EPICEDGE INC
Form 10-Q
August 28, 2001

Form 10-Q

UNITED STATES SECURITIES AND EXCHANGE COMISSION

Washington, D.C. 20549

ý QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2001

OR

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

Commission File Number: 0-9129

EPICEDGE, INC.

Formerly Known as Design Automation Systems, Inc.
(Exact name of Registrant as specified in its charter)

TEXAS	**75-1657943**
(State or other jurisdiction of Incorporation or organization)	(IRS Employer Identification Number)

5508 Hwy. 290 West Suite 300
Austin, TX 78735
512-261-3346
(Address and telephone number of principal executive offices)

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 filing requirements for the past 90 days.

ý Yes o No

The number of shares of common stock of the Registrant outstanding at August 2, 2001 was 28,495,050.

EPICEDGE, INC.
FORM 10-Q
FOR THE QUARTER ENDED June 30, 2001

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

EPICEDGE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	(unaudited) **June 30, 2001**	**December 31, 2000**
Current Assets:		
Cash and cash equivalents	$ 801,000	$ 1,435,000
Trade receivables	3,259,000	6,112,000
Allowance for doubtful accounts	(774,000)	(767,000)
Other current assets	902,000	373,000
Total Current Assets	4,188,000	7,153,000
Property and equipment, net	2,042,000	2,765,000
Goodwill, net	2,999,000	13,077,000
Other non current assets	301,000	1,781,000
TOTAL	$ 9,530,000	$ 24,776,000
LIABILITIES AND SHAREHOLDERS EQUITY (DEFICIT)		
Current Liabilities:		
Notes payable	$ 8,971,000	$ 15,639,000
Accounts payable	2,747,000	4,911,000

Accrued expenses and other current liabilities	3,988,000	3,732,000
Total Current Liabilities	15,706,000	24,282,000
Shareholders Equity (Deficit):		
Common stock 29,262,396 shares issued and 28,495,050 shares outstanding at June 30, 2001	293,000	296,000
Common stock warrants	7,534,000	7,534,000
Additional paid in capital	73,063,000	81,908,000
Treasury stock 767,346 shares at June 30, 2001	(631,000)	(398,000)
Unearned compensation		(333,000)
Unearned compensation IPS ESOP		(8,979,000)
Accumulated deficit	(86,435,000)	(79,534,000)
Total Shareholders Equity (Deficit)	(6,176,000)	494,000
TOTAL	$ 9,530,000	$ 24,776,000

See notes to condensed consolidated financial statements.

EPICEDGE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	**2000**	**2001**	**2000**
REVENUES:				
Professional services	$ 3,923,000	$ 4,555,000	$ 7,061,000	$ 6,399,000
Technology integration	0	6,938,000	0	11,883,000
Total revenues	3,923,000	11,493,000	7,061,000	18,282,000
COST OF REVENUES:				
Professional services	2,501,000	2,619,000	4,924,000	3,833,000
Technology integration	0	5,757,000	0	10,083,000
Total cost of revenues	2,501,000	8,376,000	4,924,000	13,916,000
GROSS PROFIT	1,422,000	3,117,000	2,137,000	4,366,000

OPERATING EXPENSES:				
Selling, general and administration	1,137,000	2,220,000	2,114,000	3,623,000
Compensation and benefits	1,042,000	3,059,000	3,011,000	5,019,000
Stock-based compensation and costs		6,344,000		6,946,000
Depreciation and amortization	1,452,000	979,000	2,904,000	1,385,000
Total operating expenses	3,631,000	12,602,000	8,029,000	16,973,000
OPERATING LOSS	(2,209,000)	(9,485,000)	(5,892,000)	(12,607,000)
OTHER INCOME (EXPENSE):				
Debt discount amortization	(600,000)	0	(1,200,000)	0
Interest expense	(222,000)	(119,000)	(303,000)	(235,000)
Interest income	0	132,000	0	157,000
Other	10,000	83,000	16,000	92,000
	(812,000)	96,000	(1,487,000)	14,000
LOSS FROM CONTINUING OPERATIONS BEFORE EXTRAORDINARY ITEM	(3,021,000)	(9,389,000)	(7,379,000)	(12,593,000)
INCOME FROM DISCONTINUED OPERATIONS	0	17,000	0	18,000
EXTRAORDINARY ITEM				
Gain on restructuring of payables	404,000	0	479,000	0
NET LOSS	$ (2,617,000)	$ (9,372,000)	$ (6,900,000)	$ (12,575,000)
Loss Per Share basic and diluted:				
Continuing operations	$ (0.11)	$ (0.36)	$ (0.26)	$ (0.50)
Extraordinary item	0.02	-	0.02	-
Net loss	$ (0.09)	$ (0.36)	$ (0.24)	$ (0.50)
Weighted Average Shares Outstanding	28,462,217	26,127,363	28,773,113	25,185,562

See notes to condensed consolidated financial statements.

EPICEDGE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30,	
	2001	**2000**
Operating Activities:		

Net loss from continuing operations	$ (7,379,000)	$ (12,593,000)
Non-cash items in net loss above:		
Depreciation and amortization	2,904,000	1,385,000
Stock-based compensation and costs		6,946,000
Debt discount amortization	1,200,000	
Provision for doubtful accounts	54,000	42,000
Changes in operating assets and liabilities, net of effects of purchase and sale of subsidiaries:		
Accounts receivable	(229,000)	(1,892,000)
Unbilled receivable		(793,000)
Inventory		(488,000)
Prepaid and other assets	(624,000)	353,000
Accounts payable	(1,187,000)	(1,073,000)
Accrued expenses and other liabilities	716,000	636,000
Net cash used in operating activities	(4,545,000)	(7,477,000)
Investing Activities:		
Purchase of property and equipment	(282,000)	(2,081,000)
Cash for acquisitions		(2,821,000)
Cash from sale of subsidiary	5,700,000	
Increase in other assets		(477,000)
Net cash provided by (used in) investing activities	5,418,000	(5,379,000)
Financing Activities:		
Net proceeds from the issuance of common stock		10,906,000
Repurchase of common stock, net	(138,000)	
Proceeds from revolving line of credit		2,700,000
Repayment of debt, net	(1,369,000)	(223,000)
Net cash (used in) provided by financing activities	(1,507,000)	13,383,000
(Decrease) Increase in cash and cash equivalents	(634,000)	527,000
Cash and cash equivalents, beginning of period	1,435,000	1,517,000
Cash and cash equivalents, end of period	$ 801,000	$ 2,044,000

See notes to condensed consolidated financial statements.

EPICEDGE, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by EpicEdge, Inc.(the "Company" or "EpicEdge") pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2000 included in the Company's Annual Report on Form 10-KSB. The accompanying condensed consolidated financial statements reflect all adjustments (consisting solely of normal, recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of results for the interim periods presented. The results of operations for the three and six months ended June 30, 2001 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

In connection with the Company's acquisitions, the Company has recorded goodwill that was being amortized on a straight-line basis in 1999 and 2000 over an eight-year period. Goodwill represents the amount that the Company paid for these acquired businesses in excess of the fair value of the acquired tangible and separately measurable intangible net assets, less impairment write-offs. At June 30, 2001, the unamortized portion of these intangibles was approximately $3.0 million, which represented 31.5% of total assets.

The Company periodically reviews the carrying value and recoverability of its unamortized goodwill and other intangible assets for impairment. If conditions suggest that the goodwill or other intangible assets may be impaired, the carrying value of these assets are evaluated and adjusted as necessary by an immediate charge against income during the period of the adjustment. Goodwill impairment write-offs of $36,440,000 were recognized in the fourth quarter 2000. After this write-off, the remaining goodwill relates fully to the acquisitions made in 1999. The length of the remaining amortization period may also be shortened, which will result in an increase in the amount of goodwill amortization during the period of adjustment and each period thereafter until fully amortized. Once adjusted, there can be no assurance that there will not be further adjustments for impairment and recoverability in future periods. In evaluating impairment, a principal factor considered is the failure to achieve expected cash flows from the related operations. Based upon these factors, during the quarter ended March 31, 2001, the Company decreased the amortization period of the original goodwill to approximately 32 months beginning in that quarter. For future quarters, the Company will amortize approximately $1,217,000 quarterly.

2. Acquisitions

In March 2000, the Company acquired all the outstanding common shares of The Growth Strategy Group, Inc. (Growth Strategy), an e-marketing and strategy consulting firm, for 277,000 unregistered shares of the Company's common stock valued at $6,077,000 and $375,000 in cash. Goodwill of $6,100,000 was recorded related to this acquisition. As a result of a review by Management of the carrying value and recoverability of this goodwill, Management wrote off the unamortized balance of Growth Strategy s goodwill as of December 31, 2000. Accumulated amortization of $643,000 had been recorded related to this goodwill through December 31, 2000.

In June 2000, the Company acquired all of the issued and outstanding stock of IPS, a project management firm, for $3,000,000 in cash, 1,472,586 unregistered shares of the Company's common stock, options to purchase 1,082,060 shares of the Company's common stock and the assumption of net liabilities of $2,940,000. The aggregate value of the shares and stock options issued in connection with the transaction was $36,405,000. The Company also assumed an employee stock ownership plan (ESOP) from IPS, and 607,023 of the 1,472,586 shares of common stock related to the transaction were issued to the ESOP. The Company recorded unearned compensation of $9,445,000 related to 493,220 shares of common stock issued to the ESOP, but not yet committed to be released by the ESOP s trustee. This amount was to be amortized over a period of approximately three to five years as the shares were committed to be released. In connection with the assumption of the ESOP, the Company assumed a note payable to a financial institution for ESOP financing of approximately $5,000,000. The note is secured by the accounts receivable, investments, and property and equipment of IPS. Goodwill of $34,240,000 was recorded related to this acquisition. Accumulated amortization of $2,558,000 had been recorded related to this goodwill through December 31, 2000. As discussed in Note 3, IPS was sold effective January 1, 2001, at a substantial loss. This loss was recorded in the financial statements as of December 31, 2000.

In connection with the IPS acquisition, the Company paid a commission of $300,000 in cash to an organization that facilitated the execution of the transaction and issued 25,065 unregistered shares of the Company's common stock valued at $576,000 all of which was recorded as part of the cost of the IPS acquisition.

The above acquisitions were accounted for under the purchase method of accounting and resulted in the Company recording goodwill of $40,340,000. The results of operations of Growth Strategy and IPS have been included in the Company's financial statements commencing on April 1, 2000 and June 1, 2000, respectively, the effective dates of the transactions for accounting purposes. IPS was sold with an effective date of January 1, 2001, as discussed in Note 3; therefore, the unaudited consolidated results of operations on a pro forma basis as though Growth Strategy only had been made and the related common shares were issued as of January 1, 2000 are as follows:

	Six Months Ended June 30, 2000
Revenues	$16,952,000
Net loss from continuing operations	$(14,402,000)
Loss per share	$(0.58)
Weighted average common shares outstanding	25,034,146

3. Financial Restructuring and Related Matters

Effective January 1, 2001, with a closing date of February 5, 2001, the Company sold all of the issued and outstanding stock of IPS to Red & Blue, Inc., a Delaware corporation, and to the IPS Associates, Inc. Stock Ownership Plan. The consideration for the sale was (1) the return of an aggregate 740,260 shares of the Company's common stock, including ESOP shares, (2) $5,700,000 in net proceeds and (3) the transfer of the IPS ESOP plan, along with the note payable to a financial institution for the ESOP financing of $4,861,000. The stock purchase agreement provided that 143,323 shares of the 740,260 shares of the Company's common stock be held in escrow until the earlier of (1) the completion of audited financial statements of IPS for the year ended December 31, 2000, or (2) six months from the date of closing. In the event that the net equity, revenues or net earnings of IPS differed by more than $500,000 from the financial statements disclosed in the purchase agreement, Red & Blue, Inc. had the right to setoff the difference against the shares held in escrow at a value based upon the closing price of the Company's common stock on the day before the setoff. In the event of a setoff, the Company has agreed to immediately register the setoff shares. Based on audited financial results of IPS, no such setoff occurred.

The sale of IPS resulted in write-offs of goodwill with a non-cash charge to income of approximately $24,040,000 in the fourth quarter ended December 31, 2000.

In the first quarter 2001, the Company received the above described proceeds, cancellation of inter-company payables and receivables with IPS, along with the return of 740,260 shares now in Treasury, in exchange for the transfer of assets of $6,085,000 and liabilities of $8,028,000. In addition, with the return of the shares held by the ESOP, a reduction in unearned compensation of $8,979,000 associated with these unreleased ESOP shares was recorded as a charge against the additional paid in capital arising from the IPS acquisition.

The net proceeds from the sale of IPS were used to pay off the secured debt of $2,275,000 and the balance was used to fund working capital needs such as payroll and current accounts payable.

In February 2001, the Company hired a consulting group to assist in designing and executing a repayment plan (the Plan) with its unsecured creditors. This Plan, which was executed in June 2001, after achieving an acceptable percentage of consents from the unsecured creditors, is designed to repay this group over time up to 60% of the original unsecured accounts payable amount as of February 1, 2001 with certain further reductions in the amount to be paid based upon the acceleration of payments over the Plan requirements. This additional unsecured debt reduction is designed to provide an incentive to the Company to accelerate its return back to a cash flow positive position. To date the Company has received consents from unsecured creditors, which total approximately $ 2.9 million.

In June 2001, the Company paid the initial installment to consenting unsecured creditors under the Plan. As a result, the Company recognized a gain from this restructuring of $404,000 in the second quarter which represents a portion of the agreed upon reduction in the obligation due to the consenting unsecured creditors. As additional consents are received, the Company will make the required payments and recognize additional restructuring gains. The initial installment represented 18% of the original obligation. The second installment of 4% due under the Plan is scheduled to be made in the fourth quarter 2001 and each quarter thereafter until a total of 60% of the original obligation is repaid.

In March 2001, the Company negotiated new terms for $1,933,000 of other notes payable, which extended repayment terms into 2002.

On June 21, 2001 the Company executed letter agreements and promissory notes (the Notes) with certain existing shareholders with an initial funding of $800,000. The Notes, once fully funded, will be for no less than $2,000,000. The Notes are for a term of one year and have a stated interest rate of 8%. The Notes have an ultimate right to convert the outstanding balance, plus any accrued interest, into shares of cumulative 8% Series A Convertible Preferred Stock (Series A Preferred Stock). In the event of any liquidation or dissolution of the Company, the holders of the Series A Preferred Stock will be entitled to receive at their option, either (a) an amount equal to two and one-half (2½) times the original purchase price along with all accrued but unpaid dividends or (b) a ratable share of the distribution of assets and property with the holders of the common stock, participating on an as converted basis. These shares of Series A Preferred Stock are further convertible, at the option of the holders, at any time, into shares of common stock at a conversion price equal to one share of common stock for each $0.25 of stated value.

In July 2000, the Company completed a $5,000,000 convertible debt offering (Convertible Notes Payable) with certain private investors. The Convertible Notes Payable bear annual interest at 9.5%. Principal and interest was due at maturity on December 31, 2000. On July 20, 2001, the Company reached an agreement related to the Convertible Notes Payable, which was due on demand, under which the maturity date was extended to August 1, 2002. The conversion terms were to be renegotiated by August 15, 2001; otherwise, a penalty of $500,000 would have been assessed and payable in February 2002. The Company is in the process of completing these renegotiations and the new terms are the principal and accrued interest underlying the Convertible Notes Payable shall be exchanged into Series B Preferred Stock with a stated value of approximately $5 million dollars. These new terms also include a waiver of the penalty. These Series B Preferred Stock shall have the following terms: a conversion rate equal to one share of common stock for each $.75 of stated value or a liquidation preference such that in the event of any liquidation, dissolution or winding up of the Company, the holders thereof shall be entitled to receive, at their option, either (a) in preference to the holders of the common stock an amount equal to two and one-half (2½) times the stated value, or (b) a ratable share of the distribution of assets and property with the holders of the common stock, participating on an as converted basis. A merger, acquisition or sale of all or substantially all of the assets of the Company in which the shareholders of the Company do not own a majority of the outstanding shares of the surviving corporation shall be deemed to be a liquidation.

In October 2000, the Company reduced its workforce by 43 full-time positions, or 14% of our workforce at that time. In the first quarter 2001, a strategy and plan of execution was adopted to attempt to stabilize the organization and return to cash flow positive and eventually profitability. This strategy included a strict line-by-line review and evaluation of non-compensation expenses as well as another 15% reduction in the Company s workforce in the Creative, Research and Sales departments. In the fourth quarter 2000 and in the first quarter 2001, there were continuing additional non-recurring expenses associated with these reductions in force. Due to the eventual reductions in compensation and benefits along with the results of the line-by-line review and evaluation of non-compensation expenses, the Company expects to be cash flow positive by the end of 2001; however, no assurances can be made that these expense reductions will have the expected effect or occur in the anticipated timeframe.

At June 30, 2001, the Company had a working capital deficit of $11,518,000. Additionally, over the preceding two years the Company has completed several acquisitions that have placed an additional strain on its cash resources as the operations of the acquired businesses were integrated with its operations. Management is currently in the process of raising additional financing to meet planned working capital requirements. In the event that management is unable to obtain additional financing on terms that are acceptable to them, then they will have to modify their business plan to reduce future cash outflows to enable the Company to meet its liquidity requirements for the next twelve months. Furthermore, the Company will require additional cash to meet its short- and long-term liquidity requirements and to execute its current business plan.

Management expects that the execution of the unsecured creditor plan, the promissory notes and the expected results from future operations will provide the working capital necessary to enable the Company to continue to implement its business plan for the next twelve months. There can be no assurance that these events will provide the necessary working capital to fulfill the Company s needs; therefore, additional reductions or additional sources of funds may be necessary in 2002. These uncertainties could have a material adverse affect on the Company s ability to execute its current business plan.

4. Capital Transactions

In the first quarter 2001, there was a reduction in unearned compensation of $8,979,000 associated with unreleased ESOP shares and an increase in treasury stock of $233,000 as a result of the sale of IPS, as more fully described elsewhere in this Form 10-Q.

In December 2000, the Company granted 400,000 options to an employee with a six (6) month vesting period. These options had an exercise price of $0.125 per share and, accordingly, the Company recorded unearned compensation of $400,000 based upon the market price of the stock on the date of grant. On January 4, 2001, the employee resigned his executive position; therefore, in January 2001, the Company reversed the remaining unearned compensation of $333,000 related to these options. After resigning, this ex-employee exercised his vested portion of 66,668 options.

In 1999, the Company issued 1,100,000 shares of stock to a consulting firm for the performance of various services. The value of these shares was recorded as an operating expense at the time of grant. In 2000, the Company made a claim for the return of a portion of these shares as the consulting firm failed to fully execute on the original contractual arrangement as agreed. In the first quarter 2001 this issue was settled with the return and cancellation of 480,000 shares, which was recorded at the estimated current value of the stock of $0.34 per share as of the return date.

5. Earnings (Loss) Per Share

Earnings (loss) per basic share is calculated by dividing net income (loss) available to common stockholders by the weighted average shares of common stock outstanding during the period. Diluted earnings per share is calculated by dividing net income available to common stockholders by the weighted average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming conversion of all potentially dilutive shares outstanding. Stock options, warrants, and Convertible Notes of approximately 17,462,784 and 17,056,131 for the three months and six months ended June 30, 2001 and 2,287,000 and 2,212,000 for the three months and six months ended June 30 2000 were excluded from the calculation of the loss per share because the effect would have been anti-dilutive.

6. New Accounting Pronouncements

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which establishes standards for measuring, classifying and reporting all derivative financial instruments in the financial statements. The Company adopted SFAS No. 133 in the first quarter of fiscal year 2001. The adoption of this standard did not have a material impact on the Company's financial position or results of operations.

In July 2001, the FASB issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 includes requirements to test goodwill and indefinite lived intangible assets for impairment rather than amortize them. These standards will be adopted in fiscal 2002. The Company is currently evaluating the impact that these standards will have on its financial statements.

* * * *

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

Overview

The following analysis of the results of operations and financial condition of the Company should be read in conjunction with the condensed financial statements, including the notes thereto, contained elsewhere in this Form 10-Q.

This discussion contains forward-looking statements. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, believ estimates, predicts, potential, or the negative of these terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of these forward-looking statements. We are under no duty to update any of the forward-looking statements after the date of this report to conform our prior statements to actual results.

EpicEdge, Inc. is a publicly held Texas corporation listed on the American Stock Exchange under the symbol EDG. We were originally incorporated under the name Loch Exploration, Inc. in June 1979. In April 1989, Loch Exploration, Inc. filed for Chapter 11 bankruptcy, and was reorganized in connection with its Plan of Reorganization, effective November 17, 1989. In December 1998, Loch Exploration, Inc. transferred all of its assets and liabilities to Loch Energy, Inc., in exchange for shares of Loch Energy, Inc. common stock, whereby Loch Energy, Inc. became a subsidiary of Loch Exploration, Inc. In January 1999 Loch Exploration, Inc. acquired all of the issued and outstanding capital stock of Design Automation Systems, Inc., a private company, in exchange for shares of common stock. In April 1999, Design Automation Systems, Inc. was merged into Loch Exploration, Inc., and Loch Exploration, Inc. changed its name to Design Automation Systems Incorporated. In March 2000, we changed our name to EpicEdge, Inc. During the quarter ended September 30, 2000, we irrevocably transferred our investment in the remaining shares of Loch Energy to a designated trustee.

In 2000, we engaged in the business of providing professional services in enabling our clients to meet their business goals through implementation and support of client/server ERP financial and human resource systems, custom web application development of object oriented Internet applications, and implementing strategic marketing plans. Unix systems integration was also a major line of business in 2000, providing hardware and integration services on platforms such as, SUN, IBM, and Hewlett Packard. However, during 2000 we successfully transitioned away from system integrations and focused on professional services.

Our services currently include assisting clients in dealing with issues during the entire software development life cycle of their projects, including the following: strategic planning, business process evaluation, integrated marketing and communications, brand structure and design, system architecture and design, product acquisition, configuration and implementation, ongoing operational support, and evolutions in technology. We provide solutions to complex information technology problems focusing on enabling our clients to take advantage of the evolving Internet technologies. Our methodology includes the concept to completion approach that provides customers maximum return on their software investment and lower total cost of ownership. This methodology encapsulates a holistic approach to technology that is driven by an organizations business needs. The majority of our revenues are associated with providing project management, consulting services, and software implementation to state and local governments, including the States of Texas, Washington, Tennessee, and Montana.

RESULTS OF OPERATIONS

The following table sets forth certain condensed consolidated statement of operations data expressed as a percentage of total revenues for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	63.7	72.9	69.7	76.1
Gross margin	36.3	27.1	30.3	23.9
Operating expenses:				
Selling, general and administrative	29.0	19.3	30.0	19.8
Compensation and benefits	26.6	26.6	42.6	27.5
Stock based compensation	-	55.2	-	38.0
Depreciation and amortization	37.0	8.5	41.1	7.6
	92.6	109.6	113.7	92.9
Loss from operations	(56.3)	(82.5)	(83.4)	(69.0)
Interest and other income (expense), net	(20.7)	0.8	(21.1)	0.1
Loss from continuing operations	(77.0)	(81.7)	(104.5)	(68.9)
Income (loss) from discontinued operations	-	0.1	-	0.1
Extraordinary item-Gain on restructuring	10.3	-	6.8	-
Net loss	(66.7)%	(81.6)%	(97.7)%	(68.8)%

REVENUES

In 2000, we had two primary sources of revenue, technology integration and professional services. However, during 2000 we successfully transitioned away from the technology integration business as a systems integrator and reseller of Unix systems providing hardware and integration services on platforms such as SUN, IBM, and Hewlett Packard. The surviving source of revenue, professional services, which we believe has the most future profit potential, is in the business of enabling our clients to meet their business goals through implementation and support of client/server ERP financial and human resource systems, custom application development of open source, object oriented internet applications, and strategic marketing.

For the three months ended June 30, 2001, as compared to the three months ended June 30, 2000, total revenues decreased $7,570,000, or 65.9%, to $3,923,000 from $11,493,000. For the six months ended June 30, 2001, as compared to the six months ended June 30, 2000, total revenues decreased $11,221,000, or 61.4%, to $7,061,000 from $18,282,000. The decrease in revenue is due primarily to system integration revenue which decreased from $6,938,000 and $11,883,000 for the three and six months ended June 30, 2000, respectively, to $-0- for both periods in 2001.

In June 2000 we bought IPS from which we recorded $1,546,000 in professional services revenue in the second quarter 2000. IPS was sold effective January 1, 2001, as more fully described elsewhere in this Form 10-Q, and therefore no professional services revenue was recognized in the current quarter from that entity. Excluding the revenue from IPS in 2000, revenue from professional services increased $914,000, or 30.4%, and $2,208,000, or 45.5%, for the three and six months ended June 30, 2001 over the respective periods in 2000. Two customers represented 52% and 53% of total revenues in the three and six months ended June 30, 2001, respectively and revenue from no single customer represented 10% or more of total revenue in the three or six months ended June 30, 2000. This increase in concentration is primarily the result of new long-term contracts that were entered into in the third and fourth quarter 2000 and one of which has a term through the third quarter 2007.

COST OF REVENUES and GROSS PROFIT

For the three months ended June 30, 2001, total gross profit decreased to $1,422,000, or 54.4%, as compared to the three months ended June 30, 2000 of $3,117,000, and for the six months ended June 30, 2001, total gross profit decreased to $2,137,000, or 51.1%, as compared to the six months ended June 30, 2000 of $4,366,000. This reduction is primarily the result of the planned elimination of system integration as a source of revenue. Gross profit from professional services decreased $514,000, or 26.5%, to $1,422,000 from $1,936,000 for the three months ended June 30, 2001 and 2000, respectively, and it decreased $429,000, or 16.7%, to $2,137,000 from $2,566,000 for the six months ended June 30, 2001 and 2000, respectively. However, after eliminating the comparative effect of the gross margin recorded from the IPS professional services revenue in 2000, the gross profit from professional services increased $442,000, or 45.1%, from $980,000 for the three months ended June 30, 2000, and it increased $527,000, or 32.7%, from $1,610,000 for the six months ended June 30, 2000.

The gross margin percent from professional services, after eliminating the effects of the gross margin realized from IPS in 2000, increased 11.0% for the three months ended June 30 from 32.6% in 2000 to 36.2% in 2001. The comparable gross margin percent for the six months ended June 30 decreased 8.7% from 33.2% in 2000 to 30.3% in 2001. The higher gross margin percent for the six months in 2000 was the result of the completion of the final phase of milestone projects. Milestone projects are those that must meet a certain contractual milestones. Depending on the timing of the acceptance, the final phase can provide higher gross margins than those realized over the entire contract.

OPERATING EXPENSES

Selling, general and administrative expenses decreased $1,083,000, or 48.8%, to $1,137,000 from $2,220,000 for the three months ended June 30, 2001, and 2000, respectively. For the six months ended June 30, 2001, as compared to the six months ended June 30, 2000, selling, general and administrative expenses decreased $1,509,000, or 41.7%, from $3,623,000 to $2,114,000. After eliminating the selling, general and administrative expenses relating to IPS in 2000, the decrease was $694,000, or 37.9%, and $1,120,000, or 34.6%, for the three and six months ended June 30, respectively. In the first quarter 2001, a strategy and plan of execution was adopted to attempt to stabilize the organization and return to cash flow positive and eventually profitability. This strategy included a strict line-by-line review and evaluation of non-compensation expenses. This review and evaluation is a on-going effort and we continued to control and decrease our selling, general and administrative expenses during the second quarter.

Compensation and benefit expenses decreased $2,017,000, or 65.9%, to $1,042,000 from $3,059,000 for the three months ended June 30, 2001, and 2000, respectively. For the six months ended June 30, 2001, as compared to the six months ended June 30, 2000, compensation and benefit expenses decreased $2,008,000, or 40.0%, to $3,011,000 from $5,019,000. After eliminating the compensation and benefit expenses relating to IPS in 2000, the decrease was $1,606,000, or 60.6%, and $1,597,000, or 34.7%, for the three and six months ended June 30, respectively. We are beginning to see the effects of the October 2000 reduction in our workforce by 43 full-time positions, or 14% of our workforce at that time, as well as another 15% reduction in our workforce in the Creative, Research and Sales departments in the first quarter of 2001. With these reductions in compensation and benefits along with the results of the line-by-line review and evaluation of non-compensation expenses, we expect to be cash flow positive by the end of 2001; however, no assurances can be made that these expense reductions will have the effect we expect or occur in the timeframe we anticipate.

Depreciation and Amortization

In connection with the Company's acquisitions, the Company has recorded goodwill that was being amortized on a straight-line basis in 1999 and 2000 over an eight-year period. Goodwill represents the amount that the Company paid for these acquired businesses in excess of the fair value of the acquired tangible and separately measurable intangible net assets, less impairment write-offs. At June 30, 2001, the unamortized portion of these intangibles was approximately $3.0 million, which represented 31.5% of total assets.

The Company periodically reviews the carrying value and recoverability of its unamortized goodwill and other intangible assets for impairment. If conditions suggest that the goodwill or other intangible assets may be impaired, the carrying value of these assets are evaluated and adjusted as necessary by an immediate charge against income during the period of the adjustment. Goodwill impairment write-offs of $36,440,000 were recognized in the fourth quarter 2000. After this write-off, the remaining goodwill relates fully to the acquisitions made in 1999. The length of the remaining amortization period may also be shortened, which will result in an increase in the amount of goodwill amortization during the period of adjustment and each period thereafter until fully amortized. Once adjusted, there can be no assurance that there will not be further adjustments for impairment and recoverability in future periods. In evaluating impairment, a principal factor considered is the failure to achieve expected cash flows from the related operations. Based upon these factors, during the quarter ended March 31, 2001, the Company decreased the amortization period of the original goodwill to approximately 32 months beginning in that quarter. For future quarters, the Company will amortize approximately $1,217,000 quarterly.

Stock-based Compensation and Costs

Stock-based compensation and costs was $6.3 million and $6.9 million for the three and six months ended June 30, 2000, representing 55% and 38% of total revenues in the respective periods. No stock-based compensation was recorded during the three and six months ended June 30, 2001. The stock-based compensation charges during the three and six months ended June 30, 2000 were based on certain transactions discussed below.

In November 1999, the Company granted 190,000 unregistered shares of the Company's common stock to two of its board members as compensation for their participation on the Company's Board of Directors. The shares are issued to each board member in equal installments at the end of each quarter through the December 31, 2000. The Company recorded the value of the shares issued each quarter by multiplying the average quoted market price of the stock for the period in which the stock was issued times the number of shares issued for that period. The Company recorded stock-based compensation related to the shares issued of $875,000 and $1,476,000, respectively, for the three and six months ended June 30, 2000. The Company issued 47,500 shares to these board members during the six months ended June 30, 2000.

In March 2000, the Company issued warrants for the purchase of 40,000 shares of the Company's common stock to two advisory board members for services to be rendered from April 2000 to March 2002. The warrants have an exercise price of $21.88 and are exercisable for five years from the date of grant. One third of the warrants vest upon grant, and the remaining two-thirds vest in one half increments on the first and second anniversary of the grant date. The Company recorded the initial value of these warrants based on the Black-Scholes model, totaling $346,000, as unearned compensation on the date of grant. The Company was amortizing this amount as compensation expense over the consulting period, and will revalue the warrants over the consulting period. The Company revalued the warrants at December 31, 2000 and based on the lower stock price, it reduced the amount of unearned compensation to zero. The Company recorded stock-based compensation of $159,000 for the three months ended June 30, 2000.

In April 2000, the Company issued a client s venture capital affiliate a warrant to purchase 500,000 shares of the Company's common stock at an exercise price of $22.00 per share. The warrant is exercisable at any time after the earlier of (i) 60 days after the consummation of a registered public offering and (ii) October 3, 2001 (such earlier date being the vesting date), through the third anniversary of the vesting date. The warrant was issued contemporaneously with the negotiation of a consulting contract between the Company and the client. The Company has determined the value of the warrant to be $4,843,000 based on the Black-Scholes model. At June 30, 2000 there was no assurance that the client would continue to engage the Company under the agreement or would enter into any future agreements; accordingly, the Company recorded an estimated value of the warrants as stock-based compensation and costs charge of $4,843,000 during the three months ended June 30, 2000. The client cancelled the consulting agreement in January 2001.

In June 2000, the Company entered into a severance agreement with one of its employees that provided, among other things, for the modification of the employee's stock options allowing a cashless exercise of vested and unexercised stock options. As a result, the Company accounted for the stock options as variable options and recorded a stock-based compensation charge on the measurement date during the three months ended June 30, 2000 of $467,000 based on the difference between the exercise price and the quoted market price of the underlying stock. The Company issued 22,353 shares of its common stock to the former employee as a result of the cashless exercise.

Debt Discount Amortization

In November 2000, our Chairman and principal stockholder provided a $1,000,000 line of credit to us in the form of a convertible note (the November Convertible Note). We may draw upon the line of credit from time to time as needed. As of June 30, 2001, we had drawn $900,000 on the line of credit. The November Convertible Note bears annual interest at the rate of 8%, is convertible at the lenders option at $.50 per share and matures on December 31, 2001. The lender had the option to demand repayment of the November Convertible Note within 30 days after the IPS sale; however, the lender made no such demand. In connection with the November Convertible Note, the lender was issued five-year warrants to purchase an aggregate of 2,000,000 shares of our common stock at $.01 per share. We recorded debt discount of $900,000 in connection with the issuance of the warrants, which resulted in a net carrying value of zero for the November Convertible Note. This discount will be amortized into interest expense over the life of the November Convertible Note. Debt discount amortization of $225,000 and $450,000 was recorded for the three and six months ended June 30, 2001, respectively.

In December 2000, we issued $1,500,000 in convertible notes to two of our stockholders (the December Convertible Notes), one of which is currently represented on our Board of Directors and one of which formerly served on our Board of Directors. The December Convertible Notes are convertible at the lenders option at $.50 per share. The December Convertible Notes bear interest at 8% per annum and mature on December 31, 2001. The lenders had the option to demand repayment of the December Convertible Notes within 30 days after the IPS sale. In connection with the December Convertible Notes, the lenders were issued five-year warrants to purchase an aggregate 3,000,000 shares of our common stock at $.01 per share. We recorded debt discount of $1,500,000 in connection with the issuance of the warrants, which resulted in a net carrying value of zero for the December Convertible Notes. This discount will be amortized into interest expense over the life of the December Convertible Notes. Debt discount amortization of $375,000 and $750,000 was recorded for the three and six months ended June 30, 2001, respectively.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2001, the Company s primary sources of liquidity were cash and cash equivalents of $801,000 and net accounts receivable of $2,485,000.

As of December 31, 2000, our primary sources of liquidity were cash and cash equivalents of $1,435,000 and net accounts receivable of $5,345,000. We also relied on amounts available under lines of credit totaling $3,434,000 with two financial institutions. There were no additional amounts available under the lines of credit on December 31, 2000. We had executed and in place three lines of credit totaling $6.5 million with three financial institutions. We could draw on the lines of credit based on a borrowing base that is 85% of eligible accounts receivable. Amounts outstanding under the lines of credit bear interest ranging from the prime rate plus 0.5% to the prime rate plus 2.5%. The lines of credit were secured by accounts receivables, inventory, investments and property and equipment. The outstanding balance on the lines of credit was $3,434,000. We also were the guarantor on a note payable to a financial institution for a loan made to an Employee Stock Ownership Plan sponsored by us (the "ESOP loan"). The ESOP loan bears annual interest at 8.02% and is secured by accounts receivables, inventory, investments, property and equipment, and the personal guarantees of certain employees and stockholders of the Company. The outstanding balance of the ESOP loan at December 31, 2000 was $4,861,000. At December 31, 2000, we were in technical default of our lines of credit and the ESOP loan and the creditors had asserted the default under the loan agreements. The financial institutions agreed to temporarily standstill and forbear accelerating the outstanding balances through approximately January 20, 2001 to allow us time to either replace the lines of credit with new creditors or repay the outstanding balances. In February 2001, $2,275,000 was paid in full by the use of a portion of the proceeds from the IPS sale as discussed more fully elsewhere in this Form 10-Q; the remaining $1,159,000 and entire ESOP loan were assumed by the acquirer in the IPS sale transaction.

Net cash used in operating activities was $4,545,000 for the six months ended June 30, 2001, as compared to $7,477,000 at June 30, 2000. The difference was primarily due to losses from operations, net of the increase in non-cash items for depreciation and amortization and stock-based compensation, a decrease in accounts payable, timing of payments to vendors and consultants, and operating payments to brokers and attorneys all related to the equity funding in February 2000.

Net cash provided by investing activities was $5,418,000 for the six months ended June 30, 2001, as compared to net cash used in investing activities of $5,379,000 for the six months ended June 30, 2000. This was primarily due to the proceeds received with the sale of IPS as opposed to the cash used in the aforementioned acquisition of Growth Strategy of $375,000 and fixed asset additions in 2000.

Net cash used in financing activities was $1,507,000 for the six months ended June 30, 2001, as compared to net cash provided by financing activities of $13,383,000 for the six months ended June 30, 2000. This difference was primarily a result of the $11,300,000 equity funding in February 2000 and the proceeds from the revolving line of credit of $2,700,000, which was offset in part by scheduled payments made against notes payable in the current year.

On June 21, 2001 the Company executed letter agreements and promissory notes (the Notes) with certain existing shareholders with an initial funding of $800,000. The Notes, once fully funded, will be for no less than $2,000,000. The Notes are for a term of one year and have a stated interest rate of 8%. The Notes have an ultimate right to convert the outstanding balance, plus any accrued interest, into shares of cumulative 8% Series A Convertible Preferred Stock (Series A Preferred Stock). In the event of any liquidation or dissolution of the Company, the holders of the Series A Preferred Stock will be entitled to receive at their option, either (a) an amount equal to two and one-half (2½) times the original purchase price along with all accrued but unpaid dividends or (b) a ratable share of the distribution of assets and property with the holders of the common stock, participating on an as converted basis. These shares of Series A Preferred Stock are further convertible, at the option of the holders, at any time, into shares of common stock at a conversion price equal to one share of common stock for each $0.25 of stated value.

In July 2000, the Company completed a $5,000,000 convertible debt offering (Convertible Notes Payable) with certain private investors. The Convertible Notes Payable bear annual interest at 9.5%. Principal and interest was due at maturity on December 31, 2000. On July 20, 2001, the Company reached an agreement related to the Convertible Notes Payable, which was due on demand, under which the maturity date was extended to August 1, 2002. The conversion terms were to be renegotiated by August 15, 2001; otherwise, a penalty of $500,000 would have been assessed and payable in February 2002. The Company is in the process of completing these renegotiations and the new terms are the principal and accrued interest underlying the Convertible Notes Payable shall be exchanged into Series B Preferred Stock with a stated value of approximately $5 million dollars. These new terms also include a waiver of the penalty. These Series B Preferred Stock shall have the following terms: a conversion rate equal to one share of common stock for each $.75 of stated value or a liquidation preference such that in the event of any liquidation, dissolution or winding up of the Company, the holders thereof shall be entitled to receive, at their option, either (a) in preference to the holders of the common stock an amount equal to two and one-half (2½) times the stated value, or (b) a ratable share of the distribution of assets and property with the holders of the common stock, participating on an as converted basis. A merger, acquisition or sale of all or substantially all of the assets of the Company in which the shareholders of the Company do not own a majority of the outstanding shares of the surviving corporation shall be deemed to be a liquidation.

In October 2000, the Company reduced its workforce by 43 full-time positions, or 14% of our workforce at that time. In the first quarter 2001, a strategy and plan of execution was adopted to attempt to stabilize the organization and return to cash flow positive and eventually profitability. This strategy included a strict line-by-line review and evaluation of non-compensation expenses as well as another 15% reduction in the Company s workforce in the Creative, Research and Sales departments. In the fourth quarter 2000 and in the first quarter 2001, there were continuing additional non-recurring expenses associated with these reductions in force. Due to the eventual reductions in compensation and benefits along with the results of the line-by-line review and evaluation of non-compensation expenses, the Company expects to be cash flow positive by the end of 2001; however, no assurances can be made that these expense reductions will have the expected effect or occur in the anticipated timeframe.

RESTRUCTURING PLAN

Effective January 1, 2001, with a closing date of February 5, 2001, the Company sold all of the issued and outstanding stock of IPS to Red & Blue, Inc., a Delaware corporation, and to the IPS Associates, Inc. Stock Ownership Plan. The consideration for the sale was (1) the return of an aggregate 740,260 shares of the Company's common stock, including ESOP shares, (2) $5,700,000 in net proceeds and (3) the transfer of the IPS ESOP plan, along with the note payable, to a financial institution for the ESOP financing of $4,861,000. The stock purchase agreement provided that 143,323 shares of the 740,260 shares of the Company's common stock be held in escrow until the earlier of (1) the completion of audited financial statements of IPS for the year ended December 31, 2000, or (2) six months from the date of closing. In the event that the net equity, revenues or net earnings of IPS differed by more than $500,000 from the financial statements disclosed in the purchase agreement, Red & Blue, Inc. had the right to setoff the difference against the shares held in escrow at a value based upon the closing price of the Company's common stock on the day before the setoff. In the event of a setoff, the Company has agreed to immediately register the setoff shares. Based on audited financial results of IPS, no such setoff occurred.

The sale of IPS resulted in write-offs of goodwill with a non-cash charge to income of approximately $24,040,000 in the fourth quarter ended December 31, 2000. IPS was included in the Company's results of operations since IPS s acquisition in June 2000.

In the first quarter 2001, the Company received the above-described proceeds, cancellation of inter-company payables and receivables with IPS, along with the return of 740,260 shares now in Treasury, in exchange for the transfer of assets of $6,085,000 and liabilities of $8,028,000. In addition, with the return of the shares held by the ESOP, a reduction in unearned compensation of $8,979,000 associated with these unreleased ESOP shares was recorded as a charge against additional paid in capital arising from the IPS acquisition.

The net proceeds from the sale of IPS were used to pay off the secured debt of $2,275,000 and the balance was used to fund working capital needs such as payroll and current accounts payable.

In February 2001, the Company hired a consulting group to assist in designing and executing a repayment plan (the Plan) with its unsecured creditors. This Plan, which was executed in June 2001, after achieving an acceptable percentage of consents from the unsecured creditors, is designed to repay this group over time up to 60% of the original unsecured accounts payable amount as of February 1, 2001 with certain further reductions in the amount to be paid based upon the acceleration of payments over the Plan requirements. This additional unsecured debt reduction is designed to provide an incentive to the Company to accelerate its return back to a cash flow positive position. To date the Company has received consents from unsecured creditors, which total approximately $ 2.9 million.

In June 2001, the Company paid the initial installment to consenting unsecured creditors under the Plan. As a result, the Company recognized a gain from this restructuring of $404,000 in the second quarter which represents a portion of the 40% agreed upon reduction in the obligation due to the consenting unsecured creditors. As additional consents are received, the Company will make the required payments and recognize additional restructuring gains. The initial installment represented 18% of the original obligation. The second installment of 4% due under the Plan is scheduled to be made in the fourth quarter 2001 and each quarter thereafter until a total of 60% of the original obligation is repaid.

In March 2001, the Company negotiated new terms for $1,933,000 of other notes payable, which extended repayment terms into 2002.

In October 2000, we reduced our workforce by 43 full-time positions, or 14% of our workforce at that time. In the spring of 2001, a strategy and plan of execution was adopted to stabilize the organization and return to cash flow positive and eventually profitability. This strategy includes a strict line-by-line review and evaluation of non-compensation expenses as well as another 15% reduction in our workforce in the Creative, Research and Sales departments. In the fourth quarter 2000 and in the first quarter 2001, there were continuing additional non-recurring expenses associated with these reductions in force. However, because of the eventual reductions in compensation and benefits along with the results of the line-by-line review and evaluation of non-compensation expenses, we expect to be cash flow positive by the end of 2001; however, no assurances can be made that these expense reductions will have the effect we expect or occur in the timeframe we anticipate.

At June 30, 2001, we had a working capital deficit of $11,518,000. Additionally, over the preceding two years we have completed several acquisitions that have placed an additional strain on our cash resources as the operations of the acquired businesses were integrated with our operations. Management is currently in the process of raising additional financing to meet planned working capital requirements. In the event that we are unable to obtain additional financing on terms that are acceptable to us, then we will have to modify our business plan to reduce future cash outflows to enable us to meet our liquidity requirements for the next twelve months. Furthermore, we will require additional cash to meet our short- and long-term liquidity requirements and to execute our current business plan.

Management expects that the execution of the unsecured creditor Plan, the promissory Notes and the expected results from future operations will provide the working capital necessary to enable us to continue to implement our business plan for the next twelve months. There can be no assurance that these events will provide the necessary working capital to fulfill our needs; therefore, additional reductions or additional sources of funds may be necessary in 2002. These uncertainties could have a material adverse affect on our ability to execute our current business plan.

Investment Considerations

The following important factors could cause actual results to differ materially from those contained in forward-looking statements made in this Quarterly Report on Form 10-Q or presented elsewhere by management from time to time.

Our Clients May Cancel or Delay Spending on Business and Technology Initiatives because of the Current Economic Climate.

Since the second half of 2000, many companies have experienced financial difficulties or uncertainty, and have begun to cancel or delay spending on business and technology consulting initiatives as a result. Additionally, the severe financial difficulties that many start-up Internet companies have experienced have further reduced the perceived urgency by larger companies to begin or continue technology initiatives. If large companies continue to cancel or delay their business and technology consulting initiatives because of the current economic climate, or for other reasons, our business, financial condition and results of operations could be materially adversely affected.

Businesses May Decrease or Delay Their Use of Advanced Technologies as a Means for Conducting Commerce.

Our future success depends heavily on the increased acceptance and use of advanced technologies as a means for conducting commerce and streamlining operations. We focus our services on the development and implementation of advanced technology strategies and solutions. If use of these advanced technologies does not continue to grow, or grows more slowly than expected, our revenue growth could slow or decline and our business, financial condition and results of operations could be materially adversely affected. Consumers and businesses may delay adoption of advanced technologies for a number of reasons, including:

- inability to implement and sustain profitable business models using advanced technologies;
- inadequate network infrastructure or bandwidth;
- delays in the development or adoption of new technical standards and protocols required to handle increased levels of usage;
- delays in the development of security and authentication technology necessary to effect secure transmission of confidential information; and
- failure of companies to meet their customers' expectations in delivering goods and services using advanced technologies.

Our Market is Highly Competitive and We May Not Be Able to Continue to Compete Effectively.

The business and technology consulting market in which we operate includes a large number of companies and is highly competitive. Our primary competitors are large accounting and consulting firms and systems consulting and implementation firms. We compete to a lesser extent with specialized e-business consulting firms, strategy-consulting firms, other package technology vendors, and internal information systems groups. Furthermore, the competitive landscape is changing rapidly. We compete for client engagements against companies with far larger revenues and numbers of consultants than we have. These larger competitors may have the ability to offer a wider range of services and to deploy a large number of professionals. Certain other consulting firms that we competed against during 2001 and 2000 have experienced financial difficulties. These firms may attempt to win new business by offering large pricing concessions, which could impair our ability to compete for that business. If we cannot keep pace with the intense competition in our marketplace, our business, financial condition and results of operations could suffer.

If Our Marketing Relationships with Software Vendors Deteriorate, We Would Lose Their Potential Client Referrals.

We currently have marketing relationships with software vendors, including PeopleSoft, iPlanet, Siebel, and Sun Microsystems. Although we have historically received a number of business leads from these software vendors to implement their products, they are not required to refer business to us and they may terminate these relationships at any time. If our relationships with these software vendors deteriorate, we may lose their client leads and our ability to develop new clients could be negatively impacted. Any decrease in our ability to obtain clients may cause a reduction in our revenue growth.

Our Business is Dependent on Our Ability to Keep Pace with the Latest Technological Changes.

Our market and the enabling technologies used by our clients are characterized by rapid technological change. Failure to respond successfully to these technological developments, or to respond in a timely or cost-effective way, will result in serious harm to our business and operating results. We expect to derive a substantial portion of our revenues from creating e-business systems that are based upon today s leading technologies and that are capable of adapting to future technologies. As a result, our success will depend, in part, on our ability to offer services that keep pace with continuing changes in technology, evolving industry standards and changing client preferences. There can be no assurance that we will be successful in addressing these developments on a timely basis or that if addressed we will be successful in the marketplace. Our failure to address these developments could have a material adverse effect on our business, financial condition and results of operations.

If We Do Not Attract and Retain Qualified Professional Staff, We May Not Be Able to Adequately Perform Our Client Engagements and Could Be Limited in Accepting New Client Engagements.

Our business is labor intensive and our success will depend upon our ability to attract, retain, train and motivate highly skilled employees. Although many specialized e-business and other business and technology companies have reduced their workforces or slowed their hiring efforts, and we reduced our workforce in October 2000 and March 2001, intense competition still exists for certain employees who have specialized skills or significant experience in business and technology consulting. We may not be successful in attracting a sufficient number of these highly skilled employees in the future. Additionally, the industry turnover rates for these types of employees are high, and we may not be successful in retaining, training and motivating the employees we are able to attract. Any inability to attract, retain, train and motivate employees could impair our ability to adequately manage and complete existing projects and to bid for or accept new client engagements.

The Price of Our Common Stock Is Subject to Significant Fluctuation.

The trading price of our common stock could be subject to wide fluctuations in response to:

general economic or stock market conditions unrelated to our operating performance;

quarterly variations in operating results;

changes in earnings estimates by analysts;

any differences between reported results and analysts published or unpublished expectations;

announcements of new contracts or service offerings by us or our competitors; and

other events or factors.

We Depend Heavily on Our Principal Clients.

We have derived, and believe that we will continue to derive, a significant portion of our revenues from a limited number of large clients. In the second quarter 2001, four clients each accounted for more than 5% of our revenues and two accounted for 52% of our revenue. The volume of work performed for specific clients is likely to vary from year to year, and a major client in one year may not use our services in a subsequent year. The loss of any large client could have a material adverse effect on our business, financial condition and results of operations. In addition, revenues from a large client may constitute a significant portion of our total revenues in a particular quarter.

We Have Significant Fixed Operating Costs and Our Operating Results Are Subject to Fluctuation.

A high percentage of our operating expenses, particularly personnel and rent, are fixed in advance of any particular quarter. As a result, unanticipated variations in the number, or progress toward completion, of our projects or in employee utilization rates may cause significant variations in operating results in any particular quarter and could result in losses for such quarter.

An unanticipated termination of a major project, a client s decision not to proceed to the subsequent stage of a project, or the completion during a quarter of several major client projects could require us to maintain underutilized employees and could therefore have a material adverse effect on our business, financial condition and results of operations. Our revenues and earnings may also fluctuate from quarter to quarter based on such factors as the contractual terms and degree of completion of such projects, any delays incurred in connection with projects, the accuracy of estimates of resources required to complete ongoing projects, and general economic conditions.

We Sometimes Enter into Fixed-Price Contracts.

Some of our projects are based on fixed-price, fixed-timeframe contracts, rather than contracts in which payment to us is determined on a time and materials basis. Our failure to accurately estimate the resources required for a project or our failure to complete our contractual obligations in a manner consistent with the project plan upon which our fixed-price, fixed-timeframe contract was based would adversely affect our overall profitability and could have a material adverse effect on our business, financial condition and results of operations. We have at times been required to commit unanticipated additional resources to complete certain projects, which has resulted in losses on certain contracts. We recognize that we may experience similar situations in the future. In addition, for certain projects we may fix the price before the design specifications are finalized, which could result in a fixed price that turns out to be too low and therefore adversely affects our profitability.

Many of Our Contracts Can Be Cancelled with Limited Notice and Without Significant Penalty.

Many of our contracts are terminable by the client following limited notice and without significant penalty. Such terminations could result in a loss of expected revenue and additional unreimbursed expenses for staff, which were allocated to that client s project. The cancellation or significant reduction in the scope of a large project could have a material adverse effect on our business, financial condition and results of operations.

We Face Significant Competition in Markets that Are New, Intensely Competitive and Rapidly Changing.

The markets for the services we provide are highly competitive. We believe that we currently compete principally with strategy consulting firms, Internet and e-business professional services providers, software integration firms, application software vendors, and internal information systems groups. Many of the companies that provide such services have significantly greater financial, technical and marketing resources than we do and generate greater revenues and have greater name recognition than we do. In addition, there are relatively low barriers to entry into our markets and we have faced, and expect to continue to face, additional competition from new entrants into our markets. We believe that the principal competitive factors in our markets include:

- Internet expertise and talent;
- quality of service, price and speed of delivery;
- ability to integrate strategy, technology and creative design services;
- vertical industry knowledge; and
- project management capability.

We believe that our ability to compete also depends in part on a number of competitive factors outside our control, including:

- the ability of our competitors to hire, retain and motivate their senior staff;

the development by others of Internet solutions or software that is competitive with our products and services; and

the extent of our competitors responsiveness to client needs.

There can be no assurance that we will be able to compete successfully with our competitors.

Our Business is Sensitive to Economic Downturns.

Our revenues and results of operations are likely to be influenced by general economic conditions. In the event of a general economic downturn or a recession in the United States, Europe or Asia, our clients and potential clients may substantially reduce their information technology and related budgets. Such an economic downturn may materially and adversely affect our business, financial condition and results of operations.

Increasing Government Regulation Could Affect Our Business.

We are subject not only to regulations applicable to businesses generally, but also laws and regulations directly applicable to electronic commerce. Although there are currently few such laws and regulations, state, federal and foreign governments may adopt a number of these laws and regulations. Any such legislation or regulation could dampen the growth of the Internet and decrease our acceptance as a communications and commercial medium. If such a decline occurs, companies may decide in the future not to use our services to create an electronic business channel. This decrease in the demand for our services would seriously harm our business and operating results.

Our Business Could be Adversely Affected if We Are Unable to Protect Our Proprietary Technology.

Our success depends, in part, upon our proprietary methodologies and other intellectual property rights. We rely upon a combination of trade secret, nondisclosure and other contractual arrangements, and copyright and trademark laws to protect our proprietary rights. We enter into confidentiality agreements with our employees; generally require that our consultants and clients enter into such agreements, and limit access to and distribution of our proprietary information. There can be no assurance that the steps taken by us in this regard will be adequate to deter misappropriation of our proprietary information or that we will be able to detect unauthorized use and take appropriate steps to enforce our intellectual property rights. In addition, although we believe that our services and products do not infringe on the intellectual property rights of others, there can be no assurance that such a claim will not be asserted against us in the future, or that if asserted any such claim will be successfully defended. A successful claim against us could have material adverse affect on our business, financial condition and results of operations.

We May Not Have the Right to Resell or Reuse Applications Developed for Specific Clients.

A portion of our business involves the development of Internet and software applications for specific client engagements. Ownership of such software is the subject of negotiation and is frequently assigned to the client, although we may retain a license for certain uses. Issues relating to the ownership of and rights to use software applications can be complicated and there can be no assurances that disputes will not arise that affect our ability to resell or reuse such applications. Any limitation on our ability to resell or reuse an application could require us to incur additional expenses to develop new applications for future projects.

We are Dependent on a Number of Key Personnel.

Our success will depend in large part upon the continued services of a number of key employees, including our CEO, key consultants and practice leaders. The loss of the services of any of these individuals or of one or more of our other key personnel could have a material adverse effect on us. In addition, if one or more of our key employees resigns to join a competitor or to form a competing company, the loss of such personnel and any resulting loss of existing or potential clients to any such competitor could have a material adverse effect on our business, financial condition and results of operations. In the event of the loss of any such personnel, there can be no assurance that we would be able to prevent the unauthorized disclosure or use of our technical knowledge, practices or procedures by such personnel.

We May Need to Raise Additional Capital, Which May Not Be Available.

Although we have recently received $800,000 of initial funding under a Promissory Note which is agreed to be no less than $2,000,000 and will not exceed $3,000,000, as more fully described elsewhere in this Form 10-Q, we may need to raise additional funds to continue to operate beyond 2001, and it is uncertain that we will be able to obtain additional financing on favorable terms or at all. Additionally, we have experienced a sharp decline in our stock price and as a result, any financing equity transaction will likely be highly dilutive to existing shareholders. If we cannot raise additional capital on acceptable terms, we will not be able to implement our current operating plan or continue to operate in our existing form. Issuance of debt may require us to agree to restrictive covenants that could hamper our business and operations. These uncertainties could have a material adverse affect on us.

We Face Intense Competition in Our Market

Our services are targeted at the new and rapidly evolving market for e-commerce solutions. Although the competitive environment in this market has yet to develop fully, we anticipate that it will be intensely competitive, subject to rapid change and significantly affected by new service and product introductions and other market activities of industry participants.

Increased competition could result in pricing pressures, reduced margins or the failure of our services to achieve or maintain market acceptance, any of which could have a serious adverse effect on our business, financial condition and results of operations.

Our Industry is Subject to Rapid Technological Change

The emerging market for e-commerce solutions and related services is characterized by rapid technological developments and services and evolving industry standards. The emerging nature of this market and its rapid evolution will require us to improve existing services as well as be first to market new services in the e-commerce environment. Our failure to develop and introduce new and existing services successfully and on a timely basis could have a significant adverse effect on our business, financial condition and result of operations.

Our Stock Price May be Volatile in the Future

The trading price of our common stock has been, and is expected to continue to be, highly volatile and may be significantly and adversely affected by factors such as: (1) actual or anticipated fluctuations in our operating results, (2) new services, products or contracts offered by us or our competitors, (3) developments with respect to patents, copyrights and propriety rights, (4)conditions and trends in the e-commerce industry, (5) changes in financial estimates by securities analysts, (6) private placement transactions completed to raise needed capital and, (7) general market conditions and other factors.

The public markets have from time-to-time experienced significant price and volume fluctuations that have particularly affected the market prices for the stock of technology companies as a group but have been unrelated to the performance of particular companies. The market price of our common stock may be adversely affected by these broad market fluctuations as well as (1) shortfalls in sales or earnings as compared with securities analysts' expectations, (2) changes in such analysts' recommendations or projections, and (3) general economic and market conditions.

Our Common Stock May be Delisted from The American Stock Exchange. If it is Delisted, the Market Price of the Common Stock Could Decline Potentially to Zero and You Could Lose Your Investment.

We have received a letter from The American Stock Exchange (AMEX) that due to the information contained in our 2000 filings with the SEC and recent Press Releases that they are reviewing our continued listing eligibility. We met with AMEX in February and reviewed our plans and expectations with them. However, as a result of our delay in filing of our Form 10-KSB, the first quarter 10-Q, and this second quarter 10-Q, they have suspended the trading of our stock on the AMEX. They will re-evaluate our trading status once they have reviewed these items.

However, AMEX may decide to delist our common stock at an earlier time based upon our financial condition. Although we intend to take steps to maintain our listing, we can give no assurances that our securities will not be delisted from trading by AMEX. If we lose our AMEX listing status, our common stock would most likely trade in the over-the-counter market, which is viewed by most investors as a less desirable and less liquid marketplace. In that event, trading in shares of our common stock would likely decrease substantially or cease altogether, and the market price of the common stock would likely decline further, potentially to zero.

Cautionary Statement Regarding Risks and Uncertainties That May Affect Future Results

This report contains "forward-looking statements" within the meaning of section 27(a) of the Securities Act of 1933 and section 21(e) of the Securities Exchange Act of 1934 and are subject to the safe harbor provisions of those sections and The Private Securities Litigation Reform Act of 1995. These forward-looking statements relate to expected reductions in our operating expenses, to expected increases in our revenues and earnings before non-cash and interest expenses, and to our ability to continue providing a complete range of services. These forward-looking statements are based on management's current views and assumptions and are not guarantees of future performance. Actual results may vary materially from those set out in the forward-looking statements. Furthermore, such statements are subject to risks and uncertainties, including the following: our ability to raise additional capital to continue operations, the continued development of the internet as a means for commerce; unauthorized access or computer viruses affecting our information systems; our ability to keep pace with rapidly changing technologies; general economic conditions; our ability to successfully manage our growth and to integrate acquired businesses; increased competition from competitors with greater financial and other resources; our ability to attract and retain qualified employees; our dependence on principal clients and the effects of governmental regulation, all as more fully described in our SEC filings. The foregoing important factors should not be construed as exhaustive. We undertake no obligation to update the forward-looking statements, whether as a result of new information, future events or otherwise.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company does not believe there is any material market risk exposure with respect to derivative or other financial instruments, which would require disclosure under this item. However, we have obligations that have fixed interest rates and, therefore, contain market rate risk.

Revolving Lines of Credit and Term Loan Facility - On August 10, 1999, the Company entered into a Loan and Security Agreement (the Agreement) for a total credit facility of up to $5,000,000, limited to the available borrowing base, which is based on levels of eligible accounts receivable and inventory, as defined in the Agreement, expiring August 10, 2001, with three one-year renewals at the lender s option. On December 29, 1999, the Company amended its Agreement to include a $1,000,000 term loan under the total credit facility of $5,000,000. In connection with this amendment, the Company entered into a warrant purchase agreement with the lender and issued warrants to purchase 25,000 shares of the Company's common stock. The fair value assigned to these warrants of $115,000 was accounted for as a debt discount and amortized over the period of the term loan. At December 31, 2000, there was no available unused balance under the Agreement. In February 2001, the entire outstanding balance of the Agreement of $2,275,000 was paid in full by the use of a portion of the proceeds from the IPS sale.

Convertible Notes Payable - In July 2000, the Company completed a $5,000,000 convertible debt offering (the "$5,000,000 Convertible Notes") with certain private investors, who are stockholders, Edgewater Private Equity Fund III, L.P. and Fleck T.I.M.E. Fund, L.P. The $5,000,000 Convertible Notes bear annual interest of 9.5%. Principal and interest was due at maturity on December 30, 2000, if not converted earlier. The principal and accrued and unpaid interest is convertible at the option of the holder into common stock of the Company at a 25% discount from the per-share price of a Qualified Financing consummated prior to the maturity date. A Qualified Financing is defined as an equity financing in which the Company raises at least $7,000,000. If a Qualified Financing is not consummated prior to the maturity date, then the principal and accrued and unpaid interest is convertible at the option of the holder into common stock of the Company at a conversion price of $5.00 per share. The Company recorded an imputed debt discount of $5,000,000 related to the beneficial conversion feature and based on the quoted market price of our common stock of $19.50 per share on the date of issuance. At December 31, 2000, this debt was due on demand, and the imputed discount was fully amortized to expense. On July 20, 2001, the Company reached an agreement related to the $5,000,000 Convertible Notes, which were due on demand, under which the maturity date was extended to August 1, 2002. The conversion terms were to be renegotiated by August 15, 2001; otherwise, a penalty of $500,000 would have been assessed and payable in February 2002. The Company is in the process of completing these renegotiations and the new terms are the principal and accrued interest underlying the $5,000,000 Convertible Notes shall be exchanged into Series B Preferred Stock with a stated value of approximately $5 million dollars. These new terms also include a waiver of the penalty. These Series B Preferred Stock shall have the following terms: a conversion rate equal to one share of common stock for each $.75 of stated value or a liquidation preference such that in the event of any liquidation, dissolution or winding up of the Company, the holders thereof shall be entitled to receive, at their option, either (a) in preference to the holders of the common stock an amount equal to two and one-half (2½) times the stated value, or (b) a ratable share of the distribution of assets and property with the holders of the common stock, participating on an as converted basis. A merger, acquisition or sale of all or substantially all of the assets of the Company in which the shareholders of the Company do not own a majority of the outstanding shares of the surviving corporation shall be deemed to be a liquidation.

In November 2000, our Chairman and principal stockholder provided a $1,000,000 line of credit to us in the form of a convertible note (the November Convertible Note). We may draw upon the line of credit from time to time as needed. As of June 30, 2001, we had drawn $900,000 on the line of credit. The November Convertible Note bears annual interest at the rate of 8%, is convertible at the lenders option at $.50 per share and matures on December 31, 2001. The lender had the option to demand repayment of the November Convertible Note within 30 days after the IPS sale; however, the lender made no such demand. In connection with the November Convertible Note, the lender was issued five-year warrants to purchase an aggregate of 2,000,000 shares of our common stock at $.01 per share. We recorded debt discount of $900,000 in connection with the issuance of the warrants, which resulted in a net carrying value of zero for the November Convertible Note. This discount will be amortized into interest expense over the life of the November Convertible Note. Debt discount amortization of $225,000 and $450,000 was recorded for the three and six months ended June 30, 2001, respectively.

In December 2000, we issued $1,500,000 in convertible notes to two of our stockholders (the December Convertible Notes), one of which is currently represented on our Board of Directors and one of which formerly served on our Board of Directors. The December Convertible Notes are convertible at the lenders option at $.50 per share. The December Convertible Notes bear interest at 8% per annum and mature on December 31, 2001. The lenders had the option to demand repayment of the December Convertible Notes within 30 days after the IPS sale. In connection with the December Convertible Notes, the lenders were issued five-year warrants to purchase an aggregate 3,000,000 shares of our common stock at $.01 per share. We recorded debt discount of $1,500,000 in connection with the issuance of the warrants, which resulted in a net carrying value of zero for the December Convertible Notes. This discount will be amortized into interest expense over the life of the December Convertible Notes. Debt discount amortization of $375,000 and $750,000 was recorded for the three and six months ended June, 2001, respectively.

Notes Payable - Other - In March 2001, the Company negotiated new terms for $1,933,000 of other notes payable. Under these new terms, the Company is required to make equal bi-monthly payments, which represent principal and interest at 10%, of $25,000 through January 2002 and $75,000 bi-monthly payments from January 2002 until the amount is repaid in full.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are, from time to time, a party to litigation arising in the normal course of business. We do not believe that any of these actions, individually or in the aggregate, will have a material adverse affect on our financial position or results of operations.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

EXHIBIT NUMBER	DESCRIPTION
2.1 (1)	Exchange Agreement by and between Loch Exploration, Inc. and Design Automation Systems Incorporated
2.2 (2)	Exchange Agreement by and between Loch Exploration, Inc. and COAD Solutions, Inc.
2.3 (2)	Acquisition Agreement of Cherokee Methane Corporation
2.4 (2)	Plan of Merger between the Company and Design Automation Systems Incorporated
2.5 (6)	Exchange Agreement between the Company and Dynamic Professional Services, LLC
2.6 (7)	Exchange Agreement between the Company and Connected Software Solutions, Inc.
2.7 (10)	Acquisition Agreement by and among the Company, EACQ, LLC and The Growth Strategy Group, Inc.
2.8 (11)	Agreement and Plan of Merger by and between the Company, EACQ, LLC and The Growth Strategy Group, Inc.
2.9 (13)	Agreement and Plan of Merger by and between the Company and IPS Associates, Inc.
2.10(14)	Asset Purchase Agreement among the Company, Tumble Interactive Media, Inc. and Charles C. Vornberger
2.11(15)	Stock Purchase Agreement by and between the Company, RED & BLUE, INC. and IPS Associates, Inc. Employee Stock Ownership Plan for the sale of all the outstanding stock of IPS Associates, Inc.
3.1 (3)	Articles of Incorporation
3.2 (4)	Amended Articles of Incorporation
3.3 (3)	By-laws
4.1 (3)	Common Stock Specimen
10.1 (4)	1999 Employee Stock Option Plan
10.2 (2)	Employment Agreement with Carl Rose
10.3 (2)	Employment Agreement with Charles Leaver
10.4 (5)	Employment Agreement with Kelly Knake

10.5 (2)	Lease Agreement
10.6 (2)	Indirect Reseller Agreement between the Company, Hewlett-Packard Company and Hall-Mark Computer Products
10.7 (2)	Indirect Reseller Agreement between the Company, Hewlett-Packard Company and Client Systems, Inc.
10.8 (2)	Indirect Value Added Reseller Agreement between the Company and Sun Microsystems Computer Corporation
10.9 (2)	IBM Business Partner Agreement for Solution Providers
10.10 (8)	1999 Line of Credit with FINOVA Capital Corporation
10.11 (2)	Line of Credit with Finova Corporation
10.12 (9)	Agreement for Services with Optimization Group, LLC
10.13(12)	Microsystem Products Purchase Agreement
10.14(12)	Sun Channel Agreement Master Terms
10.15(12)	Ferrari/Connected Software Solutions Lease
10.16(12)	Sun Trademark and Logo Policies
10.17(12)	HP Authorized Reseller Agreement
10.18(12)	IBM Business Partner/Solutions Provider Agreement
10.19(12)	HP Agreement for Authorized Solutions Direct Resellers
10.20(12)	Office Space Lease Austin
10.21(12)	Texas Association of Realtors Commercial Lease
10.22(12)	Seattle Lease Agreement
10.23(12)	St. Louis Lease Agreement
10.24(12)	Line of Credit with Finova Corporation
10.25(14)	Convertible Bridge Loan Agreement
10.26(14)	Jeffrey Sexton Employment Agreement
10.27(14)	Warrant Purchase Agreement between the Company and FINOVA Capital Corporation
10.29 (15)	Form of Convertible Note
10.28(14)	FINOVA Warrant
10.30 (15)	Form of Warrant
10.31(16)	Termination of Employment Agreement with Chuck Leaver
10.32(17)	Form of Consent to Settlement of Claim

21.1 (2)	List of Subsidiaries of the Registrant
23.1 (16)	Consent of independent public accountants

(1) Filed as an exhibit to our Current Report on Form 8-K dated January 15, 1999 and incorporated herein by reference.

(2) Filed as an exhibit to our 10-KSB for the year ended December 31, 1998 and incorporated herein by reference.

(3) Filed as an exhibit to our Registration Statement on Form S-1 dated September 7, 1979 and incorporated herein by reference.

(4) Filed as an exhibit to our Definitive Information Statement filed March 9, 1999 and incorporated herein by reference.

(5) Filed as an exhibit to our 10-QSB for the quarter ended March 31, 1999 and incorporated herein by reference.

(6) Filed as an exhibit to our Current Report on Form 8-K filed June 14, 1999 and incorporated herein by reference.

(7) Filed as an exhibit to our Current Report on Form 8-K filed August 11, 1999 and incorporated herein by reference.

(8) Filed as an exhibit to our 10-QSB for the quarter ended June 30, 1999 and incorporated herein by reference.

(9) Filed as an exhibit to our 10-QSB for the quarter ended September 30, 1999 and incorporated herein by reference.

(10) Filed as an exhibit to our Current Report on Form 8-K filed December 14, 1999 and incorporated herein by reference.

(11) Filed as an exhibit to our Current Report on Form 8-K filed March 15, 2000 and incorporated herein by reference.

(12) Filed as an exhibit to our 10-KSB for the year ended December 31, 1999 and incorporated herein by reference.

(13) Filed as an exhibit to our Current Report on Form 8-K filed July 14, 2000 and incorporated herein by reference.

(14) Filed as an exhibit to our 10-QSB for the quarter ended September 30, 2000 and incorporated herein by reference.

(15) Filed as an exhibit to our Current Report on Form 8-K filed April 16, 2000 and incorporated herein by reference.

(16) Filed as an exhibit to our 10-KSB for the year ended December 31, 2000 and incorporated herein by reference.

(17) Filed herewith

(b) Reports on Form 8-K

A Current Report on Form 8-K was filed on April 16, 2001 reporting the sale all the outstanding stock of IPS Associates, Inc., the issuance of $2,500,000 of convertible notes along with the issuance of warrants to purchase 5,000,000 shares of common stock, the resignation of various senior management, the Board created Office of Management and Budget, appointment of new senior management, the notification of a clients termination of a contract, the move of our corporate office, and the resignation of various members of our Board of Directors.

A Current Report on Form 8-K was filed on August 13, 2001 announcing the appointment of two new members to the Board of Directors.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

EpicEdge, Inc.

Date: August 28, 2001	By /s/ Peter B. Covert
	Peter B. Covert
	Vice President of Finance, and Principal Accounting Officer