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UPGRADE INTERNATIONAL CORP /FL/
Form 10QSB
February 19, 2002

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended DECEMBER 31, 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 No. 0-27649

UPGRADE INTERNATIONAL CORPORATION
(Exact name of small business issuer as specified in its charter)

Washington _____ 58-2441311

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

1411 FOURTH AVENUE - SUITE 629 SEATTLE, WASHINGTON 98101
(Address of principal executive offices)

(206) 903-3116
(Issuer's telephone number, including area code)

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

YES x NO
--- ---

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: As of January 31, 2002, 41,331,578 shares of common stock, \$.0001 par value were outstanding.

Transitional Small Business Disclosure Format (Check one): Yes No

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PART I - Financial Information

Item 1. Financial Statements

Consolidated balance sheets at September 30, 2001 (audited) and December 31, 2001 (unaudited)

Consolidated statements of operations for the three months ended December 31, 2000 and 2001 (unaudited) and cumulative since inception (February 5, 1997) through December 31, 2001 (unaudited)

Consolidated statement of stockholders' equity since inception through September 30, 2001 and for the period ended December 31, 2001 (unaudited)

Consolidated statement of cash flows for the three months ended December 31, 2000 and 2001 (unaudited) and cumulative since inception (February 5, 1997) through December 31, 2001 (unaudited)

Notes to the Financial Statements (unaudited)

Item 2. Management's Discussion and Analysis or Plan of Operation

PART II - Other Information

Item 1. Legal Proceedings

Item 2. Changes In Securities and Use of Proceeds

Item 5. Other Information

Item 6. Exhibits and Reports on Form 8 - K

Signatures

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED BALANCE SHEETS

ASSETS

| | September 30, 2001 | December 31, 2001 |
|---------------------------|-----------------------|----------------------|
| | ----- | ----- |
| | | (unaudited) |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 2,551,465 | \$ 350,928 |

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| | | |
|---|---------------|--------------|
| Restricted deposit | 300,000 | 300,000 |
| Subscriptions receivable | 500,000 | - |
| Note receivable from related party | 135,243 | 137,864 |
| Prepaid expenses, deposits and other | 110,022 | 109,190 |
| | ----- | ----- |
| Total current assets | 3,596,730 | 897,982 |
| PROPERTY AND EQUIPMENT - AT COST, less accumulated depreciation and amortization | 2,071,663 | 2,055,707 |
| SPUTTERING MACHINE, held for sale | 2,000,000 | 2,000,000 |
| ADVANCES TO ROCKSTER GROUP | 1,084,000 | 1,449,000 |
| OTHER ASSETS | | |
| Intangible and deferred assets, net of accumulated amortization | 466,256 | 361,969 |
| Acquisition deposits | 1,820,715 | 1,820,715 |
| Deposits | 194,128 | 194,128 |
| | ----- | ----- |
| Total assets | \$ 11,233,492 | \$ 8,779,501 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 3,853,950 | \$ 3,769,004 |
| Payable to related parties | 5,503,022 | 3,471,810 |
| Accrued liabilities | 2,972,713 | 2,233,380 |
| Notes payable | 1,717,231 | 2,474,874 |
| Convertible debentures, net of unamortized discount | - | 1,075,756 |
| Equipment purchase contract payable | 2,024,748 | 2,024,748 |
| Royalty fee payable to Card Tech, Inc. | 1,161,873 | 2,233,168 |
| | ----- | ----- |
| Total current liabilities | 17,233,537 | 17,282,740 |
| CONVERTIBLE DEBENTURES, net of unamortized discount | 2,004,488 | - |
| MINORITY INTEREST | 1,473,179 | 46,179 |
| COMMITMENTS AND CONTINGENCIES | - | - |
| STOCKHOLDERS' DEFICIT | | |
| Common stock - \$.0001 par value, 100,000,000 shares authorized | 24,524 | 37,918 |
| Stock subscriptions | 2,742,586 | 1,372,553 |
| Additional paid in capital | 53,947,618 | 68,219,820 |
| Deferred compensation | (498,559) | (449,233) |
| Receivable from stockholders of subsidiary | (266,621) | (266,621) |
| Accumulated development stage deficit | (65,427,260) | (77,463,855) |
| | ----- | ----- |
| | (9,477,712) | (8,549,418) |
| | ----- | ----- |
| Total liabilities and stockholders' deficit | \$ 11,233,492 | \$ 8,779,501 |
| | ===== | ===== |

The accompanying notes are an integral part of these statements.

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

| | Three months ended December 31, | | Cumulative |
|---|---------------------------------|---------------|--------------|
| | 2000 | 2001 | results |
| | | | operations |
| | | | inception |
| | | | (February 5, |
| | | | 2000) |
| Costs and expenses | | | |
| Research and development | \$ 2,414,425 | \$ 1,778,670 | \$ 16,3 |
| Purchased in-process research and development | - | - | 5,9 |
| Sales and marketing | 713,837 | 107,390 | 5,3 |
| General and administrative | 1,599,790 | 2,321,098 | 25,2 |
| | 4,728,052 | 4,207,158 | 52,8 |
| Other expenses | | | |
| Equity in losses of UltraCard | - | - | 1,2 |
| Interest expense | 303,112 | 7,614,950 | 14,3 |
| Loss on advances to Pathway | - | - | 3,5 |
| Other, net | 24,205 | 913,839 | 2,6 |
| | 328,317 | 8,528,789 | 21,8 |
| Minority interest in losses of subsidiaries | - | (699,352) | (3,2 |
| NET LOSS | \$ 5,056,369 | \$ 12,036,595 | \$ 71,4 |
| LOSS PER COMMON SHARE-BASIC AND DILUTED | \$ 0.24 | \$ 0.36 | \$ |

The accompanying notes are an integral part of these statements.

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

STATEMENT OF STOCKHOLDERS' EQUITY

Since inception through September 30, 2001 and December 31, 2001 (unaudited)

| Voting common stock | | Common stock subscribed | | Additional | Def |
|---------------------|--------|-------------------------|--------|------------|------|
| Shares | Amount | Shares | Amount | paid-in | comp |
| | | | | capital | |
| | | | | | |

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| | | | | | | | | | |
|--|------------|----|--------|---|-------------|---|-----------|---|----------|
| Balance at February 5, 1997 | - | \$ | - | - | \$ | - | \$ | - | \$ |
| Issuance of founder's shares at \$.03 per share in February 1997 adjusted for December 1997 1:2 reverse stock split | 500,000 | | 500 | | - | | - | | 29,500 |
| Issuance of common stock in February 1997 at \$.10 per share adjusted for December 1997 1:2 reverse stock split | 29,000 | | 29 | | - | | - | | 5,771 |
| Issuance of common stock at \$.0025 per share in December 1997 Reg. D Rule 504 offering | 4,000,000 | | 4,000 | | - | | - | | 6,000 |
| Issuance of common stock in December 1997 to an officer in exchange for property contribution | 4,000,000 | | 4,000 | | - | | - | | 47,250 |
| Sale of common stock at \$.50 per share in January 1998 Reg. D Rule 504 offering | 1,680,988 | | 1,681 | | - | | - | | 838,813 |
| Common stock subscribed in September 1998 at \$.065 per share | - | | - | | 2,250,000 | | 146,250 | | - |
| Net loss for the year ended September 30, 1998 | - | | - | | - | | - | | - |
| Balances at September 30, 1998 | 10,209,988 | | 10,210 | | 2,250,000 | | 146,250 | | 927,334 |
| Issuance of subscribed shares in November 1998 Reg. D Rule 04 offering | 2,250,000 | | 2,250 | | (2,250,000) | | (146,250) | | 144,000 |
| Issuance of common stock in January 1999 to satisfy trade liabilities | 437,500 | | 438 | | - | | - | | 103,312 |
| Issuance of common stock warrants at \$.25 per share in January 1999 | - | | - | | - | | - | | 221,000 |
| Common stock subscribed at \$1.80 per share in February 1999 private placement | - | | - | | 999,999 | | 1,799,998 | | - |
| Issuance of common stock warrants for services in August 1999 | - | | - | | - | | - | | 64,155 |
| Common stock subscribed at \$.25 per share in August 1999 through exercise of common stock warrants | - | | - | | 27,500 | | 71,030 | | (64,155) |
| Issuance of common stock | | | | | | | | | |

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| | | | | | |
|---|--------|---------------------------------------|----|-------------|---------|
| warrants and options at exercise prices of \$.25 and \$2.50 per share in September 1999 for services | - | - | - | - | 671,893 |
| Issuance of common stock at \$.25 per share in September 1999 through exercise of employee stock options | 60,000 | 60 | - | - | 14,940 |
| | | Accumulated Development stage deficit | | Total | |
| | | ----- | | ----- | |
| Balance at February 5, 1997 | \$ | - | \$ | - | |
| Issuance of founder's shares at \$.03 per share in February 1997 adjusted for December 1997 1:2 reverse stock split | | - | | 30,000 | |
| Issuance of common stock in February 1997 at \$.10 per share adjusted for December 1997 1:2 reverse stock split | | - | | 5,800 | |
| Issuance of common stock at \$.0025 per share in December 1997 Reg. D Rule 504 offering | | - | | 10,000 | |
| Issuance of common stock in December 1997 to an officer in exchange for property contribution | | - | | 51,250 | |
| Sale of common stock at \$.50 per share in January 1998 Reg. D Rule 504 offering | | - | | 840,494 | |
| Common stock subscribed in September 1998 at \$.065 per share | | - | | 146,250 | |
| Net loss for the year ended September 30, 1998 | | (1,213,530) | | (1,213,530) | |
| Balances at September 30, 1998 | | (1,213,530) | | (129,736) | |
| Issuance of subscribed shares in November 1998 Reg. D Rule 04 offering | | - | | - | |
| Issuance of common stock in January 1999 to satisfy trade liabilities | | - | | 103,750 | |
| Issuance of common stock warrants at \$.25 per share in January 1999 | | - | | 221,000 | |

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| | | |
|---|---|-----------|
| Common stock subscribed at \$1.80 per share in February 1999 private placement | - | 1,799,998 |
| Issuance of common stock warrants for services in August 1999 | - | 64,155 |
| Common stock subscribed at \$.25 per share in August 1999 through exercise of common stock warrants | - | 6,875 |
| Issuance of common stock warrants and options at exercise prices of \$.25 and \$2.50 per share in September 1999 for services | - | 671,893 |
| Issuance of common stock at \$.25 per share in September 1999 through exercise of employee stock options | - | 15,000 |

Continued
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Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - Continued

Since inception through September 30, 2001 and December 31, 2001 (unaudited)

| | Voting common stock | | Common stock subscribed | | Additional paid-in capital |
|---|---------------------|--------|-------------------------|------------|----------------------------|
| | Shares | Amount | Shares | Amount | |
| Common shares subscribed at \$2.50 per share in September 1999 | - | - | 4,189,434 | 10,473,585 | - |
| Receivable from UltraCard stockholders for payroll taxes and related charges in connection with stock issued by UltraCard as compensation | - | - | - | - | - |
| Net loss for the year ended September 30, 1999 | - | - | - | - | - |
| Balances at September 30, 1999 | 12,957,488 | 12,958 | 5,216,933 | 12,344,613 | 2,082,479 |
| Common shares subscribed by a broker at \$2.50 per share in October 1999 in connection | | | | | |

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| | | | | | |
|---|--------------|-------|---|--------------|------------|
| with placement of \$1 million in convertible debentures | - | - | 16,000 | 40,000 | (40,000) |
| Issuance of common stock warrants with a strike price of \$.25 per share in October 1999 | - | - | - | - | 339,500 |
| Issuance of subscribed shares in November 1999 | 999,999 | 1,000 | (999,999) | (1,799,998) | 1,798,998 |
| Issuance of common shares, including shares subscribed, in November 1999 at \$2.50 per share, net of expenses | 4,652,281 | 4,652 | (4,045,583) | (10,113,957) | 11,521,038 |
| Common shares subscribed by a broker at \$2.50 per share in November 1999 in connection November 2000 private placements | - | - | 24,000 | 60,000 | (60,000) |
| Issuance of common stock at \$.25 per share in December 1999 through exercise of employee stock options | 90,000 | 90 | - | - | 22,410 |
| Common shares issued for services in December 1999 | 70,000 | 70 | - | - | 242,830 |
| Allocation of debenture proceeds to beneficial conversion feature | - | - | - | - | 676,360 |
| Allocation of debenture proceeds to stock warrants | - | - | - | - | 323,640 |
| Issuance of common stock at \$44 per share in January 2000 through a private placement, net of expenses | 100,000 | 100 | - | - | 4,289,900 |
| Issuance of common stock at \$.25 and \$2.50 per share in February 2000 through exercise of stock warrants | 294,449 | 295 | - | - | 304,046 |
| | | | Accumulated Development stage deficit | Total | |
| | | | ----- | ----- | |
| Common shares subscribed at \$2.50 per share in September 1999 | | - | | 10,473,585 | |
| Receivable from UltraCard stockholders for payroll taxes and related charges in connection with stock issued by UltraCard as compensation | | - | | (400,000) | |
| Net loss for the year ended September 30, 1999 | (10,623,048) | | | (10,623,048) | |

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| | ----- | ----- |
|--|--------------|-----------|
| Balances at September 30, 1999 | (11,836,578) | 2,203,472 |
| Common shares subscribed by a broker at \$2.50 per share in October 1999 in connection with placement of \$1 million in convertible debentures | - | - |
| Issuance of common stock warrants with a strike price of \$.25 per share in October 1999 | - | 339,500 |
| Issuance of subscribed shares in November 1999 | - | - |
| Issuance of common shares, including shares subscribed, in November 1999 at \$2.50 per share, net of expenses | - | 1,411,733 |
| Common shares subscribed by a broker at \$2.50 per share in November 1999 in connection November 2000 private placements | - | - |
| Issuance of common stock at \$.25 per share in December 1999 through exercise of employee stock options | - | 22,500 |
| Common shares issued for services in December 1999 | - | 242,900 |
| Allocation of debenture proceeds to beneficial conversion feature | - | 676,360 |
| Allocation of debenture proceeds to stock warrants | - | 323,640 |
| Issuance of common stock at \$44 per share in January 2000 through a private placement, net of expenses | - | 4,290,000 |
| Issuance of common stock at \$.25 and \$2.50 per share in February 2000 through exercise of stock warrants | - | 304,341 |

Continued

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Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - Continued

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Since inception through September 30, 2001 and December 31, 2001 (unaudited)

| | Voting common stock | | Common stock subscribed | | Additional paid-in capital | Deferred compensation |
|--|---------------------|--------|-------------------------|-----------|----------------------------|-----------------------|
| | Shares | Amount | Shares | Amount | | |
| Issuance of common stock in February 2000 subscribed to in August 2000 through exercise of common stock warrants | 27,500 | 27 | (27,500) | (71,030) | 71,003 | |
| Issuance of common stock in April 2000 in connection with reverse acquisition of Second CMA, Inc. | 45,000 | 45 | - | - | 1,155 | |
| Issuance of common stock options with a strike price of \$10.00 per share in April 2000 for legal services | - | - | - | - | 1,047,670 | |
| Issuance of common stock at \$10 per share in April 2000 through a private placement, net of expenses | 50,000 | 50 | - | - | 449,950 | |
| Issuance of common stock at \$11.31 per share in May 2000 through a private placement, net of expenses | 80,000 | 80 | - | - | 859,480 | |
| Common shares subscribed to through a cashless exercise of common stock warrants in May 2000 | - | - | 102,609 | 323,640 | (323,640) | |
| Issuance of common stock at \$2.50 per share in June 2000 through exercise of stock warrants | 91,878 | 92 | - | - | 229,603 | |
| Issuance of common stock at \$10.48 per share in July 2000 through a private placement | 160,000 | 160 | - | - | 1,676,640 | |
| Issuance of common stock at \$.25 and \$2.50 per share in July 2000 through exercise of stock warrants | 130,000 | 130 | - | - | 156,120 | |
| Distribution of common stock warrants on August 16, 2000 | - | - | - | - | 6,016,795 | |
| Issuance of common stock at \$12.25 per share in September 2000 through a private placement, net of expenses | 408,164 | 408 | - | - | 4,899,301 | |
| Issuance of common stock in September 2000 subscribed in September 1999 | 143,851 | 144 | (143,851) | (359,628) | 359,484 | |

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| | | | | | |
|--|------------|---------------------------------------|-----------|-----------|------------|
| Issuance of common stock in September 2000 subscribed in October and November of 1999 | 40,000 | 40 | (40,000) | (100,000) | 99,960 |
| Adjustment to market of options granted for services in April 2000 | - | - | - | - | (118,885) |
| Adjustment to receivable from subsidiary's stockholders | - | - | - | - | - |
| Net loss for the year ended September 30, 2000 | - | - | - | - | - |
| | ----- | ----- | ----- | ----- | ----- |
| Balances at September 30, 2000 | 20,340,610 | \$20,341 | 102,609 | 323,640 | 36,925,837 |
| Issuance of shares in October 2000 subscribed to shares in May 2000 | 102,609 | 102 | (102,609) | (323,640) | 323,538 |
| Issuance of common shares at \$10.50 per share in October 2000, net of costs | 142,860 | 143 | - | - | 1,349,857 |
| Shares subscribed to at \$6.00 per share in October 2000, net of costs | - | - | 258,333 | 1,070,000 | (100,000) |
| Allocation of debenture proceeds to common stock | 167,768 | 168 | - | - | 444,435 |
| Allocation of debenture proceeds to common stock warrants | - | - | - | - | 829,551 |
| Allocation of debenture proceeds to beneficial conversion feature | - | - | - | - | 1,051,096 |
| Allocation of promissory note proceeds to common stock | 40,000 | 40 | - | - | 136,167 |
| Common stock subscribed to at \$4.00 per share in December 2000 | - | - | 125,000 | 500,000 | - |
| Common shares subscribed at \$2.00 per share in December 2000, net of issuance costs | - | - | 389,129 | 778,257 | (102,208) |
| | | | | | |
| | | Accumulated development stage deficit | Total | | |
| | | ----- | ----- | | |
| Issuance of common stock in February 2000 subscribed to in August 2000 through exercise of common stock warrants | | - | - | | |

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| | | |
|--|-------------|-----------|
| Issuance of common stock in April 2000 in connection with reverse acquisition of Second CMA, Inc. | - | 1,200 |
| Issuance of common stock options with a strike price of \$10.00 per share in April 2000 for legal services | - | 1,047,670 |
| Issuance of common stock at \$10 per share in April 2000 through a private placement, net of expenses | - | 450,000 |
| Issuance of common stock at \$11.31 per share in May 2000 through a private placement, net of expenses | - | 859,560 |
| Common shares subscribed to through a cashless exercise of common stock warrants in May 2000 | - | - |
| Issuance of common stock at \$2.50 per share in June 2000 through exercise of stock warrants | - | 229,695 |
| Issuance of common stock at \$10.48 per share in July 2000 through a private placement | - | 1,676,800 |
| Issuance of common stock at \$.25 and \$2.50 per share in July 2000 through exercise of stock warrants | - | 156,250 |
| Distribution of common stock warrants on August 16, 2000 | (6,016,795) | - |
| Issuance of common stock at \$12.25 per share in September 2000 through a private placement, net of expenses | - | 4,899,709 |
| Issuance of common stock in September 2000 subscribed in September 1999 | - | - |
| Issuance of common stock in September 2000 subscribed in October and November of 1999 | - | - |
| Adjustment to market of options granted for services in April 2000 | - | (118,885) |
| Adjustment to receivable from subsidiary's stockholders | - | 133,379 |

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| | | |
|--|--------------|--------------|
| Net loss for the year ended September 30, 2000 | (17,403,990) | (17,403,990) |
| Balances at September 30, 2000 | (35,257,363) | 1,745,834 |
| Issuance of shares in October 2000 subscribed to shares in May 2000 | - | - |
| Issuance of common shares at \$10.50 per share in October 2000, net of costs | - | 1,350,000 |
| Shares subscribed to at \$6.00 per share in October 2000, net of costs | - | 970,000 |
| Allocation of debenture proceeds to common stock | - | 444,603 |
| Allocation of debenture proceeds to common stock warrants | - | 829,551 |
| Allocation of debenture proceeds to beneficial conversion feature | - | 1,051,096 |
| Allocation of promissory note proceeds to common stock | - | 136,207 |
| Common stock subscribed to at \$4.00 per share in December 2000 | - | 500,000 |
| Common shares subscribed at \$2.00 per share in December 2000, net of issuance costs | - | 676,049 |

Continued

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Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - Continued

Since inception through September 30, 2001 and December 31, 2001 (unaudited)

| | Voting common stock | | Common stock subscribed | | Additional paid-in capital |
|--|---------------------|--------|-------------------------|--------|----------------------------------|
| | Shares | Amount | Shares | Amount | |
| Common shares subscribed in December 2000 at \$0.25 through the exercise of stock warrants | - | - | 20,000 | 5,000 | - |

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| | | | | | |
|--|---------|-----|-----------|-----------|-----------|
| Issuance of common shares at \$2.02 per share pursuant to conversion of debenture | 107,981 | 108 | - | - | 218,014 |
| Issuance of common shares pursuant to warrant exercise at \$0.25 per share | - | - | 200,000 | 50,000 | - |
| Shares subscribed to at \$2.50 per share in January 2001, net of costs | - | - | 200,000 | 500,000 | (50,000) |
| Modification of warrants | - | - | - | - | 2,414,000 |
| Issuance of common shares at \$1.43 per share pursuant to conversion of debentures | 307,509 | 307 | - | - | 438,049 |
| Shares subscribed to at \$2.50 per share in February 2001 net of costs | - | - | 80,000 | 200,000 | (20,000) |
| Common shares subscribed at \$3.75 per share as additional consideration on debt | - | - | 16,267 | 61,001 | - |
| Common shares subscribed at \$3.31 as additional consideration on debt | - | - | 18,429 | 61,001 | - |
| Common stock issued in March 2001 for shares previously subscribed | 253,334 | 254 | (253,334) | (925,000) | 924,746 |
| Warrants issued with a strike price of \$6.00 per share as additional compensation on debt | - | - | - | - | 7,708 |
| Warrants issued with a strike price of \$3.75 per share as additional compensation on debt | - | - | - | - | 14,659 |
| Warrants issued with a strike price of \$3.31 per share as additional compensation on debt | - | - | - | - | 12,715 |
| Issuance of common shares at \$2.00 per share net of financing costs | - | - | 806,073 | 1,612,146 | (5,000) |
| Placement fees accrued on prior financings | - | - | - | - | (831,133) |
| Allocation of debenture proceeds to beneficial conversion feature | - | - | - | - | 790,369 |
| Adjustment to remeasurement of attorney stock options | - | - | - | - | (510,315) |
| Issuance of common stock in April for shares previously | | | | | |

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| | | | | | |
|---|-----------|-------|---------------------------------------|-------------|-----------|
| subscribed | 1,606,721 | 1,607 | (1,606,721) | (3,703,442) | 3,701,835 |
| Common stock subscribed at \$2.00 per share in April | - | - | 15,000 | 30,000 | - |
| Common stock subscribed at \$1.74 per share pursuant to conversion of debentures in June 2001 | - | - | 12,784 | 22,203 | - |
| Common stock subscribed at \$2.70 per share in connection with debt in June 2001 | - | - | 50,000 | 106,299 | - |
| Common stock subscribed at \$2.32 to \$2.83 per share from April through June 2001 as additional financing fees | - | - | 47,490 | 125,000 | - |
| Shares issued pursuant to conversion of debentures at \$1.25 per share | 82,000 | 82 | - | - | 102,418 |
| Shares issued pursuant to conversion of debentures at \$1.74 | 115,606 | 116 | - | - | 200,692 |
| Shares issued pursuant to conversion of debentures at \$1.00 | 29,433 | 29 | - | - | 29,404 |
| Shares subscribed in April, 2001 for \$2.00 per share pursuant to private placement net of stock issue costs | 375,000 | 375 | - | - | 649,625 |
| Issuance of warrants issued at \$2.03 to \$3.75 as additional financing fees | - | - | - | - | 1,383,353 |
| | | | Accumulated development stage deficit | Total | |
| | | | ----- | ----- | |
| Common shares subscribed in December 2000 at \$0.25 through the exercise of stock warrants | | - | 5,000 | | |
| Issuance of common shares at \$2.02 per share pursuant to conversion of debenture | | - | 218,122 | | |
| Issuance of common shares pursuant to warrant exercise at \$0.25 per share | | - | 50,000 | | |
| Shares subscribed to at \$2.50 per share in January 2001, net of costs | | - | 450,000 | | |
| Modification of warrants | | - | 2,414,000 | | |

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| | | |
|---|---|-----------|
| Issuance of common shares at \$1.43 per share pursuant to conversion of debentures | - | 438,356 |
| Shares subscribed to at \$2.50 per share in February 2001 net of costs | - | 180,000 |
| Common shares subscribed at \$3.75 per share as additional consideration on debt | - | 61,001 |
| Common shares subscribed at \$3.31 as additional consideration on debt | - | 61,001 |
| Common stock issued in March 2001 for shares previously subscribed | - | - |
| Warrants issued with a strike price of \$6.00 per share as additional compensation on debt | - | 7,708 |
| Warrants issued with a strike price of \$3.75 per share as additional compensation on debt | - | 14,659 |
| Warrants issued with a strike price of \$3.31 per share as additional compensation on debt | - | 12,715 |
| Issuance of common shares at \$2.00 per share net of financing costs | - | 1,607,146 |
| Placement fees accrued on prior financings | - | (831,133) |
| Allocation of debenture proceeds to beneficial conversion feature | - | 790,369 |
| Adjustment to remeasurement of attorney stock options | - | (510,315) |
| Issuance of common stock in April for shares previously subscribed | - | - |
| Common stock subscribed at \$2.00 per share in April | - | 30,000 |
| Common stock subscribed at \$1.74 per share pursuant to conversion of debentures in June 2001 | - | 22,203 |
| Common stock subscribed at \$2.70 per share in connection with debt in June 2001 | - | 106,299 |

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| | | |
|---|---|-----------|
| Common stock subscribed at \$2.32 to \$2.83 per share from April through June 2001 as additional financing fees | - | 125,000 |
| Shares issued pursuant to conversion of debentures at \$1.25 per share | - | 102,500 |
| Shares issued pursuant to conversion of debentures at \$1.74 | - | 200,808 |
| Shares issued pursuant to conversion of debentures at \$1.00 | - | 29,433 |
| Shares subscribed in April, 2001 for \$2.00 per share pursuant to private placement net of stock issue costs | - | 650,000 |
| Issuance of warrants issued at \$2.03 to \$3.75 as additional financing fees | - | 1,383,353 |

Continued
8

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - Continued

Since inception through September 30, 2001 and December 31, 2001 (unaudited)

| | Voting common stock | | Common stock subscribed | | Additional paid-in capital |
|---|---------------------|--------|-------------------------|---------|----------------------------|
| | Shares | Amount | Shares | Amount | |
| Allocation of debenture proceeds to beneficial conversion feature | - | - | - | - | 281,843 |
| Allocation of debenture proceeds to cashless exercise warrants | - | - | - | - | 48,487 |
| Common stock subscribed in lieu of loan origination fees | - | - | 50,000 | 145,000 | - |
| Common stock issued at \$3.19 per share from April through June 2001 as additional financing fees | 53,185 | 53 | - | - | 169,474 |

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| | | | | | |
|---|---------|-----|-----------|-----------|---------|
| Common stock subscribed at \$0.54 per share pursuant to conversion of debentures in September 2001 | - | - | 563,080 | 304,063 | - |
| Common stock subscribed at \$0.60 per share pursuant to conversion of debentures in September 2001 | - | - | 284,042 | 170,425 | - |
| Common stock subscribed at \$1.30 in September 2001 to satisfy penalty on late filing of the Registration Statement with the SEC for conversion shares in connection with convertible debt agreements dated November 2000 | - | - | 124,721 | 162,141 | - |
| Common stock issued in July 2001 for shares previously subscribed | 262,784 | 263 | (262,784) | (178,506) | 178,243 |
| Common stock issued at \$2.70 per share in June 2001 in lieu of loan origination fee | 50,000 | 50 | - | - | 134,950 |
| Common stock subscribed at \$1.00 per share in July 2001 | - | - | 37,000 | 74,000 | - |
| Common stock subscribed at \$1.00, net of financing costs, per share in September 2001 | - | - | 200,000 | 200,000 | - |
| Common stock subscribed at \$0.50, net per share in September 2001 | - | - | 1,000,000 | 500,000 | - |
| Common stock issued at \$0.72 to \$2.08 per share from July through September 2001 as additional finance fees | 363,432 | 363 | - | - | 361,774 |
| Common stock issued in September 2001 for shares previously subscribed | 82,186 | 82 | - | - | 246,920 |
| Common stock issued at \$1.98 per share in July 2001 for late issuance of debt converted in June 2001 | 2,649 | 3 | (82,186) | (247,002) | 5,242 |
| Common stock issued at \$1.56 per share in July 2001 for prepaid debt penalty | 14,322 | 14 | - | - | 22,328 |
| Common stock issued at \$0.96 per share in August 2001 as prepaid debt penalty | 23,534 | 24 | - | - | 22,569 |
| Warrants issued between July and September 2001, with exercise price from \$0.72 to \$6.00, as additional financing fees | - | - | - | - | 828,602 |
| Adjustment of warrants issued | | | | | |

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| | | | | | |
|--|------------|---|-----------|-----------|------------|
| between January and June 2001 as a result of settlement agreement dated June 2001 regarding additional finance fees | - | - | - | - | (559,273) |
| Warrants issued in August 2001 with exercise price of \$1.00 in connection with debt | - | - | - | - | 114,484 |
| Stock option issued to employees below fair market value on March 27, 2001 | - | - | - | - | 1,763,563 |
| Common stock subscribed on September 26, 2001 at \$0.70, net per share | - | - | 1,600,000 | 1,120,000 | - |
| Net loss for the year ended September 30, 2001 | - | - | - | - | - |
| Balances at September 30, 2001 | 24,523,523 | 24,524 | 3,892,323 | 2,742,586 | 53,947,618 |
| Shares issued on October 5, 2001 in connection with September 2001 conversions of debentures at \$.54 to \$1.30 per share | 971,725 | 972 | (971,843) | (636,625) | 635,653 |
| Contribution from minority interest | - | - | - | - | 727,648 |
| Shares issued on October 11, 2001 in lieu of loan interest and penalties at \$1.48 per share | 52,434 | 52 | - | - | 77,550 |
| | | Accumulated development stage deficit | Total | | |
| Allocation of debenture proceeds to beneficial conversion feature | - | - | 281,843 | | |
| Allocation of debenture proceeds to cashless exercise warrants | - | - | 48,487 | | |
| Common stock subscribed in lieu of loan origination fees | - | - | 145,000 | | |
| Common stock issued at \$3.19 per share from April through June 2001 as additional financing fees | - | - | 169,527 | | |
| Common stock subscribed at \$0.54 per share pursuant to conversion of debentures in September 2001 | - | - | 304,063 | | |
| Common stock subscribed at \$0.60 per share pursuant to conversion | | | | | |

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| | | |
|---|---|-----------|
| of debentures in September 2001 | - | 170,425 |
| Common stock subscribed at \$1.30 in September 2001 to satisfy penalty on late filing of the Registration Statement with the SEC for conversion shares in connection with convertible debt agreements dated November 2000 | - | 162,141 |
| Common stock issued in July 2001 for shares previously subscribed | - | - |
| Common stock issued at \$2.70 per share in June 2001 in lieu of loan origination fee | - | 135,000 |
| Common stock subscribed at \$1.00 per share in July 2001 | - | 74,000 |
| Common stock subscribed at \$1.00, net of financing costs per share in September 2001 | - | 200,000 |
| Common stock subscribed at \$0.50, net per share in September 2001 | - | 500,000 |
| Common stock issued at \$0.72 to \$2.08 per share from July through September 2001 as additional finance fees | - | 362,137 |
| Common stock issued in September 2001 for shares previously subscribed | - | - |
| Common stock issued at \$1.98 per share in July 2001 for late issuance of debt converted in June 2001 | - | 5,245 |
| Common stock issued at \$1.56 per share in July 2001 for prepaid debt penalty | - | 22,342 |
| Common stock issued at \$0.96 per share in August 2001 as prepaid debt penalty | - | 22,593 |
| Warrants issued between July and September 2001, with exercise price from \$0.72 to \$6.00, as additional financing fees | - | 828,602 |
| Adjustment of warrants issued between January and June 2001 as a result of settlement agreement dated June 2001 regarding additional finance fees | - | (559,273) |

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| | | |
|--|--------------|--------------|
| Warrants issued in August 2001 with exercise price of \$1.00 in connection with debt | - | 114,484 |
| Stock option issued to employees below fair market value on March 27, 2001 | - | 1,264,004 |
| Common stock subscribed on September 26, 2001 at \$1.10, net of financing costs per share | - | 1,120,000 |
| Net loss for the year ended September 30, 2001 | (30,169,897) | (30,169,897) |
| Balances at September 30, 2001 | (65,427,260) | (9,477,712) |
| Shares issued on October 5, 2001 in connection with September 2001 conversions of debentures at \$.54 to \$1.30 per share | - | - |
| Contribution from minority interest | - | 727,648 |
| Shares issued on October 11, 2001 in lieu of loan interest and penalties at \$1.48 per share | - | 77,602 |

Continued
9

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - Continued

Since inception through September 30, 2001 and December 31, 2001 (unaudited)

| | Voting common stock | | Common stock subscribed | | Additional paid-in capital |
|--|---------------------|--------|-------------------------|--------|----------------------------------|
| | Shares | Amount | Shares | Amount | |
| Shares issued on October 20 and 21, 2001 at \$1.58 per share in lieu of loan interest and penalties | 151,671 | 152 | - | - | 239,488 |
| Shares issued on November 7, 2001 in connection with October 10, 11 and 12, 2001 conversion of debentures at \$.535 per share | 3,116,633 | 3,117 | - | - | 1,684,299 |
| Shares issued on November 7, 2001 in connection with October 12, | | | | | |

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| | | | | | |
|---|-----------|-------|-------------|-------------|-----------|
| 2001 conversion of convertible debentures \$.543 per share | 979,095 | 979 | - | - | 595,830 |
| Shares issued on November 7, 2001 at \$1.48 per share in lieu of penalties in connection with October 11, 2001 conversion of convertible debentures | 351,743 | 352 | - | - | 520,228 |
| Shares issued on November 7, 2001 at \$1.41 per share in lieu of penalties in connection with October 12, 2001 conversion of convertible debentures | 445,540 | 445 | - | - | 627,766 |
| Shares issued on November 7, 2001 at \$1.71 per share in lieu of penalties in connection with October 10, 2001 conversion of convertible debentures | 413,864 | 414 | - | - | 707,293 |
| Shares issued on November 9, 2001 (previously subscribed to in September 2001 at \$.50, \$.70, and \$1.00 per share) | 2,800,000 | 2,800 | (2,800,000) | (1,820,000) | 1,817,200 |
| Shares issued on November 9, 2001 in lieu of finder's fees on previous placements | 750,000 | 750 | - | - | (750) |
| Shares issued on November 9, 2001 at a \$1.00 in lieu of settlement of payables to stockholders and cash, net of fees | 905,205 | 905 | - | - | 901,700 |
| Shares issued on November 9, 2001 at a \$1.41 lieu of fees in connection with a private placement | 25,000 | 25 | - | - | (25) |
| Shares issued on November 9, 2001 (previously subscribed to in July 2001 at \$2.00 per share) | 25,000 | 25 | (25,000) | (50,000) | 49,975 |
| Shares issued on November 9, 2001 in connection with October 15, 2001 conversion of debentures at \$1.25 and \$1.50 per share | 776,919 | 777 | - | - | 1,010,433 |
| Shares subscribed to on November 11, 2001 at \$1.41 per share in lieu of interest and penalties | - | - | 56,970 | 80,328 | - |
| Shares subscribed to on November 19 and 21, 2001 at \$1.15 per share in lieu of interest and penalties | - | - | 48,532 | 55,812 | - |
| Shares subscribed to on December 1 and 2, 2001 at \$1.34 per share in lieu of interest | | | | | |

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| | | | | | |
|---|---------|-----|---------------------------------------|-----------|---------|
| and penalties | - | - | 56,419 | 75,601 | - |
| Shares subscribed to on December 9, 2001 at \$1.09 per share in lieu of interest and penalties | - | - | 32,593 | 35,526 | - |
| Shares subscribed to on December 12, 2001 at \$1.05 per share in lieu of interest and penalties | - | - | 22,070 | 23,102 | - |
| Shares subscribed to on December 19, 2001 at \$0.88 per share in lieu of interest and penalties | - | - | 47,124 | 41,469 | - |
| Shares subscribed to on December 22 and 29, 2001 at \$0.80 per share in lieu of interest and penalties | - | - | 33,914 | 27,131 | - |
| Shares subscribed to on December 31, 2001 at \$0.78 per share in lieu of interest and penalties | - | - | 26,253 | 20,477 | - |
| Shares issued on November 26, 2001 in lieu of payment of legal fees | 100,000 | 100 | - | - | 99,900 |
| Shares issued on November 26, 2001 in connection with a private placement at \$1.36 per share | 18,437 | 18 | - | - | 24,982 |
| Shares issued on November 26, 2001 in connection with a private placement and satisfaction of liabilities at \$1.10, net of transactions costs per share | 562,171 | 562 | - | - | 443,184 |
| Shares issued on December 7, 2001 at \$1.09 per share in lieu of fees and penalties in connection with October 10 through 12, 2001 conversion of convertible debentures | 948,843 | 949 | - | - | 972,536 |
| | | | Accumulated development stage deficit | Total | |
| | | | ----- | ----- | |
| Shares issued on October 20 and 21, 2001 at \$1.58 per share in lieu of loan interest and penalties | - | - | - | 239,640 | |
| Shares issued on November 7, 2001 in connection with October 10, 11 and 12, 2001 conversion of debentures at \$.535 per share | - | - | - | 1,687,416 | |
| Shares issued on November 7, 2001 | | | | | |

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| | | |
|---|---|-----------|
| in connection with October 12, 2001 conversion of convertible debentures \$.543 per share | - | 596,809 |
| Shares issued on November 7, 2001 at \$1.48 per share in lieu of penalties in connection with October 11, 2001 conversion of convertible debentures | - | 520,580 |
| Shares issued on November 7, 2001 at \$1.41 per share in lieu of penalties in connection with October 12, 2001 conversion of convertible debentures | - | 628,211 |
| Shares issued on November 7, 2001 at \$1.71 per share in lieu of penalties in connection with October 10, 2001 conversion of convertible debentures | - | 707,707 |
| Shares issued on November 9, 2001 (previously subscribed to in September 2001 at \$.50, \$.70, and \$1.00 per share) | - | - |
| Shares issued on November 9, 2001 in lieu of finder's fees on previous placements | - | - |
| Shares issued on November 9, 2001 at a \$1.00 in lieu of settlement of payables to stockholders and cash, net of fees | - | 902,605 |
| Shares issued on November 9, 2001 at a \$1.41 lieu of fees in connection with a private placement | - | - |
| Shares issued on November 9, 2001 (previously subscribed to in July 2001 at \$2.00 per share) | - | - |
| Shares issued on November 9, 2001 in connection with October 15, 2001 conversion of debentures at \$1.25 and \$1.50 per share | - | 1,011,210 |
| Shares subscribed to on November 11, 2001 at \$1.41 per share in lieu of interest and penalties | - | 80,328 |
| Shares subscribed to on November 19 and 21, 2001 at \$1.15 per share in lieu of interest and penalties | - | 55,812 |
| Shares subscribed to on December 1 and 2, 2001 at \$1.34 per | | |

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| | | |
|---|---|---------|
| share in lieu of interest and penalties | - | 75,601 |
| Shares subscribed to on December 9, 2001 at \$1.09 per share in lieu of interest and penalties | - | 35,526 |
| Shares subscribed to on December 12, 2001 at \$1.05 per share in lieu of interest and penalties | - | 23,102 |
| Shares subscribed to on December 19, 2001 at \$0.88 per share in lieu of interest and penalties | - | 41,469 |
| Shares subscribed to on December 22 and 29, 2001 at \$0.80 per share in lieu of interest and penalties | - | 27,131 |
| Shares subscribed to on December 31, 2001 at \$0.78 per share in lieu of interest and penalties | - | 20,477 |
| Shares issued on November 26, 2001 in lieu of payment of legal fees | - | 100,000 |
| Shares issued on November 26, 2001 in connection with a private placement at \$1.36 per share | - | 25,000 |
| Shares issued on November 26, 2001 in connection with a private placement and satisfaction of liabilities at \$1.10 per share, net of transaction costs | - | 443,746 |
| Shares issued on December 7, 2001 at \$1.09 per share in lieu of fees and penalties in connection with October 10 through 12, 2001 conversion of convertible debentures | - | 973,485 |

Continued
10

Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - Continued

Since inception through September 30, 2001 and December 31, 2001 (unaudited)

Voting common stock Common stock subscribed Additional

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| | Shares | Amount | Shares | Amount | paid-in capital |
|--|------------|----------|-----------|--------------|-----------------|
| Warrants granted in lieu of interest and penalties | - | - | - | - | 1,956,457 |
| Shares subscribed to and warrants issued in lieu of additional interest on convertible debentures | - | - | 434,220 | 594,881 | 580,035 |
| Shares subscribed at \$.80 through \$1.37 per share in connection with November and December 2001 promissory notes | - | - | 202,167 | 182,265 | - |
| Warrants issued in connection with November through December 2001 promissory notes | - | - | - | - | 217,898 |
| Adjustment due to modification of warrants | - | - | - | - | 32,922 |
| Adjustment due to added conversion feature on notes payable | - | - | - | - | 200,000 |
| Allocation to beneficial conversion feature | - | - | - | - | 150,000 |
| Amortization of deferred compensation for the three months ended December 31, 2001 | - | - | - | - | - |
| Net loss for the three months ended December 31, 2001 | - | - | - | - | - |
| Balances at December 31, 2001 | 37,917,803 | \$37,918 | 1,055,742 | \$ 1,372,553 | \$68,219,820 |

| | Accumulated development stage deficit | Total |
|--|---------------------------------------|-----------|
| Warrants granted in lieu of interest and penalties | - | 1,956,457 |
| Shares subscribed to and warrants issued in lieu of additional interest on convertible debentures | - | 1,174,916 |
| Shares subscribed at \$.80 through \$1.37 per share in connection with November and December 2001 promissory notes | - | 182,265 |
| Warrants issued in connection with November through December 2001 promissory notes | - | 217,898 |

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| | | |
|--|-----------------|----------------|
| Adjustment due to modification of warrants | - | 32,922 |
| Adjustment due to added conversion feature on notes payable | - | 200,000 |
| Allocation to beneficial conversion feature | - | 150,000 |
| Amortization of deferred compensation for the three months ended December 31, 2001 | - | 49,326 |
| Net loss for the three months ended December 31, 2001 | (12,036,595) | (12,036,595) |
| Balances at December 31, 2001 | \$ (77,463,855) | \$ (8,549,418) |

The accompanying notes are an integral part of this statement.

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Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

| Increase (Decrease) in Cash and Cash Equivalents | Three months ended December | |
|--|-----------------------------|-----------------|
| | 2000 | 2001 |
| Cash flows from operating activities | | |
| Net loss | \$ (5,056,369) | \$ (12,036,595) |
| Adjustments to reconcile net loss to net cash used in operating activities | | |
| Depreciation and amortization | 140,999 | |
| Amortization of beneficial conversion feature and debt discount | 263,815 | 1,000,000 |
| Amortization of loan costs | - | |
| Modification of loan agreements | - | |
| Equity securities issued in lieu of interest and penalties on debt | - | 6,000,000 |
| Employee stock options issued below fair value | - | |
| Adjustment to receivables from subsidiary's stockholders | - | |
| Write off of uncollectible advances | - | |
| Write off due to impairment | - | |
| Write off of option cost | - | |
| Loss on sale of equipment | - | |
| Equity in loss of UltraCard | - | |
| Purchased in-process research and development | - | |
| Warrants and options issued for services | (672,685) | |
| Shares issued for services | - | |
| Expenses incurred through loan assumption | - | |
| Stock of subsidiary issued in exchange for | | |

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| | | |
|---|-------------|-------|
| contribution of intellectual property charged to expense | - | |
| Minority interest | - | |
| Changes in assets and liabilities: | | |
| Prepaid expenses, deposits and other | (272,516) | |
| Payables, accrued liabilities and other | 1,155,823 | |
| | ----- | ----- |
| Net cash used in operating activities | (4,440,933) | (3, |
| Cash flows from investing activities | | |
| Advances to The Pathways Group, Inc. | (1,264,955) | |
| Advances to Rockster, Inc. | (150,000) | |
| Advances to eCourier | - | |
| Payments on equipment under construction | - | |
| Acquisition of property and equipment, net | (403,144) | |
| Acquisition of Centurion Technologies, Inc., net of cash acquired | - | |
| Acquisition of UltraCard, Inc., net of cash acquired | - | |
| Acquisition of equity interest in EforNet Corp. from a minority shareholder | - | |
| Acquisition deposit | (15,000) | |
| Additions to intangible assets | (55,658) | |
| | ----- | ----- |
| Net cash used in investing activities | (1,888,757) | (|
| Cash flows from financing activities | | |
| Proceeds from sale of common stock and stock subscriptions | 3,428,774 | |
| Proceeds from exercise of stock options and warrants | 5,000 | |
| Borrowings, net of loan costs | 3,107,880 | |
| Principal payments on borrowings | (1,037,245) | |
| Purchase of collateral on subsidiary's letter of credit | - | |
| Proceeds from release of collateral on subsidiary's letter of credit | 505,687 | |
| | ----- | ----- |
| Net cash provided by financing activities | 6,010,096 | 1, |
| | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | (319,594) | (2, |
| Cash and cash equivalents at the beginning of the period | 398,989 | 2, |
| | ----- | ----- |
| Cash and cash equivalents at the end of the period | \$ 79,395 | \$ |
| | ===== | ===== |

The accompanying notes are an integral part of these statements.

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NOTE A - FINANCIAL STATEMENTS

The unaudited consolidated financial statements of the Company and its subsidiaries have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles of the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations. The results of operations for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year ending September 30, 2002. This form 10-QSB should be read in conjunction with the form 10-KSB that includes audited consolidated financial statements for the year ended September 30, 2000 and 2001, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended and since inception (February 5, 1997).

NOTE B - BASIS OF PRESENTATION

The Company consolidates all companies in which it has a controlling financial interest. This generally occurs when the Company owns more than 50% of the outstanding voting shares of the company. The Company also consolidates 50%-owned companies in which it has voting control through agreements with other shareholders. Investments in Companies where the Company has significant influence through ownership of 20% to 50% of the investors voting shares or contractual arrangements are accounted for by the equity method.

The balance sheet as of September 30, 2001 and December 31, 2001, reflects the consolidated financial position of the Company and its subsidiaries (Subsidiaries) as follows: UltraCard, Inc. (UltraCard); cQue Corporation (formerly Centurion Technologies, Inc.); CTI Acquisition Corporation (CTI); Global CyberSystems, Inc. (Global); EforNet Corporation (EforNet); Global CyberSystems SA. (GCSA), Global CyberSystems PLC (GCPLC) and UltraCard China Inc. The statements of operations and cash flows for the three months ended December 31, 2000 and 2001 and for the period from inception (February 5, 1997) reflect the consolidated results of operations and cash flows of the Company and the results of the subsidiaries beginning on the dates the Company acquired control. All significant inter-company balances and transactions have been eliminated in consolidation. Minority interest represents the minority stockholders' proportionate share in the equity of the Company's consolidated Subsidiaries. The losses incurred by a subsidiary are allocated on a proportionate basis to minority interest until the carrying amount of minority interest is eliminated. Further losses are then included in the net loss of the Company.

NOTE C - LOSS PER COMMON SHARE AND SHARES OUTSTANDING

Basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. The weighted average number of shares outstanding was 20,966,989 and 33,528,705 for the three months ended December 31, 2000 and 2001, respectively, and 14,148,744 since inception (February 5, 1997) through December 31, 2001. Diluted loss per share for all periods presented equaled basic loss per share due to antidilutive effect of the potentially dilutive securities. At December 31, 2000 and 2001, the Company had 5,371,869 and 8,346,042 in additional common stock equivalents.

At December 31, 2001, 3,356,000 shares of the Company's common stock were not included in the shares issued and outstanding on the consolidated statement of stockholders' deficit or loss per share computations. The excluded shares were as follows:

- Shares issued in lieu of finders' fees in connection with future findings -

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- 1,365,000 (with 1,000,000 shares outstanding at September 30, 2001 and 365,000 shares issued during the quarter ended December 31, 2001).
- Shares held by the Company in connection with loan assumptions - 2,000,000 shares. In October 2001, the Company issued 2,000,000 to replace the 2,000,000 shares originally transferred by the Company's president to an unrelated third party as a collateral for \$1,210,000 notes payable. In October 2001, the Company assumed the president's liability on the loans and issued 2,000,000 shares. The original collateral shares were then transferred into the Company's name by the president.

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Upgrade International Corporation and Subsidiaries
(A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2000 and 2001

NOTE D - MANAGEMENT PLANS

The Company is a development stage enterprise as defined under Statement of Financial Accounting Standards No. 7. The Company is devoting its present efforts into establishing a new business in the information technology industry and, is currently in the process of identifying markets and establishing applications for its technologies. Accordingly, no operating revenues have been generated. The Company's operations to date have consumed substantial and increasing amounts of cash. The Company's negative cash flow from operations is expected to continue in the foreseeable future. The development of the Company's technology and potential products will continue to require a commitment of substantial funds. The Company expects that its existing and expected financings will be adequate to satisfy the requirements of its current and planned operations until the end of the fiscal year 2002. However, the rate at which the Company expends its resources is variable, may be accelerated, and will depend on many factors. The Company will need to raise substantial additional capital to fund its operations and may seek such additional funding through public or private equity, debt financing or through strategic relationships with development partners. There can be no assurance that such additional funding will be available on acceptable terms, if at all. The Company's continued existence as a going concern is ultimately dependent upon its ability to secure additional funding for completing and marketing its technology and the success of its future operations.

The following summarizes the debt and equity transactions completed by the Company during the three months ended December 31, 2001/

In October 2001, the Company received \$500,000 pursuant to subscription agreement for a Regulation S private placement and debt settlement, subscribed in September 2001 at a net price of \$0.50 per share.

In October 2001, the Company settled \$100,000 of liabilities owed to a law firm for the services rendered by the issuance of 100,000 shares of the Company's common stock.

In November 2001, the Company issued 905,205 shares in settlement of \$802,605 in loans from shareholders and \$100,000 cash.

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In November 2001, the Company issued 562,171 shares pursuant to a private placement for aggregate proceeds of \$468,746 (including \$132,000 of funds received prior to October 1, 2001). In conjunction with the placement, the Company issued to the shareholders warrants to acquire 562,171 shares of the Company at an exercise price of \$1.00. The warrants have a five-year term and cashless exercise provision.

In November 2001, the Company issued 18,437 shares of common stock at \$1.35 per share for total proceeds of \$25,000.

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Upgrade International Corporation and Subsidiaries (A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2000 and 2001

NOTE D - MANAGEMENT PLANS - Continued

In November 2001, the holders of then outstanding \$3,037,935 of convertible debentures elected to convert into the Company's common stock. The conversion prices were determined in accordance with terms of the original agreements and varied from \$0.54 to \$1.50 per share. Total shares issued upon conversions (including shares received in lieu of accrued interest and penalties) were 5,821,490.

In November 2001, the Company borrowed \$520,000 from existing debt holders pursuant to 30-day note agreements. Interest and penalties are required under the terms of the notes payable every 30 days comprised of 10% interest, 10% to 12.5% of the original loan amount payable in common stock and up to 37.5% of the original loan amount in warrants at an exercise price of market but not more than \$1.00 to \$1.50. In addition, as a cost of the financing, the Company granted a \$50,000 note payable, 74,000 shares of common stock, and warrants entitling holder to purchase 72,250 shares of common stock at \$1.37 per share. The warrants are exercisable immediately and expire five years from the date of grant. Additionally, in connection with November 2001 notes agreements, the Company agreed to reduce exercise price on then outstanding warrants (previously issued in connection with June 2001 note agreements) from \$6 to \$3 per share, and added a conversion feature for \$200,000 of the June 2001 loans that allows conversion into the Company's common stock. As a result of the aforementioned modifications, the Company recognized \$232,922 in additional expenses.

In December 2001, the Company borrowed \$350,000 from existing shareholders pursuant to 30-day note agreements. Interest and penalties are required under the terms of the notes payable upon maturity comprised of 10% interest, 12.5% payable in share capital and warrants of 37.5% of the loan value, at a current market strike price but not to exceed \$0.80 to \$1.00. In addition, as a cost of the financing, the Company granted notes payable of \$38,500, 117,937 shares, and warrants entitling the holder to purchase 218,363 shares of common stock exercisable at a price of \$0.80 per share. The warrants are exercisable immediately and expire five years from the date of grant.

In December 2001, the Company borrowed \$25,000 from an officer. This balance, combined with then outstanding \$125,000 loan due to the officer, was rolled into a convertible note payable bearing interest at a rate of 8% per annum and convertible into the common stock of the Company at \$0.75 per share. The convertible debenture is due March 15, 2002. In addition, the Company granted

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350,000 warrants to acquire common stock at a price of \$0.75 per share with a cashless exercise provision and a five-year term. In connection with this transaction, the Company recognized \$150,000 in debt discount, with \$87,500 being expensed in the first quarter of the year ending September 30, 2002.

In addition to debt and equity transactions by the parent company described above, in October 2001, one of the Company's subsidiaries completed the sale of shares of its common stock to a minority shareholder for total proceeds of \$1,425,000 (the money was received prior to October 1, 2001). This transaction resulted in an increase of consolidated additional paid-in capital of \$727,648.

The Company is actively pursuing new investment into the Company. This financing may take the form of equity, convertible debentures and other types of debt instruments.

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Upgrade International Corporation and Subsidiaries (A development stage enterprise)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2000 and 2001

NOTE E - SUBSEQUENT EVENTS

In January 2002, the Company borrowed a further \$170,000 from existing shareholders pursuant to certain 30-day note agreements. Interest and penalties are required under the terms of the notes payable upon maturity comprised of 10% interest, 12.5% payable in share capital and warrants of 37.5% of the loan value, at a current market strike price but not to exceed \$0.80 to \$1.00. In addition, as a cost of the financing, the Company entered into note payable agreements of \$18,700, issued 37,400 shares of common stock, and granted warrants entitling holder to purchase 37,400 shares of common stock at a price of \$0.25 per share. The warrants are exercisable immediately and expire five years from the date of grant.

During January and February 2002, the Company completed the issuance of a further convertible debenture for \$200,000, to an officer of the Company, bearing interest at a rate of 8% per annum and convertible into the common stock of the Company at \$0.75 per share. The convertible debenture is due March 15, 2002. In addition, the Company granted 200,000 warrants to acquire 200,000 shares of common stock at \$0.75 per share with a cashless exercise provision and a five-year term.

In February 2002, the Company entered into a letter of intent to grant Giesecke & Devrient the right to be the exclusive provider to UltraCard for card body design, assembly, production, embedding, initialization and personalization of the UltraCard. The document also outlines joint efforts in product development and marketing for both companies' products. The Companies intend to enter into a definitive agreement within 45 days of the above referenced date.

ITEM 2. MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements contained in this Quarterly Report on Form 10-QSB, including, without limitation, statements containing the words "believes, " anticipates,"

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"estimates," "expects," and words of similar import, constitute "forward looking statements." You should not place undue reliance on these forward- looking statements. Our actual results could differ materially from those anticipated in these forward- looking statements for many reasons, including the risks faced by us described in this Quarterly Report and in other documents we file with the Securities and Exchange Commission.

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Net losses aggregated \$12 million in the first three months of the current fiscal year ended December 31, 2001 compared with a \$5.1 million net loss for the corresponding period of the prior fiscal year. This increase in net loss is reflective of the increased cost of capital incurred by the Company from financings through short-term loan agreements. Interest costs of \$7.6 million have been recorded in the current quarter which is comprised, in the most part, of shares, warrants and notes issued for interest and penalties on short term loans payable. In addition, the Company has accrued \$1.1 million in licensing fees related to the UltraCard technology, which is reflected as a part of the Company's research and development expenditures. The balance of the expenditures of 3.3 million reflects the ongoing level of investment into the Company's technology, development of production specifications and the cost associated with the commercialization process of the Company's core technology.

The Company's general and administrative costs of \$2.3 million represents an increase in the average quarterly general and administrative expenditure from the prior year attributed in the most part to the Companies current focus upon the development of it's core technology. This increase is offset somewhat by lower legal costs, and reduced compensation components related to equity grants to key employees . Research and development expenditures decreased from \$2.4 million compared in the corresponding prior period to \$1.8 million primarily due to minimal operations of cQue and dormant condition of EForNet. The other significant operating subsidiary cQue (formerly Centurion) and UltraCard China Inc. contributed \$57,000 and \$80,200 respectively of the total loss reflecting the focus of the consolidated groups efforts to complete the UltraCard technology. For the near future research and development expenditures are expected to increase to meet the Company's numerous potential market opportunities. All of the Company's research and development costs have been expensed as incurred.

Sales and marketing expenditures of \$107,000 represent a 70% decrease over the prior quarter reflecting the Company's focus upon product completion. Sales and marketing expenditures are associated with the Company's attendance at trade shows and industry awareness programs as the Company builds market awareness to establish and develop new markets and prepare for effective product launches for products which are nearing the first phase of completion.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2001 the Company had available cash balances of \$350,928. The Company is managing tight cash flows in providing funding for an aggressive research and development program at UltraCard in an effort to put into place the Company's first pilot project in China, comprised of 2,000,000 cards and 10,000 read write device.

During the quarter ended December 31, 2001, the Company raised approximately \$870,000 in smaller financings comprised of promissory notes with equity kickers (common stock and warrants) and equity penalties (common stock and warrants) for failure either to repay the notes or register shares owned by the noteholders. The Company is not in default under these notes as long as it complies with the equity penalty provisions. At December 31, 2001, the Company had total

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indebtedness of approximately \$1,265,000 under these arrangements.

The Company's cash used in operations was \$3.3 million, which represents a decrease compared to the prior quarter of \$4.4 million. This decrease results from the increase in accounts payable and accrued liability levels.

Cash flows from financing activities of \$1.8 million in the current period represents a level consistent with the last two quarters of the year ended September 30, 2001. The Company has begun to focus its efforts upon financing initiatives which have a much larger magnitude than prior financings and such initiatives have much longer lead times. While these initiatives are in progress the Company is limiting the number of smaller more expensive financings to critical needs.

In July, 2001, the Company received from its President and Chief Executive Officer, Daniel S. Bland, funds in the amount of \$1,210,000 as a loan to the company. The Company's Board of Directors as of November 1, 2001, converted the \$1,210,000 loan into equity by issuing 2,000,000 shares of common stock to Bland in full satisfaction of the company's loan obligation to him. As part of this transaction, Upgrade assumed the obligations of Bland, as borrower, under Bland's loan agreements with International Mercantile Holding Group, Inc. (IMHG), the original lender of the funds. Under the terms of the loan agreements, repayment of the loan amount is secured by collateral in the form of 2,000,000 shares of Upgrade, which have been pledged by Bland to IMHG. Bland has assigned his residual rights in the 2,000,000 pledged shares of common stock to the Company. Upon repayment of the loan and return of the collateral, Upgrade intends to cancel the 2,000,000 shares of stock. The term of the loan is five years.

In order for the Company to meet the funding requirements of its investee companies and to meet ongoing operating requirements, it will have to raise additional financing. However the rate at which the Company expends its resources is variable, may be accelerated, and will depend on many factors. The Company will need to raise substantial additional capital to fund its operations and may seek such additional funding through public or private equity or debt financing, or through the licensing of its technology. There can be no assurance that such additional funding will be available on acceptable terms, if at all. The Company's continued existence as a going concern is ultimately dependent upon its ability to secure additional funding for completing and marketing its technology and the success of its future operations.

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PART II Other Information

Item 1. Legal Proceedings

Upgrade, its president, Daniel S. Bland, and Chief Financial Officer, Howard Jaffe, are defendants in The Pathways Group, Inc. v. Upgrade International

Corporation et al., Superior Court of the State of California in for the County

of Sonoma, c/a 227650. The complaint, filed August 3, 2001, alleges breach of merger and collateral agreements between Upgrade and plaintiff, breach of oral argument, fraud, and negligent material misrepresentation, and seeks specific performance of the agreements, an injunction against exercising provisions pursuant to the merger agreement whereby Upgrade could obtain control of Pathways, and damages in excess of \$150 million. Specifically, the complaint alleges that Upgrade failed to provide interim financing to Pathways pending consummation of the proposed merger transaction, and prevented Pathways from

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obtaining alternate sources of financing. Upgrade believes that the plaintiff's allegations are without legal or factual basis and therefore it has not accrued any potential losses resulting from this claim except for the \$3.4 million debt owed by Pathways to Upgrade, which Upgrade has recorded a provision for potentially uncollectible advances to Pathways as of June 30, 2001.

Item 2. Changes in Securities and Use of Proceeds

In October, 2001, the Company issued 971,725 shares of its common stock pursuant to the conversion of debentures at prices ranging from \$.54 to \$1.30 per share. The issuances were pursuant to contractual rights granted in prior securities offerings that were exempt under Rule 506 and Section 4(2) of the Act.

In October, 2001, the Company issued warrants to purchase 766,980 shares of its common stock at an exercise price of \$1.00 per share for financial advisory services performed on behalf of the Company in the form of a private placement for 905,205 shares for total proceeds of \$905,205. Due to the foreign nationality of the investor, the issuance was exempt under Regulation S of the Act, as well as Rule 506 and Section 4(2) of the Act.

In October, 2001, the Company issued 250,000 shares and warrants to purchase an additional 230,363 shares of its common stock at exercise prices ranging from \$1.00-\$2.00 per share for financial advisory services performed on behalf of the Company in the form of a private placement of 1,200,000 shares for total proceeds of \$700,000. Due to the foreign nationality of the investor, the issuance was exempt under Regulation S of the Act, as well as Rule 506 and Section 4(2) of the Act.

In November, 2001, the Company issued 3,116,633 shares of its common stock pursuant to the conversion of debentures at \$.535 per share. The issuances were pursuant to contractual rights granted in prior securities offerings that were exempt under Rule 506, Section 4(2), and Regulation S of the Act.

In November, 2001, the Company issued 979,095 shares of its common stock pursuant to the conversion of debentures at \$.543 per share. The issuances were pursuant to contractual rights granted in prior securities offerings that were exempt under Regulation S, Rule 506 and Section 4(2) of the Act.

In November, 2001, the Company issued 351,743 shares of its common stock at \$1.48 per share in lieu of penalties in connection with the conversion of debentures. The issuances were pursuant to contractual rights granted in prior securities offerings that were exempt under Rule 506 and Section 4(2) of the Act.

In November, 2001, the Company issued 445,540 shares of its common stock at 1.41 per share in lieu of penalties in connection with the conversion of debentures. The issuances were pursuant to contractual rights granted in prior securities offerings that were exempt under Rule 506, Section 4(2), and Regulation S of the Act.

In November, 2001, the Company issued 413,864 shares of its common stock at 1.71 per share in lieu of penalties in connection with the conversion of debentures. The issuances were pursuant to contractual rights granted in prior securities offerings that were exempt under Regulation S, Rule 506 and Section 4(2) of the Act.

In November, 2001, the Company issued 525,000 shares of its common stock for financial advisory services performed on behalf of the Company in connection with a private placement of 1,600,000 shares for proceeds of \$1,120,000. The issuance was exempt under Regulation S due the to foreign nationality of the investors, and Rule 506 and Section 4(2) of the Act.

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In November, 2001, the Company issued 905,205 shares of its common stock at 1.00 per share in lieu of settlement of payables to stockholders. The issuances were exempt under Regulation S, Rule 506 and Section 4(2) of the Act.

In November, 2001, the Company issued 776,919 shares of its common stock pursuant to the conversion of debentures at prices ranging from \$1.25 - \$1.50 per share. The issuances were pursuant to contractual rights granted in prior securities offerings that were exempt under Rule 506, Section 4(2), and Regulation S of the Act.

In November, 2001, the Company issued 100,000 shares of its common stock as a settlement of debt. The issuances were exempt under Rule 506 and Section 4(2) of the Act.

In November, 2001, the Company completed a private placement of 18,437 units of one share of common stock at \$1.36 per share and one warrant to acquire one additional share of common stock at the same price. The offer and sale of securities was made pursuant to an exemption from registration under Rule 506 and Section 4(2) of the Act.

In November 2001, the Company issued 562,171 shares pursuant to a private placement for aggregate proceeds of \$468,746 (including \$132,000 of funds received prior to October 1, 2001). In conjunction with the placement, the Company issued to the shareholders warrants to acquire 562,171 shares of the Company at an exercise price of \$1.00. The warrants have a five-year term and cashless exercise provision. The offer and sale of 66,275 shares was made pursuant to an exemption from registration under Regulation S, Rule 506 and Section 4(2) and the offer and sale of 495,896 shares was made pursuant to an exemption from registration under Rule 506 and Section 4(2) of the Act.

In November, 2001, the Company converted a \$1,210,000 loan received from its President and Chief Executive Officer, Daniel S. Bland, into equity by issuing 2,000,000 shares of common stock to Bland in full satisfaction of the Company's loan obligation to him. As part of this transaction, the Company assumed the obligations of Bland, as borrower, under Bland's loan agreements with International Mercantile Holding Group, Inc. (IMHG), the original lender of the funds. Under the terms of the loan agreements, repayment of the loan amount is secured by collateral in the form of 2,000,000 shares of common stock, which have been pledged by Bland to IMHG. Bland has assigned his residual rights in the 2,000,000 pledged shares of common stock to the Company. Upon repayment of the loan and return of the collateral, the Company intends to cancel the 2,000,000 shares of stock. The term of the loan is five years. The offer and sale of securities was made pursuant to an exemption from registration under Rule 506 and Section 4(2) of the Act.

In November, 2001, the Company issued seven short term promissory notes totaling \$520,000. Each note carries an interest rate of 10%, as well as penalties in the form of stock and warrants for failure either to repay the notes or register shares owned by the noteholders. The Company is not in default under these notes as long as it complies with the equity penalty provisions. None of the notes was paid at maturity. The notes were issued pursuant to exemptions from registration under Regulation S, Rule 506 and Section 4(2).

In November, 2001, the Company issued 434,200 shares of common stock pursuant to the conversion of debentures at \$1.37 per shares. In addition, the Company issued cashless warrants to purchase 523,181 additional shares of common stock at prices ranging from \$.535 to \$3.00 in conjunction with the conversion. The offer and sale of securities were made pursuant to contractual rights granted in prior securities offerings that were exempt from registration under Regulation S, Rule 506 and Section 4(2) of the Act.

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In November, 2001, the Company issued 57,000 shares of common stock at prices ranging from \$1.37 to \$1.41 per share along with warrants to purchase 55,250 additional shares of common stock at \$1.37 per share in conjunction with promissory notes. The offer and sale of securities was made pursuant to an exemption from registration under Regulation S, Rule 506 and Section 4(2) of the Act.

In December, 2001, the Company issued 948,843 shares of its common stock pursuant to the conversion of debentures at \$1.09 per share. The issuances were made pursuant to contractual rights granted in prior securities offerings that were exempt under Rule 506, Section 4(2), and Regulation S of the Act.

In December, 2001, the Company issued 65,730 shares of common stock at prices ranging from \$.83 to \$1.09 along with warrants to purchase 218,363 additional shares of common stock at prices ranging from \$.80 to \$1.37 per share in conjunction with promissory notes. The offer and sale of securities was made pursuant to an exemption from registration under Regulation S, Rule 506 and Section 4(2) of the Act.

In December, 2001, the Company issued eight short term promissory notes totaling \$388,500. Seven of the notes carry interest rates of 12.5%, and one carries an interest rate of 10%. Each note carries penalties in the form of stock and warrants for failure either to repay the notes or register shares owned by the noteholders. The Company is not in default under these notes as long as it complies with the equity penalty provisions. None of the notes was paid at maturity. The notes were issued pursuant to exemptions from registration under Regulation S, Rule 506 and Section 4(2).

The Company has entered into short term promissory notes pursuant to which it is required to pay penalties in the form of stock and warrants if not paid in full on the maturity date.

During the month of October, the Company issued a total of 204,105 shares of common stock as such penalties at deemed prices ranging from \$1.48 to \$1.58 per share. 152,891 shares were issued pursuant to contractual rights granted in prior securities offerings that were exempt from registration under Regulation S, Rule 506 and Section 4(2) of the Act and 51,214 shares were issued pursuant to contractual rights granted in prior securities offerings that were exempt under 506 of Regulation D and Section 4(2) of the Act. During the month of October, the Company also issued a total of 637,974 warrants to purchase shares of common stock as penalties at strike prices ranging from \$.72 to \$6.00 per share. 484,303 of the warrants were issued pursuant to contractual rights granted in prior securities offerings that were exempt under Regulation S, Rule 506 and Section 4(2) of the Act and 153,671 were issued pursuant to contractual rights granted in prior securities offerings that were exempt under Regulation D and Section 4(2) of the Act.

During the month of November, the Company issued a total of 105,502 shares of common stock as such penalties at deemed prices ranging from \$1.15 to \$1.41 per share. 80,151 shares were issued pursuant to contractual rights granted in prior securities offerings that were exempt from registration under Regulation S, Rule 506 and Section 4(2) of the Act and 25,351 shares were issued pursuant to contractual rights granted in prior securities offerings that were exempt under 506 of Regulation D and Section 4(2) of the Act. During the month of November, the Company also issued a total of 685,099 warrants to purchase shares of common stock as penalties at strike prices ranging from \$1.03 to \$6.00 per share. 539,769 of the warrants were issued pursuant to contractual rights granted in prior securities offerings that were exempt under Regulation S, Rule 506 and Section 4(2) of the Act and 145,420 were issued pursuant to contractual rights granted in prior securities offerings that were exempt under Regulation D and Section 4(2) of the Act.

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During the month of December, the Company issued a total of 235,568 shares of common stock as such penalties at deemed prices ranging from \$.78 to \$1.34 per share. 175,524 shares were issued pursuant to contractual rights granted in prior securities offerings that were exempt from registration under Regulation S, Rule 506 and Section 4(2) of the Act and 60,044 shares were issued pursuant to contractual rights granted in prior securities offerings that were exempt under 506 of Regulation D and Section 4(2) of the Act. During the month of December, the Company also issued a total of 764,051 warrants to purchase shares of common stock as penalties at strike prices ranging from \$.72 to \$6.00 per share. 577,586 of the warrants were issued pursuant to contractual rights granted in prior securities offerings that were exempt under Regulation S, Rule 506 and Section 4(2) of the Act and 186,465 were issued pursuant to contractual rights granted in prior securities offerings that were exempt under Regulation D and Section 4(2) of the Act.

Item 5. Other Information

During the period of May, 2000, through June, 2001, the Company issued eight short term promissory notes totaling \$989,322. Six of the notes carry interest rates of 10%, as well as penalties in the form of stock and warrants for failure either to repay the notes or register shares owned by the noteholders. The Company is not in default under these notes as long as it complies with the equity penalty provisions. The other two notes carry interest rates of 8% without penalty. None of the notes was paid at maturity. The notes were issued pursuant to exemptions from registration under Regulation S, Rule 506 and Section 4(2).

Item 6. Exhibits

| Exhibit No. | Description |
|-------------|-------------|
| ----- | ----- |

Upgrade International Corporation

Date: February 18, 2002

Daniel Bland, President and Chief
Executive Officer, and Secretary

Date: February 18, 2002

Howard A. Jaffe, Chief Operating
and Financial Officer