ZIX CORP
Form 10-Q
August 09, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2006

o **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: 0-17995
ZIX CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Texas	**75-2216818**
(State of Incorporation)	**(I.R.S. Employer Identification Number)**

2711 North Haskell Avenue
Suite 2200, LB 36
Dallas, Texas 75204-2960
(Address of Principal Executive Offices)
(214) 370-2000
(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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o **Accelerated filer** þ **Non-accelerated filer** o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at August 1, 2006
Common Stock, par value $.01 per share	59,638,839

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ZIX CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,569,000	$ 20,240,000
Restricted cash		5,100,000
Receivables, net	509,000	149,000
Prepaid and other current assets	1,421,000	1,845,000
Total current assets	21,499,000	27,334,000
Restricted cash	35,000	35,000
Property and equipment, net	3,100,000	3,652,000
Intangible assets, net	199,000	559,000
Goodwill	2,161,000	2,161,000
Deferred financing costs and other assets	87,000	374,000
	$ 27,081,000	$ 34,115,000
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 880,000	$ 1,313,000
Accrued expenses	3,496,000	3,749,000
Deferred revenue	7,988,000	7,087,000
Customer deposit	2,000,000	1,000,000
Capital lease obligations	40,000	165,000
Promissory note payable	2,437,000	
Short-term note payable	115,000	268,000
Convertible promissory note payable		4,404,000
Total current liabilities	16,956,000	17,986,000
Long-term liabilities:		
Deferred revenue	1,509,000	1,261,000
Derivative liabilities	3,231,000	
Customer deposit		2,000,000
Promissory note payable		2,226,000
Deferred rent	349,000	245,000
Total long-term liabilities	5,089,000	5,732,000
	22,045,000	23,718,000
Contingencies (Note 15)		
Stockholders equity:		
Preferred stock, $1 par value, 10,000,000 shares authorized; none issued and outstanding		

Common stock, $0.01 par value, 175,000,000 shares authorized; 61,966,020 issued and 59,638,839 outstanding in 2006 and 51,932,561 issued and 49,605,380 outstanding in 2005	620,000	519,000
Additional paid-in capital	314,959,000	308,461,000
Treasury stock, at cost; 2,327,181 common shares in 2006 and 2005	(11,507,000)	(11,507,000)
Accumulated deficit	(299,036,000)	(287,076,000)
Total stockholders equity	5,036,000	10,397,000
	$ 27,081,000	$ 34,115,000

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Revenues:				
Services	$ 4,209,000	$ 3,199,000	$ 8,104,000	$ 6,497,000
Hardware		241,000		426,000
Software		9,000		109,000
Total revenues	4,209,000	3,449,000	8,104,000	7,032,000
Cost of revenues	3,090,000	3,508,000	6,465,000	7,399,000
Gross margin (loss)	1,119,000	(59,000)	1,639,000	(367,000)
Operating expenses:				
Research and development expenses	1,626,000	1,535,000	3,221,000	3,510,000
Selling, general and administrative expenses	6,549,000	6,559,000	13,141,000	14,061,000
Customer deposit forfeiture		(960,000)	(1,000,000)	(960,000)
Gain on sale of product lines				(950,000)
Total operating expenses	8,175,000	7,134,000	15,362,000	15,661,000
Operating loss	(7,056,000)	(7,193,000)	(13,723,000)	(16,028,000)
Other (expense) income:				
Investment and other income	294,000	143,000	511,000	286,000
Interest expense	(477,000)	(1,996,000)	(895,000)	(2,826,000)
Gain on derivative liabilities	2,930,000		2,930,000	
Loss on extinguishment of convertible debt	(871,000)		(871,000)	
Total other (expense) income	1,876,000	(1,853,000)	1,675,000	(2,540,000)
Loss before income taxes	(5,180,000)	(9,046,000)	(12,048,000)	(18,568,000)
Income tax benefit	94,000	131,000	88,000	81,000
Net loss	$ (5,086,000)	$ (8,915,000)	$ (11,960,000)	$ (18,487,000)
Basic and diluted loss per common share	$ (0.09)	$ (0.28)	$ (0.22)	$ (0.57)
Basic and diluted weighted average common shares outstanding	59,200,723	32,391,777	54,453,902	32,343,737

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(Unaudited)

	Stockholders Equity					
	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Total Stockholders Equity
Balance, January 1, 2006	51,932,561	$ 519,000	$ 308,461,000	$ (11,507,000)	$ (287,076,000)	$ 10,397,000
Issuance of common stock and related warrants upon private investment (net of issuance costs)	9,930,000	100,000	4,449,000			4,549,000
Valuation of warrants issued to brokers of the private placement of common stock			199,000			199,000
Common stock issued to employees for compensation in lieu of cash	82,196	1,000	156,000			157,000
Common stock issued in lieu of cash for third-party services	21,263		30,000			30,000
Employee share-based compensation costs			1,440,000			1,440,000
Valuation of additional warrants issued relating to the convertible promissory notes payable			50,000			50,000
Valuation of beneficial conversion feature in convertible promissory note resulting from the private placement of common stock			459,000			459,000
Valuation of additional			74,000			74,000

anti-dilutive warrants issued upon private placement of common stock						
Valuation of additional warrants issued upon retirement of convertible promissory note			6,000			6,000
Reversal of unamortized valuation of beneficial conversion feature upon retirement of convertible promissory note			(365,000)			(365,000)
Net loss					(11,960,000)	(11,960,000)
Balance, June 30, 2006	61,966,020	$ 620,000	$ 314,959,000	$ (11,507,000)	$ (299,036,000)	$ 5,036,000

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2006	**2005**
Operating activities:		
Net loss	$ (11,960,000)	$ (18,487,000)
Non-cash items in net loss:		
Depreciation and amortization	1,545,000	2,195,000
Amortization of debt discount / premium, financing costs and other	686,000	2,198,000
Value of additional warrants issued	10,000	
Common stock issued to employees and non-employee in lieu of cash	187,000	243,000
Loss on extinguishment of convertible debt	871,000	
Gain on derivative liabilities	(2,930,000)	
Employee share-based compensation costs	1,440,000	
Customer deposit forfeiture	(1,000,000)	(960,000)
Changes in deferred taxes	(87,000)	
Common stock issued in lieu of cash interest payments		267,000
Non-employee stock-based compensation costs		119,000
Gain on sale of product line		(950,000)
Changes in operating assets and liabilities		
Accounts receivable	(360,000)	234,000
Other assets	443,000	682,000
Accounts payable	(393,000)	(542,000)
Deferred revenue	1,149,000	1,820,000
Accrued and other liabilities	(205,000)	8,000
Net cash used by operating activities	(10,604,000)	(13,173,000)
Investing activities:		
Purchases of property and equipment	(692,000)	(1,010,000)
Sales and maturities of marketable securities		16,000,000
Purchase of restricted cash investment		(38,000)
Proceeds from restricted cash investments	5,100,000	
Proceeds from sale of product lines		2,309,000
Net cash provided by investing activities	4,408,000	17,261,000
Financing activities:		
Proceeds from private placement of common stock	11,817,000	
Payment of expenses relating to private placement of common stock	(814,000)	
Payment of convertible debt	(5,000,000)	
Payment of premium on convertible debt	(200,000)	
Payment of short-term note payable, capital leases and other	(278,000)	(274,000)
Proceeds from exercise of stock options		3,000
Net cash provided (used) by financing activities	5,525,000	(271,000)
(Decrease) increase in cash and cash equivalents	(671,000)	3,817,000
Cash and cash equivalents, beginning of period	20,240,000	3,856,000

Cash and cash equivalents, end of period	$ 19,569,000	$ 7,673,000

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated financial statements of Zix Corporation (ZixCorp or the Company) should be read in conjunction with the audited consolidated financial statements included in the Company s 2005 Annual Report to Shareholders on Form 10-K. These financial statements are unaudited, but have been prepared in the ordinary course of business for the purpose of providing information with respect to the interim periods. Management of the Company believes that all adjustments necessary for a fair presentation for such periods have been included and are of a normal recurring nature. The results of operations for the three and six-month periods ended June 30, 2006, are not necessarily indicative of the results to be expected for the full year.

2. Company Overview and Liquidity

As of January 1, 2006, the Company operates two reporting segments, Email Encryption and e-Prescribing, which provide services that protect, manage and deliver sensitive electronic information and provide electronic prescribing at the point of care.

Email Encryption is a comprehensive suite of secure messaging services, which allows an enterprise to use policy driven rules to determine which emails need to be sent securely in order to comply with regulations or corporate policy. Email Encryption is commonly referred to as Secure Messaging. e-Prescribing consists of a single product line named PocketScript. PocketScript is an electronic prescribing service that allows physicians to use a handheld device to prescribe drugs and transmit the prescription electronically to any pharmacy. During the prescribing process, the physician is provided with real-time information such as insurance formulary and drug interactions that normally would not be available in a paper prescription format. This allows the physician to leverage technology for better patient care at the point of delivery. The Company s Email Encryption and e-Prescribing services are primarily offered as a hosted-service solution, whereby customers pay for annual service subscription contracts at the inception of the service period. These service solutions require a significant up-front investment to establish service and secure enough subscribers to make the business profitable.

Prior to January 1, 2006, the Company was operated and managed as a single reporting segment.

Company History

In 1999, the Company began developing and marketing Secure Messaging products and services that brought privacy, security and convenience to Internet users. ZixMail, a desktop solution for encrypting and securely delivering email, was first commercially introduced in the first quarter of 2001. In 2002, the Company began offering additional email encryption products such as:

ZixVPM (Virtual Private Messenger): an e-messaging gateway service that provides company-wide privacy protection for inbound and outbound email communications.

ZixAuditor: an assessment service used to analyze email traffic patterns and monitor compliance with corporate and regulatory policies.

ZixPort: a secure Web-messaging portal.

In July 2003, the Company acquired substantially all of the operating assets and the business of PocketScript, LLC (PocketScript), a privately-held development stage enterprise that provided electronic prescription services for the healthcare industry. This acquisition enabled the Company to expand its services into healthcare delivery solutions, specifically, the e-Prescribing marketplace. PocketScript is the cornerstone offering in the current e-Prescribing product segment.

In September 2003, the Company acquired substantially all of the operating assets and the business of Elron Software, Inc. ((Elron Software or Elron), a majority-owned subsidiary of Elron Electronic Industries Ltd. and a provider of anti-spam, email content filtering and Web filtering solutions, which enhanced the Company s then-Secure Messaging product segment.

In January 2004, the Company acquired substantially all of the operating assets and the business of MyDocOnline, Inc. (MyDocOnline), a subsidiary of Aventis Pharmaceuticals, Inc., the North American pharmaceuticals business of Aventis SA.

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MyDocOnline offered a variety of Internet-based healthcare services and was a provider of secure Web-based communications, disease management, online doctor visits, and laboratory information solutions.

Also in 2004, Secure Messaging was combined with the Message Inspector and Web Inspector products (MI/WI) and referred to as the eSecure product line and e-Prescribing was combined with the Dr. Chart product and referred to as the eHealth product line.

In late 2004, the Company made a strategic decision to focus the Company s resources and efforts towards the two core products of the then-Secure Messaging and e-Prescribing. Subsequently, on November 4, 2004, the Company announced that it was terminating the Connect service for online doctor visits, which was one of the products acquired in the MyDocOnline acquisition.

On March 11, 2005, MI/WI product lines, which were acquired in the Elron acquisition, were sold to CyberGuard (see Note 7).

On September 30, 2005, the Company sold the remaining MyDocOnline product (Dr. Chart) to MITEM (see Note 7).

In early 2006, the eSecure product line was renamed Email Encryption and the eHealth product line was renamed e-Prescribing to reflect the single product focus in these two remaining core product lines.

Due to the Company s history of operating with spending in excess of customer receipts, liquidity is of special importance. To date, the Company s cash flow from operations has not been sufficient to fund the Company s on-going operations and the Company has relied on equity and debt financings to fund its operations. Essential to liquidity is the ability of the Company to achieve and retain subscriber bases in both core product offerings to overcome the costs of offering the service and become cash flow positive.

The Company announced in the second quarter of 2006 that it was in the process of reducing its quarterly spending by a 15% reduction in workforce, principally in non-revenue-related headcount positions. Further, non-workforce costs would be reviewed and appropriate reductions in these cost areas would also be made with a 15% reduction target. On August 8, 2006, the Company announced that the targeted cost reductions would be increased from 15% to 25% by the end of 2006. As of August 1, 2006, the Company has taken actions to achieve roughly half of the planned cost reductions. The purpose of these reductions is to streamline the Company s operating costs in order to strengthen the Company s liquidity position by more closely matching its cost structure to short-term revenue opportunities.

The Company cannot estimate the total costs to be incurred for one-time termination benefits resulting from the planned reduction in force. For the three-month and six-month periods ending June 30, 2006, the Company recorded one-time termination expenses of $345,000. As of June 30, 2006, $249,000 were accrued and are expected to be paid during the remainder of 2006, primarily in the third quarter. Further, these expenses were classified in the Company s condensed consolidated statement of operations as follows: $3,000 for Cost of Revenues, $13,000 for Research & Development expenses and $329,000 for Selling, General and Administrative expenses. The impact of the severance expenses on the Company s segments is as follows: $29,000 for Email Encryption, $138,000 for e-Prescribing and $178,000 for Corporate.

Based on the Company s size after the cost reduction actions taken in 2006 and current order and deployment rates as of June 30, 2006, the operating spending plus capital asset purchases for the next twelve months is projected to be $35,500,000 to $37,000,000. Using flat year-on-year order rates for Email Encryption, consistent renewal rates for subscribers, and an expectation of cash flow only from payors with whom the Company has a current relationship, cash receipt projections for the next twelve months are projected to be $23,500,000 to $24,500,000. These cash receipt projections, when combined with $19,569,000 unrestricted cash on hand at June 30, 2006 provide for an estimated $43,069,000 to $44,069,000 in cash available to fund the expected operational spending for the next twelve months.

The Company believes it has adequate resources and liquidity to sustain operations for at least the next twelve months and is targeting cash flow improvements to augment its liquidity beyond that time, taking into account the following factors: relatively low contractual spending commitments over the next twelve months, historically high renewal rates for Email Encryption, continued growth in the Email Encryption business consistent with historical growth levels, increased mix of cash receipts attributable to the more profitable out years of contracts, the discretionary nature of the cash spend in excess of cash receipts in the emerging area of e-Prescribing and general flexibility of spending in other areas.

As contractual cash collections and expected increases in cash sources are not always certain, the Company has some ability to adjust cash spending to react to any shortfalls in actual cash collections or to adjust spending in certain investment areas should cash receipts make that possible or, if warranted and if the terms are acceptable, with additional external financing, receipts from exercised stock options and warrants of the Company s common stock or strategic partnerships. However, operating in emerging and developing markets involves risk and uncertainties, and there are no assurances that the Company will ultimately achieve or achieve in a sufficiently timely manner its targeted improvements in operating performance. Beyond the twelve months beginning July 1, 2006, and should business results not have improved sufficiently as projected, the Company could have to alter its business plan or further augment its cash flow position through cost reduction measures, sales of assets, additional financings or a combination of these actions. However, there can be no assurance that the Company would be successful in carrying out any of these measures should they become necessary. The Company has expressed a lack of willingness, relative to other alternatives, to raise capital by issuing new shares of common stock given the current price of the Company s common stock. Accordingly, the extent and timing of success, or lack thereof, in the e-Prescribing market and continued improvement in Email Encryption will ultimately be the most significant operational determinants of liquidity.

3. Revenue and Significant Customers

The Company recognizes revenue in accordance with accounting principles generally accepted in the United States of America, as promulgated by Statement of Position (SOP) 97-2, *Software Revenue Recognition,* SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With respect to Certain Transactions,* Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables,* and Securities and Exchange Commission Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements,* and other related pronouncements.

The Company develops, markets, licenses and supports electronic information protection services and related software products. The Company s services can be placed into several key revenue categories where each category has similar revenue recognition traits; Email Encryption subscription-based services, e-Prescribing service, various transaction fees and related professional services. A majority of the revenues generated by the Company are through direct sales; however, the Company employs a network of distributors and resellers. Under all product categories and distribution models, the Company recognizes revenue after all of the following occur: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed and determinable, and collectability is reasonably assured. In the event the arrangement has multiple elements with delivered and undelivered elements, revenue for the delivered elements are recognized under the residual method only when vendor-specific objective evidence of fair value (VSOE) exists to allocate the fair value of the total fees to the undelivered elements of the arrangement. Occasionally, when ZixCorp is engaged in a complex product deployment, customer acceptance may have to occur before the transaction is considered complete. In this situation no revenue is recognized until the customer accepts the product. Discounts provided to customers are recorded as reductions in revenue.

The Email Encryption services of ZixMail, ZixVPM, ZixPort, and ZixDirect are subscription-based services. In the first six months of 2005, subscription-based services also included Dr. Chart. Providing these services includes delivering licensed software and providing secure electronic communications and customer support throughout the subscription period. In the case of ZixVPM, typically, as part of the service, an appliance with pre-installed software is installed at the customer site at the beginning of the subscription period. In a subscription service, the customer does not own a perpetual right to a software license, but is instead granted the use of that license during the period of the service subscription. Subscriptions are generally multiple-year contracts that are irrevocable and non-refundable in nature and require annual, up-front payments. The subscription period begins on the date specified by the parties or when the service is fully functional for the customer which is consequently deemed to be the date of acceptance. Revenues from subscription services are recorded as service revenue as the services are rendered from the date of acceptance over the subscription period. Subscription fees received from customers in advance are recorded as deferred revenue and recognized as revenue ratably over the subscription period.

On September 30, 2005, the Dr. Chart product line was sold to MITEM. This product line was acquired in January 2004 through the acquisition of MyDocOnline, Inc. For the three and six-month periods ended June 30, 2005, Dr. Chart product line contributed $125,000 and $195,000 in revenue, respectively (see Note 7).

e-Prescribing service arrangements contain multiple deliverables including both hardware and services. Due to the lack of VSOE, these elements are combined into a single unit of accounting and, similar to Email Encryption, recognized as service revenue ratably over the longer of the subscription term or expected renewal period. Revenue recognition begins upon installation of the required hardware and commencement of service. Prior to the third quarter 2005, the Company did maintain VSOE for certain service elements of the e-Prescribing service. Accordingly, the residual value assigned to the PocketScript handheld device was recognized as revenue upon installation. The fair value of the undelivered services are being recognized ratably over period in which those services are delivered.

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In the first quarter 2005, the Company sold anti-spam filtering, email content filtering, and Web filtering solutions under the MI/WI product lines to customers under perpetual licensing arrangements. These perpetual software licenses were normally sold as part of multiple-element arrangements that included annual maintenance and/or subscription, and may have included implementation or training services. Evidence of VSOE for implementation and training services associated with the anti-spam, email content filtering and Web filtering arrangements was based upon standard billing rates and the estimated level of effort for the individuals expected to perform the related services. Installation and training revenues were recognized as the services were rendered. The Company established VSOE for maintenance based upon maintenance that was sold separately. Maintenance revenue was recognized over the term of the maintenance agreement, generally one year.

On March 11, 2005, the MI/WI product lines were sold to CyberGuard. For the three and six-month periods ended June 30, 2005, MI/WI contributed $9,000 and $646,000 in revenue, respectively (see Note 7).

Some of the Company s services incorporate a transaction fee per event occurrence or when predetermined usage levels have been reached. These fees are recognized as revenue when the transaction occurs or when the predetermined usage levels have been achieved, and when the amounts are fixed and determinable.

The Company does not offer standalone professional services. Further, the Company s services include various warranty provisions; however, warranty expense was not material to any period presented.

For the three months ended June 30, 2006 and 2005, Blue Cross and Blue Shield of Massachusetts, Inc., an e-Prescribing customer, accounted for approximately 10% ($425,000) and 21% ($711,000) of total revenues, respectively. No other single customer accounted for 10% or more of the Company s total revenues for the three months ended June 30, 2006 and 2005. For the six months ended June 30, 2006 and 2005, Blue Cross and Blue Shield of Massachusetts, Inc., an e-Prescribing customer, accounted for approximately 10% ($784,000) and 20% ($1,385,000) of total revenues, respectively. No other single customer accounted for 10% or more of the Company s total revenues for the six months ended June 30, 2006 and 2005.

4. Segment Information

As of January 1, 2006, the Company began to manage its business in two reportable segments: Email Encryption and e-Prescribing as discussed in Note 2.

The Company s Chief Executive Officer is the chief operating decisions maker (CODM) in assessing the performance of each segment and determining the related allocation of resources.

To determine the allocation of resources the CODM generally assesses the performance of each segment based on revenue, gross margin, and direct expenses which include research and development expenses and selling and marketing expenses that are directly attributable to the segments. Most assets and most corporate costs are not allocated to the segments and are not used to determine resource allocation. Any transactions that are considered a one-time occurrence or not likely to be repeated in future periods are excluded from the CODM s assessments. The accounting policies of the reportable segments are the same as those applied to the condensed consolidated financial statements.

Corporate includes charges such as corporate management, compliance and other non-operational activities that cannot be directly attributed to a reporting segment. In addition, corporate also includes the revenues and direct costs of products that have been sold or otherwise discontinued by the Company. In 2005, the Company sold two product lines: MI/WI and Dr. Chart (see Note 7). These products contributed $134,000 and $841,000 of revenue in the three and six months ended June 30, 2005, respectively.

Prior to January 1, 2006, the Company was operated and managed as a single reporting unit. Amounts shown below for any period prior to January 1, 2006, are estimations prepared for comparative purposes only.

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	Three Months Ended June 30, 2006				Three Months Ended June 30, 2005			
	Email Encryption	**e-Prescribing**	**Corporate**	**Total**	**Email Encryption**	**e-Prescribing**	**Corporate**	**Total**
Revenues	$ 3,369,000	$ 840,000	$	$ 4,209,000	$ 2,434,000	$ 881,000	$ 134,000	$ 3,449,000
Cost of revenues	1,319,000	1,771,000		3,090,000	1,350,000	1,731,000	427,000	3,508,000
Gross margin (loss)	2,050,000	(931,000)		1,119,000	1,084,000	(850,000)	(293,000)	(59,000)
Direct expenses	2,897,000	2,745,000		5,642,000	3,059,000	2,273,000	240,000	5,572,000
Segment (loss)	(847,000)	(3,676,000)		(4,523,000)	(1,975,000)	(3,123,000)	(533,000)	(5,631,000)
Unallocated (expense) / income								
Marketing, general and administrative expense			(2,533,000)	(2,533,000)			(2,522,000)	(2,522,000)
Customer deposit forfeiture							960,000	960,000
Gain on derivatives			2,930,000	2,930,000				
Loss on extinguishment of debt			(871,000)	(871,000)				
Investment and other income			294,000	294,000		&nbs		