\$17,480 =====

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7. Derivative Instruments

Effective January 1, 2001, the Company adopted FAS 133 as amended and interpreted. FAS 133 requires that all derivative instruments, such as interest rate swap contracts, be recognized in the financial statements and measured at their fair market value. Changes in the fair market value of derivative instruments are recognized each period in current operations or stockholders' equity (as a component of accumulated other comprehensive loss), depending on whether a derivative instrument qualifies as a hedge transaction.

In the normal course of business, the Company is exposed to changes in interest rates. The objective in managing its exposure to interest rates is to decrease the volatility that changes in interest rates might have on operations and cash flows. To achieve this objective, the Company uses interest rate swaps to hedge a portion of total long-term debt that is subject to variable interest rates and designates these instruments as cash flow hedges. Under these swaps, the Company agrees to pay fixed rates of interest. These contracts are considered to be a hedge against changes in the amount of future cash flows associated with the interest payments on variable-rate debt obligations. Accordingly, the interest rate swaps are reflected at fair value in the Consolidated Balance Sheet and the related gains or losses on these contracts, net of related income tax effect, are recorded as a component of accumulated other comprehensive loss. The Company does not enter into such contracts for speculative purposes and currently these are the only derivative instruments held by the Company as of June 30, 2001. The fair value of interest rate swap contracts are determined based on the discounted estimated cash flows derived from the forward yield curve at the inception of the swap versus the forward yield curve at the end of the reporting period.

To the extent that any of these swaps are not completely effective in offsetting the change in interest cash flows being hedged, the ineffective portion is immediately recognized in interest expenses. Effectiveness is measured on a quarterly basis using the cash flow method. No other cash payments are made unless the contract is terminated prior to maturity, in which case, the amount paid or received in settlement is established by agreement at the time of termination.

The adoption of FAS 133 at January 1, 2001, resulted in recording \$30 in accumulated other comprehensive loss for the cumulative effect of the accounting change. As of June 30, 2001, the Company had interest rate swap contracts to pay fixed rates of interest (ranging from 8.18% to 9.35%) and receive variable rates of interest based on LIBOR on an aggregate of \$6,444 notional amount of indebtedness with maturity dates ranging from March 2002 through March 2003. The aggregate fair market value of all interest rate swap contracts was (\$107) on June 30, 2001 and is included in accrued expenses and other current liabilities on the Consolidated Balance Sheet.

8. Discontinued Operations

On May 11, 2001, the Board of Directors of the Company formally approved a plan to discontinue the operations of Merinta. Since November 2000, following an investment by National Semiconductor in Merinta, the Company was prohibited from contributing cash to the subsidiary. As a result, Merinta was required to fund its working capital needs from the proceeds of the National Semiconductor investment, cash generated from operations, and proceeds from any additional investments. However, the cash generated from operations was not sufficient to cover its operating needs and the Company was not successful in raising additional equity investments to supplement the proceeds from National Semiconductor. The loss from discontinued operations for the period January 1 through March 31, 2001 was \$2,466. The Company does not expect to record a loss on the disposal of Merinta (inclusive of operating results subsequent to March

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31, 2001), which will occur in the third quarter of 2001.

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9. On June 29, 2001 the Company completed the sale of its thin client business to Neoware Systems, Inc. ("Neoware"). The sale included the Company's Capio(R) product line, SAM Remote Administrator Software, associated intellectual properties and access to the existing thin client distribution and customer databases. The sale also included an outsourcing arrangement to continue to produce, service, and support the Capio family of products for Neoware. Proceeds from the sale amounted to \$1,600. In connection with the purchase and outsourcing arrangement, Neoware made a direct equity investment in the Company of \$300, and received 333,334 shares of the Company's common stock as well as warrants to purchase an additional 33,334 shares of the Company's common stock at an exercise price of \$0.99 per share. The warrants expire five years from the date of original issuance.

10. New Accounting Standards

In June 2001, the Financial Accounting Standards Board finalized FASB Statements No. 141, Business Combinations (SFAS 141), and No. 142, Goodwill and Other Intangible Assets (SFAS 142). SFAS 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS 141 also requires that the Company recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS 142, that the Company reclassify the carrying amounts of intangible assets and goodwill based on the criteria in SFAS 141.

SFAS 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS 142 requires that the Company identify reporting units for the purposes of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS 142. SFAS 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS 142 requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company is also required to reassess the useful lives of other intangible assets within the first interim quarter after adoption of SFAS 142.

The Company's previous business combinations were accounted for using the purchase method. As of June 30, 2001, the net carrying amount of goodwill is \$4,098 and other intangible assets is \$354. Amortization expense during the six-month period ended June 30, 2001 was \$1,033. Currently, the Company is assessing but has not yet determined how the adoption of SFAS 141 and SFAS 142 will impact its financial position and results of operations.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

RESULTS OF OPERATIONS

The numbers and percentages contained in this Item 2 are approximate. Dollar

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amounts are stated in thousands.

For the Three and Six Month Periods Ending June 30, 2001

Revenue - Revenue for the quarter ended June 30, 2001 was \$14,897 as compared to \$17,480 for the quarter ended June 30, 2000. Revenue for the six months ended June 30 2001 was \$27,886 versus \$34,212 for 2000.

Sales of the Company's General Display Terminals declined 41% to \$7,558 for the quarter ended June 30, 2001 from \$11,300 for the quarter ended June 30, 2000. On a year-to-year basis revenue for General Display Terminals declined 38% to \$14,838 from \$23,785 in year 2000. Declining demand for General Display Terminals as well as a disruption in the supply chain which caused component shortages were the main reasons for the decrease in revenue.

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During February 2001 the Company was advised that a majority ownership interest in its primary supplier of plug-in logic boards, Tongkah, was being sold and that new management desired to change the manufacturing profile of the company, requiring that Tongkah eliminate the services provided to the Company. As a result, the Company was required to move the production of its plug-in logic boards to a new supplier, Goldtron (HK) Limited, located in mainland China. The Company was subject to supply disruption due to the production transition; however, as of April 17, 2001, Goldtron had successfully transitioned production to its manufacturing facility and had achieved mass-production capability.

The Company believes the market for General Display Terminals will continue to decline as customers move toward applications requiring graphical user interfaces.

Revenues for the quarter ending June 30, 2001, from Boundless Manufacturing were \$6,096, excluding intercompany revenue, as compared to \$2,975 for the quarter ending June 30, 2000. Revenue for the six-month period for Boundless Manufacturing was \$9,613 in 2001 versus \$4,379 for the comparable period in 2000. The revenue growth is attributable both to the start-up nature of Boundless Manufacturing during the first half of 2000, as well as the beginning of production for significant customers during the first half of 2001. The Company anticipates continued growth in revenues from this segment of the business as Boundless Manufacturing executes its plan of offering a complete and complementary line of services to both middle-market OEMs, and start-up companies.

Sales of the Company's WBT hardware and software amounted to \$1,200 versus \$3,204 for the periods ended June 30, 2001 and 2000, respectively. Much of this decline was attributable to the anticipated sale of this product line to Neoware on June 29, 2001. See Note 9.

Net revenue from the Company's repairs and spare parts business for the quarter ended June 30, 2001 was \$570 as compared to \$448 for the quarter ended June 30, 2000.

Comdial and Hewlett Packard were the most significant customers for the Company's products, accounting for 27% and 10% of revenue, respectively, for the quarter ended June 30, 2001.

Gross Margin - Gross margin for the three and six months ended June 30, 2001 was \$1,042 (7% of revenue) and \$2,590 (9% of revenue) respectively, as compared to gross margins of \$4,494 (26% of revenue) and \$8,397 (25% of revenue) for the comparable periods in 2000. The decrease in gross margin as a percent of revenue

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is attributable to the decline in the General Display Terminals revenue, which yields higher profit margins than the other product lines and business segments of the Company. In addition, excess capacity at the Company's manufacturing facilities resulted in under-absorbed overhead expenses of \$1,498, or 10% of revenue for the first six months of 2001.

In a continuing effort to maintain and improve margins in an industry otherwise characterized by commodity pricing, management has focused on quality, flexibility, and product cost reductions. From time-to-time margins are adversely affected by industry shortages of key components. The Company emphasizes product cost reductions in its research and development activities and frequently reviews its supplier relationships with the view to obtaining the best component prices available.

Although asset management is a stronger indication of ultimate profitability, the shift in revenue mix toward electronic manufacturing services will also adversely affect gross margin as a percent of revenue. Gross margin in future periods may be affected by several factors such as sales volume, shifts in product mix, pricing strategies and absorption of manufacturing costs.

Total Operating Expenses - For the quarter ended June 30, 2001, operating expenses decreased 42% to \$2,179 (15% of revenue), compared to expenses for the second quarter of 2000 of \$4,363 (25% of revenue). For the six months ended June 30, 2001, operating expenses were \$6,221 compared to expenses in the comparable period in 2000 of \$ 8,545. This decrease is attributable to \$1,500 in additional income associated with the Company's sale of the Capio product line to Neoware as well as \$300 income related to the release of expired warranty reserves.

Sales and Marketing Expenses - Sales and marketing expenses decreased 7% to \$1,873 (13% of revenue) for the quarter ended June 30, 2001 from \$2,119 (12% of revenue) for the quarter ended June 30, 2000. Expenses for the first six months were \$3,645 in 2001 versus \$3,778 in 2000. This decrease was mainly due to a reduction in second quarter expenditures for marketing programs related to the Capio product line. The Company promotes its products using media advertising, direct mail, telemarketing, public relations and cooperative channel marketing programs.

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General and Administrative Expenses - General and administrative expenses decreased to \$1,741 (12% of revenue), from \$2,130 (12% of revenue) for the three months ended June 30, 2001 and 2000, respectively. Expenses for the six-month period ended June 30 2001 were \$3,588 versus \$4,296 in 2000. The decrease in expenses is mainly due to a reduction in personnel costs and outside consulting services.

Research and Development Expenses - Research and development expenses for the second quarter decreased slightly to \$352 in 2001 from \$387 in 2000. For the six-month period ended June 30, 2001 expenses were \$ 753 compared to \$738 in 2000.

Interest Expense, net - Interest expense, net for the quarter ended June 30, 2001 was \$448 compared to \$363 for the comparable period in 2000. Interest expense, net for the six months was \$874 in 2001 versus \$518 in 2000. This year-to-year variance is mainly due to \$197 of interest income received from the IRS during the second quarter of 2000.

Loss From Discontinued Operations- The loss from discontinued operations, net of applicable income taxes, for the period January 1 through June 30, 2001 was \$2,466 relating to the Company's decision to discontinue the operations of

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Merinta. For the period ending June 30, 2000, the loss from discontinued operations, net of applicable income taxes was \$3,569. The Company believes that the net liabilities related to discontinued operations approximates the liabilities that the parent company has guaranteed to third parties. The Company does not expect to record a loss on the disposal of Merinta.

Income Tax Expense - For the second quarter of 2001 and 2000, the Company did not record an income tax credit against the recorded loss before income taxes of \$1,585 and \$3,801, respectively. As a result of uncertainties as to whether the related future tax benefits will be realized, the Company has provided for a 100% valuation allowance against the deferred tax assets attributable to these losses.

Net Income (Loss)- For the quarter ended June 30, 2001, the Company recorded a net loss of \$(1,585), compared to net loss of \$(3,801) for the quarter ended June 30, 2000. The net loss for the six months ended June 30, 2001 was \$(6,971) compared to a net loss of \$(6,521) in 2000.

LIQUIDITY AND CAPITAL RESOURCES

The discussion below regarding liquidity and capital resources should be read together with the information included in the Notes to Consolidated Financial Statements.

As of June 30, 2001, the Company had a working capital deficiency of \$2,005 as compared to working capital of \$5,881 at December 31, 2000. Historically, the Company has relied on cash flow from operations, bank borrowings and sales of its common stock to finance its working capital, capital expenditures and acquisitions.

On May 25, 2000, the Company signed an agreement with The Chase Manhattan Bank ("Chase") amending and restating the existing credit line to add as co-borrowers Boundless Manufacturing and Merinta. Terms of the credit line (the "Chase Credit Line") were substantially similar to those previously in effect. The Chase Credit Line also provides for a \$4,000 term loan, payable over a three-year period in equal quarterly installments beginning June 1999. The credit line expires April 14, 2003. On November 16, 2000, in connection with the equity investment secured for Merinta, the Company amended the revolving credit line entered into May 25, 2000. The amendment, amongst other things, excluded Merinta's accounts receivable and inventory from the borrowing base formula and prohibited the company from contributing cash toward Merinta's operating expenses. On April 17, 2001, the Chase Credit Line was further amended, including a reduction in the overall amount of the line from \$15,000 to \$12,000 as well as an immediate reduction in the amount of the line which could be collateralized by inventory from \$5,000 to \$3,800, to be reduced further by \$100 per month beginning August 1, 2001.

The Company is highly leveraged. As of June 30, 2001, the Company had negative tangible net worth of \$4,416 and total liabilities of \$35,686. The Company's liabilities at June 30, 2001 included repayment of a revolving loan of \$6,226 plus interest maturing April 2003, a term loan in the amount of \$400 plus interest due in equal monthly installments through December 2001, a capital lease in the amount of \$948 which requires monthly principal and interest payments through May 2003 and a ten-year promissory note in the amount of \$6,067 which requires monthly principal and interest payments through July 1, 2009.

Borrowing under the revolving loan is based on a borrowing base formula of up to 80% of eligible receivables, plus 50% of delineated eligible inventory, plus 30%

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of non-delineated eligible inventory. Up to \$5,000 is available under the revolving loan for letters of credit. As a result of the borrowing base formula, the credit available to the Company could be adversely restricted in the event of further declines in the Company's sales and increases in orders may not be able to be financed under the Company's revolving credit line.

Boundless has an agreement with a commercial lender for a loan secured by a mortgage on the Boundless facility located in Hauppauge, NY. The loan, which is in the principal amount of \$6,067 and carries a fixed interest rate of 7.75%, is being amortized over a 25-year period with a balloon payment due on July 1, 2009. The monthly payments are approximately \$50. To induce the lender to make the loan, the Company executed and delivered a guaranty of Boundless' obligations to the lender.

In connection with the creation of Merinta, the Company assigned certain contracts, to which it was a party, to Merinta. In some instances the Company, to accomplish the assignment, guaranteed Merinta's performance of the contract. Particularly, the Company is a guarantor of a software license contract requiring monthly payments by Merinta of approximately \$148 throughout 2001. As of August 6, 2001, Merinta was in default of the agreement, having not made the mandatory monthly payment since January 2001. The Company is currently negotiating a paydown schedule with the software vendor.

In the event there is a further decline in the Company's sales and earnings and/or a decrease in availability under the credit line, the Company's cash flow would be adversely affected. Accordingly, the Company may not have the necessary cash to fund all of its obligations.

Net cash used in operating activities for the three months ended June 30, 2001 was \$3,828 attributable to a loss before discontinued operations of \$4,505, a loss from discontinued operations of \$2,466 and a net change in assets and liabilities of discontinued operations of \$3,538. These uses of cash were partially offset by non-cash expenses of \$2,544, a reduction in accounts receivable of \$793, a reduction of inventory of \$171, a decrease in other assets of \$309 and increases in payables and accrued expenses of \$1,902. Net cash provided by investing activities was comprised of capital expenditures of \$251 and the proceeds from the sale of assets in the amount of \$1,600. Net cash used in financing activities included payments of the Company's revolving loan in the amount of \$548, on the term loan in the amount of \$867 and on other loans and lease obligations in the amount of \$893. This was partially offset by issuance of common stock in the amount of \$1,189.

Impact of Inflation - The Company has not been adversely affected by inflation because technological advances and competition within the microcomputer industry have generally caused prices of products sold by the Company to decline. The Company has flexibility in its pricing and could, if necessary, pass along price changes to most of its customers.

Factors That Could Affect Future Results

Competition. The Company encounters aggressive competition in all areas of its business. The Company has numerous competitors, ranging from some of the world's largest corporations to many relatively small and highly specialized firms. The Company competes primarily on the basis of technology, performance, price, quality, reliability, distribution and customer service and support. Product life cycles are short. To remain competitive, the Company must be able to develop new products and periodically enhance its existing products. In particular, the Company anticipates that it will have to continue to lower the prices of many of its products to stay competitive and effectively manage financial returns with resulting reduced gross margins. In some of the Company's markets, it may not be able to compete successfully against current and future

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competitors, and the competitive pressures it faces could harm its business and prospects.

New Product Introductions. If the Company cannot continue to rapidly develop, manufacture and market innovative products and services that meet customer requirements for performance and reliability, it may lose market share and its future revenue and earnings may suffer. The process of developing new high technology products and services is complex and uncertain. The Company must accurately anticipate customers' changing needs and emerging technological trends. The Company consequently must make long-term investments and commit significant resources before knowing whether its predictions will eventually result in products that the market will accept. After a product is developed, the Company must be able to manufacture sufficient volumes quickly at low enough costs. To do this, the Company must accurately forecast volumes, mix of products and configurations. Additionally, the supply and timing of a new product or service must match customers' demand and timing for the particular product or service. Given the wide variety of systems, products and services that Boundless offers, the process of planning production and managing inventory levels becomes increasingly difficult.

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Reliance on Third Party Distribution Channels and Inventory Management. The Company uses third-party distributors to sell its products. As a result, the financial soundness of its wholesale and retail distributors, and its continuing relationships with these distributors, are important to the Company's success. Some of these distributors may have insufficient financial resources and may not be able to withstand changes in business conditions. The Company's revenue and earnings could suffer if its distributors' financial condition or operations weaken or if its relationship with them deteriorates. Additionally, inventory management becomes increasingly complex as the Company continues to sell a significant mix of products through distributors. Third party distributors constantly adjust their product orders from the Company in response to:

- o The supply of the Company's and its competitors' products available to the distributor, and
- o The timing of new product introductions and relative features of the products.

Distributors may increase orders during times of product shortages, cancel orders if their inventory is too high or delay orders in anticipation of new products. If the Company has excess inventory, the Company may have to reduce its prices and write down inventory, which in turn could result in lower gross margins.

Short Product Life Cycles. The short life cycles of many of the Company's products pose a challenge for it to manage effectively the transition from existing products to new products. If the Company does not manage the transition effectively, its revenue and earnings could suffer. Among the factors that make a smooth transition from current products to new products difficult are delays in product development or manufacturing, variations in product costs and delays in customer purchases of existing products in anticipation of new product introductions. The Company's revenue and earnings could also suffer due to the timing of product or service introductions by its suppliers and competitors. Further, the Company's new products may replace or compete with certain of its own current products.

Intellectual Property. The Company generally relies upon patent, copyright, trademark and trade secret laws in the United States and in certain other

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countries, and agreements with its employees, customers and partners, to establish and maintain its proprietary rights in its technology and products. However, any of the Company's intellectual proprietary rights could be challenged, invalidated or circumvented. The Company's intellectual property may not necessarily provide significant competitive advantages. Also, because of the rapid pace of technological change in the information technology industry, many of the Company's products rely on key technologies developed by third parties, and the Company may not be able to continue to obtain licenses from these third parties. Third parties may claim that the Company is infringing their intellectual property. Even if the Company does not believe that its products are infringing third parties' intellectual property rights, the claims can be time-consuming and costly to defend and divert management's attention and resources away from its business. Claims of intellectual property infringement might also require the Company to enter into costly royalty or license agreements. If the Company cannot or does not license the infringed technology or substitute similar technology from another source, its business could suffer.

Reliance on Suppliers. The Company's manufacturing operations depend on its suppliers' ability to deliver quality components and products in time for it to meet critical manufacturing and distribution schedules. The Company sometimes experiences a short supply of certain component parts as a result of strong demand in the industry for those parts. If shortages or delays persist, its operating results could suffer until other sources can be developed. In order to secure components for the production of new products, at times the Company makes advance payments to suppliers, or the Company may enter into noncancelable purchase commitments with vendors. If the prices of these component parts then decrease after the Company has entered into binding price agreements, its earnings could suffer. Further, the Company may not be able to secure enough components at reasonable prices to build new products in a timely manner in the quantities and configurations needed. Conversely, a temporary oversupply of these parts could also affect its operating results.

International. Sales outside the United States make up more than 25% of the Company's revenues. In addition, key suppliers are also located outside of the United States. The Company's future earnings or financial position could be adversely affected by a variety of international factors, including:

- o Changes in a country or region's political or economic conditions,

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- o Trade protection measures,
- o Import or export licensing requirements,
- o The overlap of different tax structures,
- o Unexpected changes in regulatory requirements,
- o Differing technology standards,
- o Problems caused by the conversion of various European currencies to the Euro (see "Adoption of the Euro" section below), and
- o Natural disasters.

Market Risk. The Company is exposed to foreign currency exchange rate risk inherent in the Company's sales commitments, anticipated sales and assets and liabilities denominated in currencies other than the U.S. dollar. The Company is also exposed to interest rate risk inherent in its debt and investment

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portfolios. The Company's risk management strategy uses derivative financial instruments, primarily interest rate swaps, to hedge certain interest rate exposures. The Company's intent is to offset gains and losses that occur on the underlying exposures, with gains and losses on the derivative contracts hedging these exposures. The Company does not use foreign currency forward exchange contracts or purchased currency options to hedge local currency cash flows; however, foreign currency transaction gains or losses have not been material to the Company's results of operations. The Company does not enter into derivatives for trading purposes.

Acquisitions, Strategic Alliances, Joint Ventures and Divestitures. In the normal course of business, the Company frequently engages in discussions with third parties relating to possible acquisitions, strategic alliances, joint ventures and divestitures. The completion of any one transaction may have a material effect on the Company's financial position, results of operations or cash flows taken as a whole. Divestiture of a part of the Company's business may result in the cancellation of orders and charges to earnings. Acquisitions and strategic alliances may require the Company to integrate with a different company culture, management team and business infrastructure. The Company may also have to develop, manufacture and market products with its products in a way that enhances the performance of the combined business or product line. Depending on the size and complexity of an acquisition, the Company's successful integration of the entity into Boundless depends on a variety of factors, including:

- o The hiring and retention of key employees,
- o Management of facilities in separate geographic areas, and
- o The integration or coordination of different research and development and product manufacturing facilities.

All of these efforts require varying levels of management resources, which may divert the Company's attention from other business operations.

Environmental. Some of the Company's operations use substances regulated under various federal and state laws governing the environment. It is the Company's policy to apply strict standards for environmental protection to sites inside and outside the U.S., even when not subject to local government regulations. The Company records a liability for environmental remediation and related costs when the Company considers the costs to be probable and the amount of the costs can be reasonably estimated. Environmental costs are presently not material to the Company's results of operations or financial position.

Profit Margin. The Company's profit margins vary somewhat among its products, customer groups and geographic markets. Consequently, the Company's overall profitability in any given period is partially dependent on the product, customer and geographic mix reflected in that period's net revenue.

Stock Price. Boundless' stock price, like that of other technology companies, can be volatile. Some of the factors that can affect its stock price are:

- o The Company's, or a competitor's, announcement of new products, services or technological innovations,
- o Quarterly increases or decreases in the Company's earnings,
- o Changes in revenue or earnings estimates by the investment community, and

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- o Speculation in the press or investment community.

General market conditions and domestic or international macroeconomic factors unrelated to the Company's performance may also affect Boundless' stock price. For these reasons, investors should not rely on recent trends to predict future stock prices or financial results. In addition, following periods of volatility in a company's securities, securities class action litigation against a company is sometimes instituted. This type of litigation could result in substantial costs and the diversion of management time and resources.

Earnings Fluctuations. Although the Company believes that it has the products and resources needed for continuing success, the Company cannot reliably predict future revenue and margin trends. Actual trends may cause the Company to adjust its operations, which could cause period-to-period fluctuations in its earnings.

FORWARD-LOOKING INFORMATION MAY PROVE INACCURATE

This Form 10-Q contains forward-looking statements and information that are based on management's beliefs as well as assumptions made by and information currently available to management. When used in this document, the words "anticipate," "believe," "estimate," "expect," and, depending on the context, "will," and similar expressions are intended to identify forward-looking statements. Such statements reflect the Company's current views with respect to future events and are subject to certain risks, uncertainties and assumptions, including the specific risk factors described in the Company's Form 10-K for the year ended December 31, 2000. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, believed, estimated or expected. The Company does not intend to update these forward-looking statements and information.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's revolving credit facility and long-term debt obligations. The Company manages this risk through utilization of interest rate swap agreements in amounts not exceeding the principal amount of its outstanding obligations. At June 30, 2001 the Company had in place interest rate swap agreements in the amount of \$6,444 at an effective average interest rate of 8.62%. The balance of the swap agreement is intended as an effective hedge to interest rate changes against the outstanding balance of the Company's term and revolving loans.

The Company places its investments with high credit quality issuers and, by policy, is averse to principal loss and ensures the safety and preservation of its invested funds by limiting default risk, market risk and reinvestment risk. As of June 30, 2001 the Company's investments consisted of cash balances maintained in its corporate account with the Chase Manhattan Bank.

All sales arrangements with international customers are denominated in U.S. dollars. These customers are permitted to elect payment of their next month's orders in local currency based on an exchange rate provided one month in advance from the Company. The Company does not use foreign currency forward exchange contracts or purchased currency options to hedge local currency cash flows or for trading purposes. Foreign currency transaction gains or losses have not been material to the Company's results of operations.

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PART II - OTHER INFORMATION

Item 2. Changes in Securities and Use of Proceeds

- (c) During the quarter ended June 30, 2001, the Company sold to fourteen individuals (the "Subscribers") 947,877 shares of unregistered Common Stock of the Company for proceeds of \$964. Proceeds of the offering were used for general working capital purposes. Of the 947,877 shares, 116,854 shares were sold to seven employees of the Company, four of whom were executive officers. In addition, a member of the Company's Board of Directors participated in the sale, purchasing 23,149 shares of Common Stock. The purchase price was calculated by taking seventy (70%) of the average closing price of the Common Stock on the American Stock Exchange during the thirty (30) consecutive trading days ending on the trading date immediately preceding the purchase date. In connection with this sale, the Company granted to the Subscribers warrants to purchase 94,793 shares of the Company's Common Stock. The warrants are exercisable at between \$0.99 and \$1.19 per share of Common Stock and expire on the fifth anniversary from the date of issuance.

Item 5. Other Information

On June 29, 2001 the Company completed the sale of its thin client business to Neoware Systems, Inc., ("Neoware"). The sale included the Company's Cpio(R) product line, SAM Remote Administrator Software, associated intellectual properties and access to the existing thin client distribution and customer databases. The sale also included an outsourcing arrangement to continue to produce, service, and support the Cpio family of products for Neoware. Proceeds from the sale amounted to \$1,600. In connection with the purchase and outsourcing arrangement, Neoware made a direct equity investment in the Company of \$300 and received 333,334 shares of the Company's common stock as well as warrants to purchase an additional 33,334 shares of the Company's common stock at an exercise price of \$0.99 per share. The warrants expire five years from the date of original issuance.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 11: Statement Concerning Computation of Per Share Earnings is hereby incorporated by reference to "Condensed Consolidated Statements of Operations" of Part I-Financial Information, Item 1 - Financial Statements, contained in this Form 10-Q.

(b) Reports on Form 8-K - None

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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: August 13, 2001

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Boundless Corporation

By: /s/Joseph Gardner

Joseph Gardner
Vice President and Chief Financial Officer
(Principal Accounting and Financial Officer)

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