SSP SOLUTIONS INC
Form S-3
December 19, 2003

As filed with the Securities and Exchange Commission on December 19, 2003
Registration No. 333-__________

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM S-3

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

SSP SOLUTIONS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	33-0757190
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

17861 CARTWRIGHT ROAD
IRVINE, CALIFORNIA 92614
(949) 851-1085
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

MARVIN J. WINKLER,
CO-CHAIRMAN AND CHIEF EXECUTIVE OFFICER
SSP SOLUTIONS, INC.
17861 CARTWRIGHT ROAD
IRVINE, CALIFORNIA 92614
(949) 851-1085
(Name, address, including zip code, and telephone number, including area code, of agent for service)

COPY TO:
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CRISTY LOMENZO PARKER, ESQ.
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(714) 641-5100

Approximate date of commencement of proposed sale to public: FROM TIME TO TIME AFTER THE EFFECTIVE DATE OF THIS REGISTRATION STATEMENT.

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box: | |

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, please check the following box: |X|

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: | | __________

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: | | _____

If delivery of the prospectus is expected to be made pursuant to Rule 434 under the Securities Act, please check the following box: | |

CALCULATION OF REGISTRATION FEE

TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	AMOUNT TO BE REGISTERED (1)	PROPOSED MAXIMUM OFFERING PRICE PER SHARE	PROPOSED MAXIMUM AGGREGATE OFFERING PRICE
Common stock, $0.01 par value	45,641,471	$1.21 (2)	$55,226,180.31 (2)

(1) This registration statement covers an aggregate of 42,184,388 shares, including 2,386,819 shares issued and outstanding and 39,797,569 shares underlying warrants, convertible promissory notes and convertible preferred stock. In the event of a stock split, stock dividend, or similar transaction involving common stock of the registrant, in order to prevent dilution, the number of shares registered shall be automatically increased to cover the additional shares in accordance with Rule 416(a) under the Securities Act.

(2) The proposed maximum offering price per share has been estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) of the Securities Act based on the average of the high and low sales prices per share as reported on The Nasdaq National Market on December 17, 2003.

Pursuant to Rule 429, this registration statement contains a combined prospectus that covers the following numbers of shares of common stock registered on the Registrant's registration statement numbers shown below, in addition to the shares being registered on this registration statement:

Registration statement no. 333-90574 - 3,656,136 shares, including 989,253 outstanding shares of common stock and 2,666,883 shares of common stock underlying warrants, options and convertible promissory notes; and

Registration statement no. 333-101959 - 1,852,500 outstanding shares of common stock.

The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement becomes effective on such date as the Commission, acting under Section 8(a), may determine.

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. THE SELLING SECURITY HOLDERS IDENTIFIED IN THIS PROSPECTUS MAY NOT SELL SECURITIES UNDER THIS PROSPECTUS UNTIL THE REGISTRATION STATEMENT OF WHICH THIS PROSPECTUS IS A PART BECOMES EFFECTIVE.

SUBJECT TO COMPLETION, DATED DECEMBER 18, 2003

PROSPECTUS

SSP SOLUTIONS, INC.

51,150,107 SHARES OF COMMON STOCK

An aggregate of 5,228,572 issued and outstanding shares of our common stock and an aggregate of 45,921,535 shares of our common stock underlying warrants, convertible promissory notes, options and convertible preferred stock are being offered for resale under this prospectus by some of our security holders identified in this prospectus for their own accounts.

Our common stock currently trades on The Nasdaq National Market under the symbol "SSPX." The last reported sale price of our common stock on December 16, 2003 was $1.25 per share.

Our principal offices are located at 17861 Cartwright Road, Irvine, California 92614, and our telephone number is (949) 851-1085.

INVESTING IN OUR COMMON STOCK INVOLVES RISKS.
PLEASE SEE "RISK FACTORS" BEGINNING ON PAGE 3.

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS ACCURATE OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THIS PROSPECTUS IS NOT AN OFFER TO SELL THOSE SECURITIES AND IS NOT SOLICITING AN OFFER TO BUY THOSE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

The date of this prospectus is _______________, 2004.

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RISK FACTORS

AN INVESTMENT IN SHARES OF OUR COMMON STOCK INVOLVES A HIGH DEGREE OF RISK. IN ADDITION TO THE OTHER INFORMATION CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS, YOU SHOULD CAREFULLY CONSIDER THE FOLLOWING RISK FACTORS BEFORE DECIDING TO INVEST OR MAINTAIN AN INVESTMENT IN SHARES OF OUR COMMON STOCK. THIS PROSPECTUS CONTAINS OR INCORPORATES BY REFERENCE FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF CERTAIN FACTORS, INCLUDING THOSE SET FORTH IN THE FOLLOWING RISK FACTORS AND ELSEWHERE IN THIS PROSPECTUS. IF ANY OF THE FOLLOWING RISKS ACTUALLY OCCURS, IT IS LIKELY THAT OUR BUSINESS, FINANCIAL CONDITION AND OPERATING RESULTS WOULD BE HARMED. AS A RESULT, THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE, AND YOU COULD LOSE PART OR ALL OF YOUR INVESTMENT.

RISKS RELATED TO OUR BUSINESS

WE HAVE A HISTORY OF LOSSES AND MAY INCUR FUTURE LOSSES THAT MAY ADVERSELY IMPACT OUR BUSINESS AND OUR STOCKHOLDERS BY, AMONG OTHER THINGS, MAKING IT DIFFICULT FOR US TO RAISE ADDITIONAL DEBT OR EQUITY FINANCING TO THE EXTENT NEEDED FOR OUR CONTINUED OPERATIONS OR FOR PLANNED EXPANSION.

We may not become profitable or significantly increase our revenue. We incurred net losses of $8.6 million for the year ended December 31, 2002 and $5.1 million for the nine months ended September 30, 2003. To achieve profitability, we will need to generate and sustain sufficient revenues while maintaining reasonable cost and expense levels. We expect to continue to incur significant operating expenses primarily to support research and development and expansion of our sales and marketing efforts. These expenditures may not result in increased revenues or customer growth. We do not know when or if we will become profitable. We may not be able to sustain or increase profitability on a quarterly or annual basis.

Our losses from operations, our use of cash in operating activities, and our accumulated deficit and working capital deficiency at December 31, 2002 and 2001, among other factors, raised substantial doubt about our ability to continue as a going concern and led our independent auditors to include in their opinions contained in our consolidated financial statements as of December 31, 2002 and 2001 and for each of the years in the three-year period ended December 31, 2002 an explanatory paragraph related to our ability to continue as a going concern. Analysts and investors generally view reports of independent auditors questioning a company's ability to continue as a going concern unfavorably. Future losses may adversely affect our business, prospects, financial condition, results of operations and cash flows. We urge potential investors to review the reports of our independent auditors and our consolidated financial statements before making a decision to invest in our company.

WE HAVE NOT GENERATED ANY SIGNIFICANT SALES OF OUR PRODUCTS WITHIN THE COMPETITIVE COMMERCIAL MARKET NOR HAVE WE ESTABLISHED A SUFFICIENT SALES

AND MARKETING FORCE TO PROMOTE OUR PRODUCTS TO POTENTIAL COMMERCIAL CUSTOMERS, WHICH MAKES IT DIFFICULT TO EVALUATE OUR CURRENT BUSINESS PERFORMANCE AND FUTURE PROSPECTS.

Although we have had some success in selling our security solutions to government agencies, we are just beginning to enter the complex and competitive commercial market for digital commerce and communications security solutions. Many potential customers in our target markets are now becoming aware of the need for security products and services in the digital economy to conduct their business. Historically, only enterprises that had substantial resources developed or purchased security solutions for delivery of digital content over the Internet or through other means. Also, there is a perception that security in delivering digital content is costly and difficult to implement. Therefore, we will not succeed unless we can educate our target markets about the need for security in delivering digital content and convince potential customers of our ability to provide this security in a cost-effective and easy-to-use manner.

Even if we convince our target markets about the importance of and need for such security, we do not know if this will result in the sale of our products. We may be unable to establish sales and marketing operations at levels necessary for us to grow this portion of our business, especially if we are unsuccessful at selling this product into vertical markets. We may not be able to support the promotional programs required by selling simultaneously into several markets. If we are unable to develop an efficient sales system, or if our products or components do not achieve wide market acceptance, then our operating results will suffer and our earnings per share will be adversely affected.

WE FACE INTENSE COMPETITION AND PRICING PRESSURES FROM A NUMBER OF SOURCES, WHICH MAY REDUCE OUR AVERAGE SELLING PRICES AND GROSS MARGINS.

The markets for our products and services are intensely competitive. As a result, we face significant competition from a number of sources. We may be unable to compete successfully because many of our competitors are more established, benefit from greater name recognition and have substantially greater financial, technical and marketing resources than we have. In addition, there are several smaller and start-up companies with which we compete from time to time. We expect competition to increase as a result of consolidation in the information security technology industry.

The average selling prices for our products may decline as a result of competitive pricing pressures, promotional programs and customers who negotiate price reductions in exchange for longer-term purchase commitments. The pricing of products depends on the specific features and functions of the products, purchase volumes and the level of sales and service support required. We expect competition to increase in the future. As we experience pricing pressure, we anticipate that the average selling prices and gross margins for our products will decrease over product lifecycles. These same competitive pressures may require us to write down the carrying value of any inventory on hand, which would adversely impact our operating results and adversely affect our earnings per share.

WE DERIVE A SUBSTANTIAL PORTION OF OUR REVENUE FROM A SMALL NUMBER OF CUSTOMERS, AND THE LOSS OF ONLY ONE OF THOSE CUSTOMERS COULD ADVERSELY IMPACT OUR OPERATING RESULTS.

We depend on a limited number of customers for a substantial portion of our revenue. During the year ended December 31, 2002, and the three and nine months ended September 30, 2003, we derived 28%, 25% and 30%, respectively, of our consolidated net revenue for those periods from a single customer. Many of our contracts with our significant customers are short-term. The non-renewal of any significant contract upon expiration, or a substantial reduction in sales to any of our significant customers, would adversely affect our business unless we were able to replace the revenue we received from those customers.

OUR RELIANCE ON THIRD PARTY TECHNOLOGIES FOR SOME SPECIFIC TECHNOLOGY ELEMENTS OF OUR PRODUCTS AND OUR RELIANCE ON THIRD PARTIES FOR MANUFACTURING MAY DELAY PRODUCT LAUNCH, IMPAIR OUR ABILITY TO DEVELOP AND DELIVER PRODUCTS OR HURT OUR ABILITY TO COMPETE IN THE MARKET.

Our ability to license new technologies from third parties is and will continue to be critical to our ability to offer a complete suite of products that meets customer needs and technological requirements. Some of our licenses do not run for the full duration of the third party's patent for the licensed technology. We may not be able to renew our existing licenses on favorable terms, or at all. If we lose the rights to a patented technology, we may need to stop selling or may need to redesign our products that incorporate that technology, and we may lose a competitive advantage. In addition, competitors could obtain licenses for technologies for which we are unable to obtain licenses, and third parties may develop or enable others to develop a similar solution to digital communication security issues, either of which events could erode our market share. Also, dependence on the patent protection of third parties may not afford us any control over the protection of the technologies upon which we rely. If the patent protection of any of these third parties were compromised, our ability to compete in the market also would be impaired.

THIRD PARTIES COULD OBTAIN ACCESS TO OUR PROPRIETARY INFORMATION OR COULD INDEPENDENTLY DEVELOP SIMILAR TECHNOLOGIES BECAUSE OF THE LIMITED PROTECTION FOR OUR INTELLECTUAL PROPERTY.

Despite the precautions we take, third parties may copy or obtain and use our proprietary technologies, ideas, know-how and other proprietary information without authorization or may independently develop technologies similar or superior to our technologies. In addition, the confidentiality and non-competition agreements between us and our employees, distributors and clients may not provide meaningful protection of our proprietary technologies or other intellectual property in the event of unauthorized use or disclosure. Policing unauthorized use of our technologies and other intellectual property is difficult, particularly because the global nature of the Internet makes it difficult to control the ultimate destination or security of software or other data transmitted. Furthermore, the laws of other jurisdictions may afford little or no effective protection of our intellectual property rights. Our business, financial condition and operating results could be adversely affected if we are unable to adequately protect our intellectual property rights.

WE MAY FACE HARMFUL CLAIMS OF INFRINGEMENT OF PROPRIETARY RIGHTS, WHICH COULD REQUIRE US TO DEVOTE SUBSTANTIAL TIME AND RESOURCES TOWARD MODIFYING OUR PRODUCTS OR OBTAINING APPROPRIATE LICENSES.

There is a risk that our products infringe on proprietary rights of third parties. Regardless of whether our products infringe on proprietary rights of third parties, infringement or invalidity claims may be asserted or prosecuted against us and we could incur significant expenses in defending them. If any infringement claims or actions are asserted against us, we may be required to modify our products or seek licenses for these intellectual property rights. We may not be able to modify our products or obtain licenses on commercially reasonable terms, in a timely manner or at all. Our failure to do so could adversely affect our business by preventing us from selling some or all of our products.

OUR INABILITY TO MAINTAIN AND DEVELOP NEW STRATEGIC RELATIONSHIPS WITH PARTNERS AND SUPPLIERS COULD IMPACT OUR ABILITY TO OBTAIN OR SELL OUR PRODUCTS, AND PREVENT US FROM GENERATING SALES REVENUES.

We obtain and market many of our products through strategic alliance and supplier agreements. The loss of any of our existing strategic relationships, or the inability to create new strategic relationships in the future, could adversely affect our ability to develop and market our products.

We depend upon our partners to develop and market products and to fund and perform their obligations as contemplated by our agreements with them. We do not control the time and resources devoted by our partners to these activities. These relationships may not continue or may require us to spend significant financial, personnel and administrative resources from time to time. We may not have the resources available to satisfy our commitments, which may adversely affect our strategic relationships. Further, our products and services may compete with the products and services of our strategic partners. This competition may adversely affect our relationships with our strategic partners, which could adversely affect our business.

If alliance or supplier agreements are cancelled, modified or delayed, if alliance or supplier partners decide not to purchase our products or to purchase only limited quantities of our products, or if we are unable to enter into additional alliance or supplier agreements, our ability to produce and sell our products and to generate sales revenues could be adversely affected.

ANY COMPROMISE OF PKI TECHNOLOGY WOULD ADVERSELY AFFECT OUR BUSINESS BY REDUCING OR ELIMINATING DEMAND FOR MANY OF OUR DATA SECURITY PRODUCTS.

Many of our products are based on public key infrastructure, or PKI, technology, which is the standard technology for securing Internet-based commerce and communications. The security afforded by this technology depends on the integrity of a user's private key, which depends in part on the application of algorithms, or advanced mathematical factoring equations. The occurrence of any of the following could result in a decline in demand for our data security products:

- any significant advance in techniques for attacking PKI systems, including the development of an easy factoring method or faster, more powerful computers;
- publicity of the successful decoding of cryptographic messages or the misappropriation of private keys; and
- government regulation limiting the use, scope or strength of PKI.

A SECURITY BREACH OF OUR INTERNAL SYSTEMS OR THOSE OF OUR CUSTOMERS DUE TO COMPUTER HACKERS OR CYBER TERRORISTS COULD HARM OUR BUSINESS BY ADVERSELY AFFECTING THE MARKET'S PERCEPTION OF OUR PRODUCTS AND SERVICES.

Since we provide security for Internet and other digital communication networks, we may become a target for attacks by computer hackers. The ripple effects throughout the economy of terrorist threats and attacks and military activities may have a prolonged effect on our potential commercial customers, or on their ability to purchase our products and services. Additionally, because we provide security products to the United States government, we may be targeted by cyber terrorist groups for activities threatened against United States-based targets.

We will not succeed unless the marketplace is confident that we provide effective security protection for Internet and other digital communication networks. Networks protected by our products may be vulnerable to electronic break-ins. Because the techniques used by computer hackers to access or sabotage networks change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques. Although we have not experienced any act of sabotage or unauthorized access by a third party of our internal network to date, if an actual or perceived breach of security for Internet and other digital communication networks occurs in our internal systems or those of our end-user customers, regardless of whether we caused the breach, it could adversely affect the market's perception of our products and services. This could cause us to lose customers, resellers, alliance partners or other business partners.

WE MAY BE EXPOSED TO SIGNIFICANT LIABILITY FOR ACTUAL OR PERCEIVED FAILURE TO PROVIDE REQUIRED PRODUCTS OR SERVICES.

Products as complex as those we offer may contain undetected errors or may fail when first introduced or when new versions are released. Despite our product testing efforts and testing by current and potential customers, it is possible that errors will be found in new products or enhancements after commencement of commercial shipments. The occurrence of product defects or errors could result in adverse publicity, delay in product introduction, diversion of resources to remedy defects, loss of or a delay in market acceptance, or claims by customers against us, or could cause us to incur additional costs, any of which could adversely affect our business. Because our customers rely on our products for critical security applications, we may be exposed to claims for damages allegedly caused to an enterprise as a result of an actual or perceived failure of our products. An actual or perceived breach of enterprise network or data security systems of one of our customers, regardless of whether the breach is attributable to our products or solutions, could adversely affect our business reputation. Furthermore, our failure or inability to meet a customer's expectations in the performance of our services, or to do so in the time frame required by the customer, regardless of our responsibility for the failure, could result in a claim for substantial damages against us by the customer, discourage customers from engaging us for these services, and damage our business reputation.

IF USE OF THE INTERNET AND OTHER COMMUNICATION NETWORKS BASED ON INTERNET PROTOCOLS DOES NOT CONTINUE TO GROW, DEMAND FOR OUR PRODUCTS MAY NOT INCREASE.

Increased demand for our products largely depends on the continued growth of the Internet and Internet protocol-based networks and the widespread acceptance and use of these mediums for electronic commerce and communications. Because electronic commerce and communications over these networks are evolving, we cannot predict the size of the market and its sustainable growth rate. A number of factors may affect market size and growth rate, including increases in governmental regulation and the continued ability of the Internet infrastructure and communications services to support growing demands, which ability could be adversely affected by, among other things, delays in development or adoption of new standards and protocols to handle increased levels of activity. If the use of electronic commerce and communications does not increase, or increases more slowly than we expect, demand for our products and services will be adversely impacted.

IF WE DO NOT RESPOND TO RAPID TECHNOLOGICAL CHANGES, OUR PRODUCT AND SERVICE OFFERINGS COULD BECOME OBSOLETE.

The markets we serve are characterized by rapidly changing technology, emerging industry standards and frequent introduction of new products. The introduction of products embodying new technologies and the emergence of new industry standards may render our products obsolete or less marketable. The process of developing our products and services is extremely complex and requires significant continuing development efforts. If we are unable to modify existing products and develop new products and services that are responsive to changing technology and standards and to meet customer needs in a timely and cost effective manner, our business could be adversely affected because we would be unable to sell our product and service offerings that have become obsolete.

DOING BUSINESS WITH THE UNITED STATES GOVERNMENT ENTAILS MANY RISKS THAT COULD ADVERSELY AFFECT US BY DECREASING THE PROFITABILITY OF GOVERNMENTAL CONTRACTS WE ARE ABLE TO OBTAIN AND INTERFERING WITH OUR ABILITY TO OBTAIN FUTURE GOVERNMENTAL CONTRACTS.

Sales to United States government agencies accounted for 18%, 33% and 40% of our consolidated revenues for the year ended December 31, 2002, and the three and nine months ended September 30, 2003, respectively. Our sales to these agencies are subject to risks that include:

- early termination of our contracts;
- disallowance of costs upon audit; and
- the need to participate in competitive bidding and proposal processes, which are costly and time consuming and may result in unprofitable contracts.

In addition, the government may be in a position to obtain greater rights with respect to our intellectual property than we would grant to other entities. Government agencies also have the power, based on financial difficulties or investigations of their contractors, to deem contractors unsuitable for new contract awards. Because we engage in the governmental contracting business, we have been and will be subject to audits and may be subject to investigation by governmental entities. Failure to comply with the terms of any of our governmental contracts could result in substantial civil and criminal fines and penalties, as well as our suspension from future governmental contracts for a significant period of time, any of which could adversely affect our business by requiring us to spend money to pay the fines and penalties and prohibiting us from earning revenues from governmental contracts during the suspension period.

DELAYS IN DELIVERIES FROM OUR SUPPLIERS OR DEFECTS IN GOODS OR COMPONENTS SUPPLIED BY OUR VENDORS COULD CAUSE OUR REVENUES AND GROSS MARGINS TO DECLINE.

We rely on a limited number of vendors for certain components for the products we are developing. Any undetected flaws in components supplied by our vendors could lead to unanticipated costs to repair or replace these parts. We currently purchase some of our components from a single supplier, which presents a risk that the components may not be available in the future on commercially reasonable terms or at all. For example, Atmel Corporation has completed development of a specially designed Forte microprocessor that we have incorporated into a Forte PKI card. Commercial acceptance of the Forte microprocessor will be dependent on continued development of applications to service customer requirements. Any inability to receive or any delay in receiving adequate supplies of the Forte microprocessor, whether as a result of delays in development of applications or otherwise, would adversely affect our ability to sell the Forte PKI card.

We do not anticipate maintaining a supply agreement with Atmel Corporation for the Forte microprocessor. If Atmel Corporation were unable to deliver the Forte microprocessor for a lengthy period of time or were to terminate its relationship with us, we would be unable to produce the Forte PKI card until we could design a replacement computer chip for the Forte microprocessor. We anticipate this would take substantial time and resources to complete, which could result in delays or reductions in product shipments that could adversely affect our business by requiring us to expend resources while preventing us from selling the Forte PKI card.

Also, if we are unable to obtain or generate sufficient funds to sustain our operations, we may damage our relationships with our vendors. Slow and delinquent payments may cause vendors not to sell products to us, or only with advance payment. If this occurs, we will not have components and services available for our products. We may not be able to replace any of our supply sources on economically advantageous terms. Further, if we experience price increases for the components for our products, we will experience declines in our gross margins.

OUR SUCCESS DEPENDS ON OUR ABILITY TO RETAIN OUR CURRENT MANAGEMENT TEAM.

Our founder, co-chairman, president, and chief operating officer, Kris Shah, has been with us since 1970, and our co-chairman and chief executive officer, Marvin Winkler, co-founded one of our wholly-owned subsidiaries. Their experience, expertise, industry knowledge and historical company knowledge would be extremely difficult to replace if we were to lose the services of either of them. The precise impact of the loss of services of either of them is difficult to predict, but would likely result in, at a minimum, significant costs to recruit, hire and retain a successor and impaired operating results while the successor was being recruited and transitioning into the position. We do not currently maintain key-man life insurance on the lives of either of these officers.

THERE IS SIGNIFICANT COMPETITION IN OUR INDUSTRY FOR HIGHLY SKILLED EMPLOYEES, AND OUR FAILURE TO ATTRACT AND RETAIN TECHNICAL PERSONNEL WOULD ADVERSELY AFFECT OUR BUSINESS BY IMPAIRING OUR ABILITY TO EFFICIENTLY CONDUCT OUR OPERATIONS.

We may not be able to attract or retain highly skilled employees. Our inability to hire or retain highly qualified individuals may impede our ability to develop, install, implement and service our software and hardware systems, to retain existing customers and attract new customers, or to efficiently conduct our operations, all of which would adversely affect our business. A high level of employee mobility characterizes the data security and networking solution industries, and the market for highly qualified individuals in computer-related fields is intense. This competition means there are fewer highly qualified employees available to hire, and the costs of hiring and retaining these individuals are high. Even if we are able to hire these individuals, we may be unable to retain them. Furthermore, the hiring and retention of technical employees necessitates the issuance of stock options and other equity interests, which may dilute earnings per share.

OUR EFFORTS TO EXPAND OUR INTERNATIONAL OPERATIONS ARE SUBJECT TO A NUMBER OF RISKS, ANY OF WHICH COULD ADVERSELY AFFECT OUR FUTURE INTERNATIONAL SALES.

We have obtained approvals to export certain of our products and we plan to increase our international sales. Our inability to obtain or maintain federal or foreign regulatory approvals relating to the import or export of our products on a timely basis could adversely affect our ability to expand our international business. Additionally, our international operations could be subject to a number of risks, any of which could adversely affect our future international sales, including:

- increased collection risks;
- trade restrictions;
- export duties and tariffs;
- uncertain political, regulatory and economic developments; and
- inability to protect our intellectual property rights.

WE ARE UNABLE TO PREDICT THE EXTENT TO WHICH THE RESOLUTION OF LAWSUITS OR CLAIMS PENDING AGAINST US AND OUR SUBSIDIARY COULD ADVERSELY AFFECT OUR BUSINESS BY, AMONG OTHER THINGS, SUBJECTING US TO SUBSTANTIAL COSTS AND LIABILITIES AND DIVERTING MANAGEMENT'S ATTENTION AND RESOURCES.

G2 Resources, Inc. and Classical Financial Services, LLC have filed complaints against one of our subsidiaries, Pulsar Data Systems, Inc., or Pulsar, alleging that Pulsar breached a contract by failing to make payments to G2 Resources, Inc. in connection with services allegedly provided by G2 Resources, Inc. In April 2001, the court dismissed, for lack of prosecution activity for more than twelve months, the original complaint that G2 Resources, Inc. had filed against Pulsar in January 1998. G2 Resources, Inc. re-filed the action in May 2001. In 2002, the court moved this case into the same division handling other matters related to G2 and Classic Financial Services, LLC, and stayed any further action in this case pending the resolution of matters between G2 and Classical. We have been vigorously defending ourselves against the plaintiffs' claims and have asserted defenses and counterclaims.

In June 2002, Research Venture, LLC filed two lawsuits against us alleging unlawful detainer and seeking possession of two leased properties, alleged damages and lost rent. In October 2002, we negotiated a restructuring of our obligations under the leases. We subsequently defaulted on those obligations, and Research Venture obtained a judgment against us per prior stipulation in the amount of $2.7 million. In August 2003, we entered into a settlement agreement with Research Venture that imposes, among other things, registration obligations on us regarding shares of common stock that we issued to Research Venture. As of December 5, 2003, we were not in compliance with those obligations, which means that Research Venture may be entitled to entry of a stipulated judgment against us in an amount up to $373,000.

In June 2003, Venetian Casino Resort, LLC, or the Venetian, sent a demand letter to our subsidiary demanding funding, or alternatively taking action to terminate our subsidiary's operating agreement for failure of our subsidiary to meet its funding commitment and threatening to take action against our subsidiary in the matter. Subsequently, the Venetian sent a letter claiming to terminate the operating agreement. In the quarter ended June 30, 2003, we recorded an impairment charge of $142,000, which was equal to the remaining book value of our investment in our subsidiary.

In December 2003, Shane Brophy, an ex-employee, filed a lawsuit alleging causes of action for breach of employment contract, unpaid wages and wrongful termination in violation of public policy arising from our termination of his employment in July 2003. We have not yet responded to the complaint and no discovery has been conducted. Therefore, we cannot quantify the outcome or exposure. However, we strongly deny the claims and believe the complaint is without merit. We may assert claims for damages against Mr. Brophy.

Any or all of these litigation matters and claims could subject us to substantial costs and liabilities and divert our management's attention and resources during our current and future financial reporting periods. If we believe it is probable that we will incur an estimable amount of expenses in connection with a litigation matter, we will include the estimated amount of expenses in accounts payable or accrued liabilities. If we feel unable to make a reasonable judgment as to the ultimate outcome of, or to assess or quantify our exposure relating to, a litigation matter, we will not include in our financial statements an estimated amount of expenses for that matter. Consequently, if we are unable during any financial reporting period to accurately estimate our potential liability in connection with a litigation matter, our financial condition and results of operations in future financial reporting periods may be adversely affected when we record any unreserved costs or liabilities we actually have incurred in connection with a litigation matter.

GOVERNMENTAL REGULATIONS AFFECTING SECURITY OF INTERNET AND OTHER DIGITAL COMMUNICATION NETWORKS COULD LIMIT THE MARKET FOR OUR PRODUCTS AND SERVICES.

The United States government and foreign governments have imposed controls, export license requirements and restrictions on the import or export of some technologies, including encryption technology. Any additional governmental regulation of imports or exports or failure to obtain required export approval of encryption technologies could delay or prevent the acceptance and use of encryption products and public networks for secure communications and could limit the market for our products and services. In addition, some foreign competitors are subject to less rigorous controls on exporting their encryption technologies. As a result, they may be able to compete more effectively than us in the United States and in international security markets for Internet and other digital communication networks. In addition, governmental agencies such as the Federal Communications Commission periodically issue regulations governing the conduct of business in telecommunications markets that may negatively affect the telecommunications industry and us.

BIZ ACQUISITION-RELATED ACCOUNTING CHARGES MAY CONTINUE TO DELAY OR REDUCE OUR PROFITABILITY AND CAUSE THE MARKET PRICE OF OUR COMMON STOCK TO DECLINE.

In July 2001, the FASB issued Statement No. 142, "Goodwill and Other Intangible Assets." We adopted this statement effective January 1, 2002. Under this statement, goodwill is no longer amortized and is subject to periodic testing for impairment beginning January 1, 2002. The provisions of this statement require us to perform a two-step test to assess goodwill for impairment. In the first step, we compare the fair value of each reporting unit to its carrying value. If the fair value exceeds the carrying value, then goodwill is not impaired and we need not proceed to the second step. If the carrying value of a reporting unit exceeds its fair value, then we must determine and compare the implied fair value of the reporting unit's goodwill to the carrying value of its goodwill. If the carrying value of the reporting unit's goodwill exceeds its implied fair value, then we will record an impairment loss in the amount of the excess.

We accounted for our August 2001 acquisition of BIZ as a purchase. Under the purchase method of accounting, the purchase price was allocated to the fair value of the identifiable tangible and intangible assets and liabilities that we acquired from BIZ. The excess of the purchase price over BIZ's tangible net assets resulted in goodwill and other intangible assets. As of September 30, 2003, we had goodwill in the amount of $25.9 million.

We are required to perform tests for impairment at least annually, or more frequently if events occur or circumstances change that would more likely than not reduce the fair value of the net carrying amount. We cannot predict whether or when there will be additional impairment charges, or the amount of any such charges. If the charges are significant, they could cause the market price of our common stock to decline.

DEFAULTS UNDER OUR SECURED CREDIT ARRANGEMENTS COULD RESULT IN A FORECLOSURE ON OUR ASSETS BY OUR CREDITORS.

All of our assets are pledged as collateral to secure portions of our debt. We were not able to obtain waivers for past covenant defaults, and we may in the future default under certain covenants of these credit arrangements. This means that if we are unable to obtain waivers in the future or if we incur a monetary default on our secured debt obligations, our indebtedness could become immediately due and payable and the lenders could foreclose on our assets.

WE MAY RELOCATE A PORTION OF OUR SOFTWARE DEVELOPMENT TO INDIA, WHICH COULD PROVE TO BE UNPROFITABLE DUE TO RISKS INHERENT IN INTERNATIONAL BUSINESS ACTIVITIES.

We have contracted portions of our commercial software development activities to India in an effort to reduce our operating expenses. We are subject to a number of risks associated with international business activities that could adversely affect any operations we may develop in India and could slow our growth. These risks generally include, among others:

- difficulties in managing and staffing our Indian operations;
- difficulties in obtaining or maintaining regulatory approvals or in complying with Indian laws;

- reduced or less certain protection for intellectual property rights;
- differing technological advances, preferences or requirements;
- trade restrictions;
- foreign currency fluctuations; and
- general economic conditions, including instability, in the Indian market.

Any of these risks could adversely affect our business and results of operations.

CONFLICTS INVOLVING INDIA COULD ADVERSELY AFFECT ANY OPERATIONS WE MAY ESTABLISH IN INDIA, WHICH COULD INTERFERE WITH OUR ABILITY TO CONDUCT ANY OR ALL OF OUR OTHER OPERATIONS.

South Asia has from time to time experienced civil unrest and hostilities among neighboring countries, including India and Pakistan. In April 1999, India and Pakistan conducted long-range missile tests. Since May 1999, military confrontations between India and Pakistan have occurred in disputed regions. In October 1999, the leadership of Pakistan changed as a result of a coup led by the military. Additionally, other events have heightened the tensions between India and Pakistan. If a major armed conflict or nuclear war involving India and any of its neighboring countries occurs, it could, among other things, prevent us from establishing or maintaining operations in India. If the successful conduct of operations in India becomes critical to any or all of our other operations, our business would be harmed to the extent we are unable to establish or maintain operations in India.

WE ARE EXPOSED TO LIABILITY FOR ACTIONS TAKEN BY OUR DOMESTIC EMPLOYEES WHILE ON ASSIGNMENT AND MAY ALSO BE EXPOSED TO LIABILITY FOR ACTIONS TAKEN BY ANY FOREIGN EMPLOYEES WE MAY HIRE.

As a professional services provider, a portion of our business involves employing people and placing them in the workplace of other businesses. Therefore, we are exposed to liability for actions taken by our employees while on assignment. In addition, to the extent we hire employees in India or other foreign locations, we may also be exposed to liability for actions taken by those employees in the scope of their employment.

RISKS RELATED TO THIS OFFERING

THE RECENTLY COMPLETED SERIES A CONVERTIBLE PREFERRED STOCK FINANCING AND WARRANT ISSUANCE WERE HIGHLY DILUTIVE, WHICH MAY CAUSE OUR STOCK PRICE TO FALL.

On November 19, 2003, we issued shares of Series A Convertible Preferred Stock, convertible promissory notes, investor warrants and placement agent and exchange agent warrants that will become exercisable for or convertible after our 2003 annual stockholders' meeting into up to approximately 37,610,000 shares of common stock. The initial exercise and conversion prices of these securities ranged from $0.01 per share to $1.50 per share, which means that most of these derivative securities had exercise or conversion prices that were below the $1.19 closing sale price of our common stock on that date. Therefore, the issuance of shares upon exercise or conversion of these derivative securities will be highly dilutive to the voting power and value of our common stock and could cause our stock price to fall.

THE NON-CASH INTEREST EXPENSE REQUIRED IN CONNECTION WITH THE DETACHABLE WARRANTS AND BENEFICIAL CONVERSION FEATURES OF OUR APRIL 2002 FINANCING AND THE SERIES A CONVERTIBLE PREFERRED STOCK AND WARRANTS ISSUED IN NOVEMBER 2003 MAY ADVERSELY AFFECT OUR STOCK PRICE.

The secured convertible promissory notes we issued in April 2002 and the Series A Convertible Preferred Stock and replacement notes we issued in November 2003 are or will become convertible into shares of our common stock at a conversion price below the market price of our common stock at the commitment date for each of those securities. In addition, the securities were accompanied by common stock purchase warrants with an exercise price below the market price of our common stock at the commitment date. Accordingly, under accounting guidelines, we were required to record a substantial non-cash charge as interest expense for the April 2002 notes and may record similar non-cash items for the Series A Convertible Preferred Stock and the warrants. These non-cash charges substantially increased our reported loss for the year ended December 31, 2002, over the amount that would have otherwise been reported and will substantially increase our reported loss for the year ended December 31, 2003, over the amount that would have otherwise been reported. The increases in our reported losses may cause a decline in our stock price.

OUR COMMON STOCK PRICE IS SUBJECT TO SIGNIFICANT VOLATILITY, WHICH COULD RESULT IN SUBSTANTIAL LOSSES FOR INVESTORS AND IN LITIGATION AGAINST US.

The stock market as a whole and individual stocks historically have experienced extreme price and volume fluctuations, which often have been unrelated to the performance of the related corporations. During the 52-week period ended December 5, 2003, the high and low closing sale prices of our common stock were $1.84 and $0.50, respectively. The market price of our common stock may exhibit significant fluctuations in the future in response to various factors, many of which are beyond our control and which include:

- variations in our annual or quarterly financial results, which variations could result from, among other things, the timing, size, mix and customer acceptance of our product and service offerings and those of our competitors, and the timing and magnitude of required capital expenditures;

- company-issued earnings announcements that vary from consensus analyst estimates;

- changes by financial research analysts in their recommendations or estimates of our earnings;

- conditions in the economy in general or in the information technology service sector in particular;

- announcements of technological innovations or new products or services by us or our competitors; and

- unfavorable publicity or changes in applicable laws and regulations, or their judicial or administrative interpretations, affecting the information technology service sector and us.

If our operating results in future quarters fall below the expectations of market makers, securities analysts and investors, the price of our common stock likely will decline, perhaps substantially. In the past, securities class action litigation often has been brought against a company following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and liabilities and could divert management's attention and resources. Consequently, the price at which investors purchase shares of our common stock may not be indicative of the price that will prevail in the trading market. Investors may be unable to sell their shares of common stock at or above their purchase price, which may result in substantial losses.

A SIGNIFICANT NUMBER OF SHARES OF OUR COMMON STOCK ARE OR WILL BECOME ELIGIBLE FOR PUBLIC SALE, AND SALES OF LARGE NUMBERS OF OUR SHARES COULD ADVERSELY AFFECT THEIR MARKET PRICE AND MAKE IT DIFFICULT FOR US TO RAISE ADDITIONAL CAPITAL, IF NEEDED, THROUGH SALES OF EQUITY SECURITIES.

As of December 15, 2003, we had issued and outstanding 28,050,177 shares of common stock, a majority of which were unrestricted, were eligible for resale without registration under Rule 144 of the Securities Act of 1933, or were registered for resale or issued with registration rights. In addition, we were obligated to register for resale approximately 45,922,000 shares of common stock that were issuable or may become issuable under derivative securities that were outstanding as of that date. Our common stock historically has been thinly traded. While our recent trading activity has increased, our average daily trading volume between December 16, 2002 and December 15, 2003 was 66,682 shares. If our stockholders seek to sell numbers of shares significantly in excess of our typical volume, the market price of our shares may decline. Any adverse effect on the market price for our common stock could make it more difficult for us to sell equity securities at a time and at a price that we deem appropriate.

THE MARKET PRICE OF OUR COMMON STOCK COULD SUBSTANTIALLY DECLINE IF ALL OR A SIGNIFICANT PORTION OF OUR OUTSTANDING DERIVATIVE SECURITIES WERE CONVERTED INTO OR EXERCISED FOR SHARES OF OUR COMMON STOCK AND RESOLD INTO THE MARKET, OR IF A PERCEPTION EXISTS THAT A SUBSTANTIAL NUMBER OF SHARES WILL BE ISSUED UPON CONVERSION OR EXERCISE AND THEN RESOLD INTO THE MARKET.

As of December 15, 2003, we had outstanding 28,050,177 shares of common stock and also had outstanding options, warrants, and promissory notes that were then exercisable for or convertible into approximately 6,340,000 shares of our common stock, and additional options, warrants, promissory notes and shares of preferred stock that could become exercisable or convertible into up to approximately 39,650,000 shares of our common stock. If the conversion or exercise prices at which our outstanding derivative securities are converted or exercised are lower than the market price, immediate dilution will occur. In addition, sales of a substantial number of shares of common stock issued upon conversion or exercise of our outstanding derivative securities, or even the perception that such sales could occur, could adversely affect the market price of our common stock. Therefore, a substantial decline in the value of our shares could result from both the actual and potential conversion or exercise of our outstanding derivative securities and the actual and potential resale of the underlying shares into the market.

IF WE ARE UNSUCCESSFUL IN COMPLYING WITH OUR SECURITIES REGISTRATION OBLIGATIONS, WE MAY BE IN DEFAULT UNDER VARIOUS AGREEMENTS AND COULD FACE SIGNIFICANT PENALTIES AND A SUBSTANTIAL STIPULATED JUDGMENT.

The agreements we entered into in connection with our issuance of secured convertible promissory notes and related warrants, our preferred stock and related warrants and in connection with settlement of litigation require us to, among other things, register for resale the shares of common stock issued or issuable under those arrangements and to maintain the effectiveness of the registration statements for an extended period of time. If we are unable to timely obtain and maintain effectiveness of the required registration statements or obtain appropriate waivers or if we default under the arrangements for any other reason, then the holders of the notes could, among other things, require us to pay substantial penalties, require us to repay the notes at a premium and/or foreclose upon their security interest in our assets, the parties to the settlement arrangements could take action against us that could include the filing of a substantial stipulated judgment, and the holders of the preferred stock and related warrants could require us to redeem their shares of preferred stock at a substantial premium. Any of these events would adversely affect our business, operating results, financial condition, and ability to service our other indebtedness by negatively impacting our cash flows.

A SMALL NUMBER OF STOCKHOLDERS, WHO INCLUDE CERTAIN OF OUR OFFICERS AND DIRECTORS, HAVE THE ABILITY TO CONTROL STOCKHOLDER VOTES AND TO TAKE ACTION BY WRITTEN CONSENT WITHOUT A MEETING OF STOCKHOLDERS.

As of December 15, 2003, our co-chairmen, Kris Shah and Marvin Winkler and certain of their family members and affiliates owned, in the aggregate, approximately 44.3% of our outstanding common stock. Those stockholders, if acting together with several other stockholders, have the ability to elect our directors and to determine the outcome of corporate actions requiring stockholder approval, irrespective of how our other stockholders may vote. Further, those stockholders have the ability to take action by written consent on those matters without a meeting of stockholders. Those matters could include the election of directors, changes in the size and composition of the board of directors, and mergers and other business combinations involving our company. In addition, through control of the board of directors and voting power, they may be able to control certain decisions, including decisions regarding the qualification and appointment of officers, dividend policy, access to capital (including borrowing from third-party lenders and the issuance of additional equity securities), and the acquisition or disposition of our assets. Also, the concentration of voting power in the hands of those individuals could have the effect of delaying or preventing a change in control of our company, even if the change in control would benefit our stockholders, and may adversely affect the market price of our common stock.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus and our filings that are incorporated by reference into this prospectus contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. We intend that those forward-looking statements be subject to the safe harbors created by those sections.

Those forward-looking statements generally include the plans and objectives of management for future operations, including plans and objectives relating to our future economic performance, and can generally be identified by the use of the words "believe," "intend," "plan," "expect," "forecast," "project," "may," "should," "could," "seek," "pro forma," "estimates," "continues," "anticipate" and similar words. Those forward-looking statements and associated risks may include, relate to, or be qualified by other important factors, including, without limitation:

- anticipated trends in our financial condition and results of operations;

- growth or contraction in the information security products and services markets in which we operate;

- our ability to finance our working capital and other cash requirements;

- our business strategy for expanding our presence in the Internet data security market; and

- our ability to distinguish ourselves from our current and future competitors.

We do not undertake to update, revise or correct any forward-looking statements. The forward-looking statements are based largely on our current expectations and are subject to a number of risks and uncertainties. Actual results could differ materially from these forward-looking statements. Important factors to consider in evaluating forward-looking statements include:

- the shortage of reliable market data regarding the Internet data security market;

- changes in external competitive market factors or in our internal budgeting process that might impact trends in our results of operations; and

- changes in our business strategy or an inability to execute our strategy due to unanticipated changes in the contract support services markets.

The information contained in this prospectus is not a complete description of our business or the risks associated with an investment in our common stock. Before deciding to buy or maintain a position in our common stock, you should carefully review and consider the various disclosures we made in this prospectus, and in our other materials filed with the Securities and Exchange Commission ("Commission") that discuss our business in greater detail and that disclose various risks, uncertainties and other factors that may affect our business, results of operations or financial condition. In particular, you should review the "Risk Factors" section of this prospectus. Any of the factors described above or in the "Risk Factors" section of this prospectus could cause our financial results, including our net income (loss) or growth in net income (loss) to differ materially from prior results, which in turn could, among other things, cause the price of our common stock to fluctuate substantially.

SELLING SECURITY HOLDERS

SELLING SECURITY HOLDER TABLE

This prospectus covers the offer and sale by the selling security holders of up to an aggregate of 51,150,107 shares of common stock, including an aggregate of 5,228,572 issued and outstanding shares of our common stock and an aggregate of 45,921,535 shares of our common stock underlying warrants, convertible promissory notes, options and convertible preferred stock. Each selling security holder has indicated to us that it is acting individually, not as a member of a group. The following table sets forth, to our knowledge, certain information about the selling security holders as of the date of the table, based on information furnished to us by the selling security holders. Except as indicated in the private placement descriptions or footnotes following the table, none of the selling security holders or their affiliates has held any position or office or had any other material relationship with us in the past three years.

Beneficial ownership is determined in accordance with the rules of the Commission, and includes voting or investment power with respect to the securities. To our knowledge, except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table below have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them. Except as described below in connection with beneficial ownership limitations, shares of common stock underlying derivative securities, if any, that currently are exercisable or convertible or are scheduled to become exercisable or convertible for or into shares of common stock within 60 days after the date of the table are deemed to be outstanding in calculating the percentage ownership of each listed person or group but are not deemed to be outstanding as to any other person or group. Percentage of beneficial ownership is based on 28,050,177 shares of common stock outstanding as of December 15, 2003, the date of the table.

The terms of the retained notes and the April 2002 warrants, as well as the terms of other warrants, which include A-1 and A-2 warrants issued with the Series A Convertible Preferred Stock ("Series A Preferred"), warrants issued with additional retained notes, placement agent warrants, exchange agent warrants, and shares of Series A Preferred held by some of the selling security holders, prohibit conversion or exercise of those derivative securities to the extent that conversion or exercise of those derivative securities would result in the holder, together with its affiliates, beneficially owning in excess of 4.999% of our outstanding shares of common stock. The rules of The Nasdaq National Market require us to obtain stockholder approval before we may issue a number of shares of common stock, or securities exercisable for or convertible into common stock, equal to or greater than 20% of the number of shares of our common stock outstanding prior to the issuance, if the issuance is for a price that is less than the greater of the book value or market value of our common stock at the time of issuance. Conversions of shares of Series A Preferred and additional retained notes, exercises of additional retained warrants, and conversions or exercises of certain other derivative securities are subject to this 20% limitation unless and until we obtain stockholder approval. We anticipate, but cannot offer assurance, that we will obtain stockholder approval at our 2003 annual stockholders' meeting and that the 20% limitation will thereafter no longer apply.

A holder of one of the retained notes or April 2002 warrants or certain other warrants that contain beneficial ownership limitations may waive the 4.999% limitation after 61 days' prior written notice to us, or immediately upon written notice to us if we are or may become subject to a change in control as defined in the retained notes and the April 2002 warrants. The 4.999% beneficial ownership limitation that relates to the Series A Preferred may only be altered or removed with the vote or written approval of a majority of the outstanding shares of our common stock and the written approval of holders of at least 50% of the outstanding shares of Series A Preferred. As of the date of the table, the 4.999% beneficial ownership limitations had not been waived or altered. However, the beneficial ownership limitations do not preclude a holder from converting or exercising a derivative security and selling the shares underlying the derivative security in stages over time where each stage does not cause the holder and its affiliates to beneficially own shares in excess of the limitation amount. As a result of the beneficial ownership limitations, the numbers of shares shown in the table as beneficially owned by certain of the selling security holders have been reduced as described in the footnotes to the table.

The shares of common stock being offered under this prospectus may be offered for sale from time to time during the period the registration statement of which this prospectus is a part remains effective, by or for the accounts of the selling security holders described below. Each of William Blair & Company, L.L.C., RBC Dain Rauscher, Inc. and Roth Capital Partners, LLC is an NASD-member firm and, therefore, is deemed by the Commission to be acting as underwriter as to the shares such firm is offering under this prospectus. We have indicated in the footnotes to the table which of the selling security holders have indicated that he or it is affiliated with an NASD-member firm or is a member of the American Stock Exchange. Each of those selling security holders has represented to us that he or it is not acting as an underwriter in this offering, he or it purchased or received the securities to be resold by him or it under this prospectus in the ordinary course of business, and at the time of such purchase or receipt, he or it had no agreements or understandings, directly or indirectly, with any person to distribute the securities.

NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED PRIOR TO OFFERING		SHARES OF COMMON STOCK BEING OFFERED
	NUMBER	PERCENTAGE	
RBC Dain Rauscher, Inc.	4,050 (2)	*	4,050
Douglas J. Burke	1,650 (3)	*	1,650
Forbes W. Burtt	2,000 (4)	*	2,000
William M. Hannan	400 (5)	*	400
Crestview Capital Fund, L.P. (6)	1,451,240 (7)	4.99%	3,307,577 (8)
Crestview Capital Fund II, L.P. (6)	1,455,909 (9)	4.99%	2,662,188 (10)
Crestview Offshore Fund, Inc. (6)	73,891 (11)	*	73,891 (11)
Richard P. Kiphart	2,064,496 (12)	7.33%	14,798,403 (13)
Nefilim Associates, LLC	475,913 (14)	1.67%	536,094 (15)
Robert Geras	731,219 (16)	2.54%	782,757 (17)
William Blair & Company, L.L.C.	110,000 (18)	*	110,000 (18)
AMG Financing Capital, Inc.	12,500 (19)	*	12,500
Robert J. Gray	174,628 (20)	*	21,374
Alpha Capital AG	756,597 (22)	2.63%	828,750 (23)
Barucha LLC	151,319 (24)	*	165,750 (25)
Bay Star Capital II, LP	1,476,014 (26)	4.99%	2,839,462 (27)
Bristol Investment Fund, Ltd.	983,576 (28)	3.39%	1,077,375 (29)
Clarion Offshore Fund, Ltd.	226,979 (30)	*	248,625 (31)
Clarion Partners, L.P.	226,979 (30)	*	248,625 (31)

NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED PRIOR TO OFFERING		SHARES OF COMMON STOCK BEING OFFERED
	NUMBER	PERCENTAGE	
David Wiener Revocable Trust - 96	60,528 (32)	*	66,300 (33)
Ellis International Limited Inc.	650,674 (34)	2.27%	712,725 (35)
Gamma Opportunity Capital Partners, LP	650,674 (36)	2.27%	712,725 (37)
Greenwich Growth Fund Ltd.	151,319 (38)	*	165,750 (39)
Generation Capital Associates	408,563 (40)	1.44%	447,525 (41)
Herman Shtern	75,660 (42)	*	82,875 (43)
Jack Gilbert	75,660 (44)	*	82,875 (45)
Jeff Hermanson	45,396 (46)	*	49,725 (47)
Lucrative Investments	75,660 (48)	*	82,875 (49)
Magellan International Ltd.	332,903 (50)	1.17%	364,650 (51)
Mark Capital LLC	60,528 (52)	*	66,300 (53)
Matthew Balk	135,334 (54)	*	141,106 (55)
Michael Loew	45,396 (46)	*	49,725 (47)
North Bar Capital Inc.	45,396 (56)	*	49,725 (47)
Platinum Partners Value Arbitrage Fund LP	453,958 (57)	1.59%	497,250 (58)
Portside Growth and Opportunity Fund	453,958 (59)	1.59%	497,250 (58)
Professional Traders Fund, LLC	302,639 (60)	1.07%	331,500 (61)
RHP Master Fund, Ltd.	1,476,014 (62)	4.99%	2,370,225 (63)
Riaz Ahmed Don	151,319 (64)	*	165,750 (39)
Richard Weiner	45,396 (46)	*	49,725 (47)
Robert A. Melnick	45,396 (46)	*	49,725 (47)
Robert J. Neborsky M.D., Inc., Combination Retirement Trust	105,924 (65)	*	116,025 (66)
SDS Capital Group SPC Ltd	1,476,014 (67)	4.99%	2,839,463 (68)
Stonestreet LP	650,674 (69)	2.27%	712,725 (70)
Vertical Ventures, LLC	650,674 (71)	2.27%	712,725 (70)
WEC Partners LLC	211,847 (72)	*	116,025 (73)

West End Convertible Fund L.P.	105,924 (74)	*	116,025 (73)
Whalehaven Fund Limited	151,319 (75)	*	165,750 (39)
Zenny Trading Ltd.	590,146 (76)	2.06%	646,425 (77)

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NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED PRIOR TO OFFERING		SHARES OF COMMON STOCK BEING OFFERED
	NUMBER	PERCENTAGE	
Castle Creek Technology Partners, LLC	650,674 (78)	2.27%	712,725 (79)
Richard Melnick	45,396 (46)	*	49,725 (47)
Michael S. Liss	75,660 (48)	*	82,875 (49)
SF Capital Partners Ltd.	650,674 (80)	2.27%	712,725 (79)
Fred and Delay Vallen	30,264 (81)	*	33,150 (82)
Stephan Rupp	45,396 (46)	*	49,725 (47)
George Manos	45,396 (46)	*	49,725 (47)
Sean M Callahan	45,396 (46)	*	49,725 (47)
SDIRA FBO: Alan E. Ennis SEP IRA	30,264 (83)	*	33,150 (82)
Timothy Sledz	45,396 (46)	*	49,725 (47)
John Simonelli	30,264 (81)	*	33,150 (82)
Frederic Bauthier	181,583 (84)	*	198,900 (85)
Dana E. Ennis	90,792 (86)	*	99,450 (87)
Christopher Choma	45,396 (46)	*	49,725 (47)
Roger & Divina Lockhart C.R.U.T.	45,396 (88)	*	49,725 (47)
Philip Bird	90,792 (86)	*	99,450 (87)
Peter A. Yaskowitz	45,396 (46)	*	49,725 (47)
Greg Downes	45,396 (46)	*	49,725 (47)
Tom Franco	45,396 (46)	*	49,725 (47)
Julie L. Michael	181,583 (84)	*	198,900 (85)
Ralph Rybacki	151,319 (89)	*	165,750 (39)
Rosen & Eichner 401K Profit			

Sharing Plan	45,396 (46)	*	49,725 (47)
Charles P. Strogen	181,583 (84)	*	198,900 (85)
Thomas Beard	30,264 (81)	*	33,150 (82)
Harry Falterbauer	60,528 (52)	*	66,300 (53)
Jerdan Enterprises, Inc.	348,035 (90)	1.23%	381,225 (91)
National Financial Services LLC, Phil Clark IRA R/O	105,924 (92)	*	116,025 (79)
Alan R. Cohen	45,396 (46)	*	49,725 (47)
James Lehman	45,396 (46)	*	49,725 (47)
Oscar Garza	45,396 (46)	*	49,725 (47)

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NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED PRIOR TO OFFERING — NUMBER	PERCENTAGE	SHARES OF COMMON STOCK BEING OFFERED
John Jay Gebhardt	60,528 (93)	*	66,300 (53)
Robert Hermanos	30,264 (81)	*	33,150 (82)
Stuart Jacobson	166,451 (94)	*	182,325 (95)
North Metropolitan Radiology Assoc., LP 401K Profit Sharing Plan FBO: Stuart Jacobson	60,528 (96)	*	66,300 (53)
Robert Klein & Myriam Gluck	90,792 (86)	*	99,450 (87)
Allen Weiss	45,396 (46)	*	49,725 (47)
RA Schafer	45,396 (46)	*	49,725 (47)
Robert Kinney	30,264 (81)	*	33,150 (82)
Joseph R. McCandless	45,396 (97)	*	49,725 (47)
Charles & Kathleen Doller	96,116 (98)	*	49,725 (99)
National Financial Services LLC, Julius H. Roma IRA R/O	60,528 (100)	*	66,300 (53)
Thomas Contino	30,264 (81)	*	33,150 (82)
Robert Cymbala	45,396 (46)	*	49,725 (47)
Dan Foley	30,264 (81)	*	33,150 (82)

SDS Merchant Fund, L.P.	1,476,014 (101)	4.99%	2,203,525 (102)	
Kris & Geraldine Shah Family Trust	4,906,045 (103)	17.49%	7,105	4,
JAW Financial, L.P.	5,705,023 (104)	20.34%	2,369	5,
Integral Systems, Inc.	150,000 (105)	*	150,000 (105)	
Research Venture, LLC	466,950 (106)	1.66%	466,950	
Pacific Crest Securities, Inc.	133,200 (107)	*	133,200 (107)	
Bluestone Partners, L.P.	236,800 (107)	*	236,800 (107)	
Roth Capital Partners, LLC	23,756 (108)	*	23,756 (108)	
Wave Systems Corp.	4,550,583 (109)	16.22%	1,800,000	2,
Burnham Hill Holdings, LLC	963,000 (110)	3.32%	963,000 (110)	
Hilary G. Bergman	58,803 (111)	*	58,803 (111)	
Bradley C. Reifler	58,803 (112)	*	58,803 (112)	
Eric Singer	20,681 (113)	*	20,681 (113)	
Kimball & Cross Investment Management Corp.	5,830 (114)	*	5,830 (114)	
Hudson Valley Capital Management, LLC	50,720 (115)	*	50,720 (115)	

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NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED PRIOR TO OFFERING		SHARES OF COMMON STOCK BEING OFFERED	
	NUMBER	PERCENTAGE		
Chris Shufeldt	1,750 (116)	*	1,750 (116)	
Brian Herman	27,040 (117)	*	27,040 (117)	
Sean Callahan	7,600 (118)	*	7,600 (118)	
Mark Ford	12,960 (119)	*	12,960 (119)	
Daniel Pietro	900 (120)	*	900 (120)	
Claude Ware	4,000 (121)	*	4,000 (121)	
James St. Clair	6,000 (122)	*	6,000 (122)	
Roger Lockhart	46,896 (123)	*	1,500 (124)	

* Less than 1.00%

(1) The figures shown assume the sale of all shares being offered under this prospectus.

(2) Power to vote or dispose of the shares beneficially owned by RBC Dain Rauscher, Inc. is held by RBC Dain Rauscher, Corp. The individuals authorized to act on behalf of RBC Dain Rauscher, Corp. in the voting and disposition of the shares are Irving Weiser, Lisa A. Ferris, Lawrence C. Holtz, Michelle R. White, Peter Armenio, Peter M. Grant, Maria T. Malark and Mary E. Zimmer.

(3) Douglas J. Burke is a managing director of Montgomery & Co. LLC, an NASD-member firm.

(4) Forbes W. Burtt is a managing director of Wedbush Morgan Securities, an NASD-member firm.

(5) William Hannan is a former employee of Tucker Anthony Sutro Capital Markets, a former NASD-member firm that merged with RBC Dain Rauscher, Inc.

(6) Crestview Capital Partners, LLC controls three funds listed in the above table: Crestview Capital Fund, L.P., Crestview Capital Fund II, L.P. and Crestview Offshore Fund, Inc. Power to vote or dispose of the shares beneficially owned by each of each of Crestview Capital Fund, L.P., Crestview Capital Fund II, L.P. and Crestview Offshore Fund, Inc. is held by Stewart Flink and Richard Levy. Stewart Flink owns Dillon Capital, Inc., an NASD-member firm.

(7) Includes 470,810 outstanding shares of common stock and 980,430 shares of common stock that represent the maximum aggregate number of shares of common stock that may be issued upon conversion of notes and preferred stock and upon exercise of warrants without waiver of beneficial ownership limitations. If beneficial ownership limitations had not been in effect, the selling security holder would have beneficially owned a total of 3,051,533 shares of common stock, or 9.96% of our outstanding common stock, including 2,580,723 shares of common stock underlying derivative securities, when calculated in accordance with Rule 13d-3.

(8) Includes 470,810 outstanding shares of common stock, 448,438 shares of common stock underlying the principal balance of, and estimated interest on, a retained note, 400,000 shares of common stock underlying an April 2002 warrant, 468,070 shares of common stock underlying the principal balance of, and estimated interest on, an additional retained note, 232,143 shares of common stock underlying an additional retained warrant, 33,333 shares of common stock underlying a September 2003 bridge warrant, 897,633 shares of common stock underlying Series A Preferred face amount and dividends, 178,575 shares of common stock underlying an A-1 warrant and 178,575 shares of common stock underlying an A-2 warrant.

(9) Includes 382,074 outstanding shares of common stock and 1,073,835 shares of common stock that represent the maximum aggregate number of shares of common stock that may be issued upon conversion of notes and preferred stock and upon exercise of warrants without waiver of beneficial ownership limitations. If beneficial ownership limitations had not been in effect, the selling security holder would have beneficially owned a total of 2,480,159 shares of common stock, or 8.23% of our outstanding common stock, including 2,098,085 shares of common stock underlying derivative securities, when calculated in accordance with Rule 13d-3.

(10) Includes 382,074 outstanding shares of common stock, 166,563 shares of common stock underlying the principal balance of, and estimated interest on, a retained note, 216,033 shares of common stock underlying the principal balance of, and estimated interest on, an additional retained note, 107,143 shares of common stock underlying an additional retained warrant, 50,000 shares of common stock underlying a September 2003 bridge warrant, 1,215,375 shares of common stock underlying Series A Preferred face amount and dividends, 262,500 shares of common stock underlying an A-1 warrant and 262,500 shares of common stock underlying an A-2 warrant.

(11) Includes 20,028 outstanding shares of common stock, 36,006 shares of common stock underlying the principal balance of, and estimated interest on, an additional retained note, and 17,857 shares underlying additional retained warrants.

(12) Includes 1,954,496 outstanding shares of common stock. Also includes 110,000 shares of common stock underlying a warrant held by William Blair & Company, L.L.C., an NASD-member firm that has acted as placement agent for us in a prior offering. Mr. Kiphart is manager - corporate finance at William Blair & Company, L.L.C. If beneficial ownership limitations had not been in effect, the selling security holder would have beneficially owned a total of 13,949,262 shares of common stock, or 34.83% of our outstanding common stock, including 11,994,766 shares of common stock underlying derivative securities, when calculated in accordance with Rule 13d-3.

(13) Includes 1,954,496 outstanding shares of common stock, 1,601,563 shares of common stock underlying the principal balance of, and estimated interest on, a retained note, 1,273,800 shares of common stock underlying an April 2002 warrant, 1,440,216 shares of common stock underlying the principal balance of, and estimated interest on, an additional retained note, 714,286 shares of common stock underlying an additional retained warrant, 166,667 shares of common stock underlying a September 2003 bridge warrant, 5,340,475 shares of common stock underlying Series A Preferred face amount and dividends, 1,153,450 shares of common stock underlying an A-1 warrant and 1,153,450 shares of common stock underlying an A-2 warrant.

(14) Includes 41,909 outstanding shares of common stock, 11,750 shares of common stock underlying options, 268,388 shares of common stock underlying the principal balance of, and estimated interest on, a retained note, and 153,866 shares of common stock underlying an April 2002 warrant. Power to vote or dispose of the shares beneficially owned by Nefilim Associates, LLC is held by Alexander T. Tennant as the managing member.

(15) Includes 41,909 outstanding shares of common stock, 11,750 shares of common stock underlying options, 328,569 shares of common stock underlying the principal balance of, and estimated interest on, a retained note, and 153,866 shares of common stock underlying an April 2002 warrant.

(16) Includes 40,857 outstanding shares of common stock, 150,000 shares of common stock underlying an April 2002 warrant, 361,812 shares of common stock underlying Series A Preferred face amount and dividends, 89,275 shares of common stock underlying an A-1 warrant and 89,275 shares of

common stock underlying an A-2 warrant.

(17) Includes 40,857 outstanding shares of common stock, 150,000 shares of common stock underlying an April 2002 warrant, 413,350 shares of common stock underlying Series A Preferred face amount and dividends, 89,275 shares of common stock underlying an A-1 warrant and 89,275 shares of common stock underlying an A-2 warrant.

(18) Represents shares underlying a warrant. Power to vote or dispose of the shares beneficially owned by William Blair & Company, L.L.C. is held by the Executive Committee of William Blair & Company, L.L.C., which was comprised of Edgar Janotta, E. David Coolidge, John Ettleson, James McKinney, Albert Lacher, Carlette McMullan, Michelle Seitz, Robert Newman and selling security holder Richard P. Kiphart.

(19) The power to vote or dispose of the shares beneficially owned by AMG Financing Capital, Inc. is held by Arthur M. Gelber as president.

(20) Includes 103,787 outstanding shares of common stock and 70,841 shares underlying options. Until June 2002, Mr. Gray was our vice president, product development and embedded systems and chief technical officer. He is now an hourly employee.

(21) Includes 82,413 outstanding shares of common stock and 70,841 shares of common stock underlying options.

(22) Includes 506,597 shares of common stock underlying Series A Preferred face amount and dividends, 125,000 shares of common stock underlying an A-1 warrant and 125,000 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Thomas Hackl and Konrad Ackerman as directors.

(23) Includes 578,750 shares of common stock underlying Series A Preferred face amount and dividends, 125,000 shares of common stock underlying an A-1 warrant and 125,000 shares of common stock underlying an A-2 warrant.

(24) Includes 101,319 shares of common stock underlying Series A Preferred face amount and dividends, 25,000 shares of common stock underlying an A-1 warrant and 25,000 shares of common stock underlying an A-2 warrant.

(25) Includes 115,750 shares of common stock underlying Series A Preferred face amount and dividends, 25,000 shares of common stock underlying an A-1 warrant and 25,000 shares of common stock underlying an A-2 warrant.

(26) Represents the maximum aggregate number of shares of common stock that may be issued upon conversion of Series A Preferred face amount and dividends and upon exercise of A-1 and A-2 warrants without waiver of beneficial ownership limitations. If beneficial ownership limitations had not been in effect, the selling security holder would have beneficially owned a total of 2,592,253 shares of common stock, or 8.46% of our outstanding common stock, all of which were underlying derivative securities, when calculated in accordance with Rule 13d-3.

(27) Includes 1,982,912 shares of common stock underlying Series A Preferred face amount and dividends, 428,275 shares of common stock underlying an

A-1 warrant and 428,275 shares of common stock underlying an A-2 warrant.

(28) Includes 658,576 shares of common stock underlying Series A Preferred face amount and dividends, 162,500 shares of common stock underlying an A-1 warrant and 162,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Paul Kessler as director and managing member of Bristol Capital Advisors, LLC, the investment manager to Bristol Investment Fund, Ltd.

(29) Includes 752,375 shares of common stock underlying Series A Preferred face amount and dividends, 162,500 shares of common stock underlying an A-1 warrant and 162,500 shares of common stock underlying an A-2 warrant.

(30) Includes 151,979 shares of common stock underlying Series A Preferred face amount and dividends, 37,500 shares of common stock underlying an A-1 warrant and 37,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned by Clarion Offshore Fund, Ltd. is held by Morton A. Cohen as investment manager. Power to vote or dispose of the shares beneficially owned by Clarion Partners, L.P. is held by Mr. Cohen as general partner.

(31) Includes 173,625 shares of common stock underlying Series A Preferred face amount and dividends, 37,500 shares of common stock underlying an A-1 warrant and 37,500 shares of common stock underlying an A-2 warrant.

(32) Includes 40,528 shares of common stock underlying Series A Preferred face amount and dividends, 10,000 shares of common stock underlying an A-1 warrant and 10,000 shares of common stock underlying an A-2 warrant.

(33) Includes 46,300 shares of common stock underlying Series A Preferred face amount and dividends, 10,000 shares of common stock underlying an A-1 warrant and 10,000 shares of common stock underlying an A-2 warrant.

(34) Includes 435,674 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Wilheim Ungar as an officer.

(35) Includes 497,725 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant.

(36) Includes 435,674 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant. Gamma Capital Advisors, Ltd. (GCAL) is the general partner of Gamma Opportunity Capital Partners, L.P. (GOCPL) and has the power to vote or dispose of the shares being offered by GOCPL. As such, GCAL may be deemed to beneficially own the shares being offered by GOCPL. Christopher Rossman and Jonathan P. Knight, PhD, are the directors of GCAL, each possessing the power to act on its behalf. GCAL, Mr. Rossman

and Dr. Knight each disclaim beneficial ownership of the shares being offered by GOCPL.

(37) Includes 497,725 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant.

(38) Includes 101,319 shares of common stock underlying Series A Preferred face amount and dividends, 25,000 shares of common stock underlying an A-1 warrant and 25,000 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Evan Schemenauer, Jonathan Walk and Don Dunston as directors.

(39) Includes 115,750 shares of common stock underlying Series A Preferred face amount and dividends, 25,000 shares of common stock underlying an A-1 warrant and 25,000 shares of common stock underlying an A-2 warrant.

(40) Includes 273,563 shares of common stock underlying Series A Preferred face amount and dividends, 67,500 shares of common stock underlying an A-1 warrant and 67,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Frank E. Hart as general partner, David A. Rapaport as executive vice president and general counsel and Fred A. Brasch as chief financial officer.

(41) Includes 312,525 shares of common stock underlying Series A Preferred face amount and dividends, 67,500 shares of common stock underlying an A-1 warrant and 67,500 shares of common stock underlying an A-2 warrant.

(42) Includes 50,660 shares of common stock underlying Series A Preferred face amount and dividends, 12,500 shares of common stock underlying an A-1 warrant and 12,500 shares of common stock underlying an A-2 warrant.

(43) Includes 57,875 shares of common stock underlying Series A Preferred face amount and dividends, 12,500 shares of common stock underlying an A-1 warrant and 12,500 shares of common stock underlying an A-2 warrant.

(44) Includes 50,660 shares of common stock underlying Series A Preferred face amount and dividends, 12,500 shares of common stock underlying an A-1 warrant and 12,500 shares of common stock underlying an A-2 warrant. Mr. Gilbert is a broker at J Alexander, an NASD-member firm.

(45) Includes 57,875 shares of common stock underlying Series A Preferred face amount and dividends, 12,500 shares of common stock underlying an A-1 warrant and 12,500 shares of common stock underlying an A-2 warrant.

(46) Includes 30,396 shares of common stock underlying Series A Preferred face amount and dividends, 7,500 shares of common stock underlying an A-1 warrant and 7,500 shares of common stock underlying an A-2 warrant.

(47) Includes 34,725 shares of common stock underlying Series A Preferred face amount and dividends, 7,500 shares of common stock underlying an

A-1 warrant and 7,500 shares of common stock underlying an A-2 warrant.

(48) Includes 50,660 shares of common stock underlying Series A Preferred face amount and dividends, 12,500 shares of common stock underlying an A-1 warrant and 12,500 shares of common stock underlying an A-2 warrant.

(49) Includes 57,875 shares of common stock underlying Series A Preferred face amount and dividends, 12,500 shares of common stock underlying an A-1 warrant and 12,500 shares of common stock underlying an A-2 warrant.

(50) Includes 222,903 shares of common stock underlying Series A Preferred face amount and dividends, 55,000 shares of common stock underlying an A-1 warrant and 55,000 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Anthony L.M. Inder Rieden as president.

(51) Includes 254,650 shares of common stock underlying Series A Preferred face amount and dividends, 55,000 shares of common stock underlying an A-1 warrant and 55,000 shares of common stock underlying an A-2 warrant.

(52) Includes 40,528 shares of common stock underlying Series A Preferred face amount and dividends, 10,000 shares of common stock underlying an A-1 warrant and 10,000 shares of common stock underlying an A-2 warrant.

(53) Includes 46,300 shares of common stock underlying Series A Preferred face amount and dividends, 10,000 shares of common stock underlying an A-1 warrant and 10,000 shares of common stock underlying an A-2 warrant.

(54) Includes 40,528 shares of common stock underlying Series A Preferred face amount and dividends, 10,000 shares of common stock underlying an A-1 warrant, 10,000 shares of common stock underlying an A-2 warrant, 65,000 shares of common stock underlying placement agent warrants and 9,806 shares of common stock underlying exchange agent warrants. Mr. Balk is an employee of Burnham Hill Partners.

(55) Includes 46,300 shares of common stock underlying Series A Preferred face amount and dividends, 10,000 shares of common stock underlying an A-1 warrant and 10,000 shares of common stock underlying an A-2 warrant.

(56) Includes 30,396 shares of common stock underlying Series A Preferred face amount and dividends, 7,500 shares of common stock underlying an A-1 warrant and 7,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Stephen Schwartz as president.

(57) Includes 303,958 shares of common stock underlying Series A Preferred face amount and dividends, 75,000 shares of common stock underlying an A-1 warrant and 75,000 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Mark Nordlicht, as managing member of Platinum Management (NY) LLC, the general partner of Platinum Partners Value Arbitrage Fund LP.

(58) Includes 347,250 shares of common stock underlying Series A Preferred face amount and dividends, 75,000 shares of common stock underlying an A-1 warrant and 75,000 shares of common stock underlying an A-2 warrant.

(59) Includes 303,958 shares of common stock underlying Series A Preferred, 75,000 shares of common stock underlying an A-1 warrant and 75,000 shares of common stock underlying an A-2 warrant. Ramius Capital Group, LLC is the investment advisor to Portside Growth and Opportunity Fund. The managing member of Ramius Capital Group, LLC is C4S & Co., the managing members of which are Peter Cohen, Morgan Stark, Thomas Strauss and Jeffrey Solomon. As such, Messrs. Cohen, Stark, Strauss and Solomon may be deemed beneficial ownership of the offered shares. However, each individual disclaims beneficial ownership. Ramius Securities, LLC, an NASD-member, is an affiliate of Ramius Capital Group, LLC. However, Ramius Securities, LLC will not sell any offered shares and will not receive compensation in connection with sales of offered shares.

(60) Includes 202,639 shares of common stock underlying Series A Preferred face amount and dividends, 50,000 shares of common stock underlying an A-1 warrant and 50,000 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Howard Berger as manager.

(61) Includes 231,500 shares of common stock underlying Series A Preferred face amount and dividends, 50,000 shares of common stock underlying an A-1 warrant and 50,000 shares of common stock underlying an A-2 warrant.

(62) Represents the maximum aggregate number of shares of common stock that may be issued upon conversion of Series A Preferred face amount and dividends and upon exercise of A-1 and A-2 warrants without waiver of beneficial ownership limitations. If beneficial ownership limitations had not been in effect, the selling security holder would have beneficially owned a total of 2,163,868 shares of common stock, or 7.16% of our outstanding common stock, all of which were underlying derivative securities, when calculated in accordance with Rule 13d-3.

(63) Includes 1,655,225 shares of common stock underlying Series A Preferred face amount and dividends, 357,500 shares of common stock underlying an A-1 warrant and 357,500 shares of common stock underlying an A-2 warrant. RHP Master Fund, Ltd. (RMFL) is a party to an investment management agreement with Rock Hill Investment Management, L.P. (RHIML), a limited partnership of which the general partner is RHP General Partner, LLC (RGPL). Pursuant to that agreement, RHIML directs the voting and disposition of shares owned by RMFL. Messrs. Wayne Bloch, Gary Kaminsky and Peter Lockhart own all of the interests in RGPL but disclaim beneficial ownership of the shares offered by RMFL.

(64) Includes 101,319 shares of common stock underlying Series A Preferred face amount and dividends, 25,000 shares of common stock underlying an A-1 warrant and 25,000 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by each of Riaz Ahmed Don and Raahim Don.

(65) Includes 70,924 shares of common stock underlying Series A Preferred face amount and dividends, 17,500 shares of common stock underlying an A-1 warrant and 17,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by Robert J. Neborsky as trustee.

(66) Includes 81,025 shares of common stock underlying Series A Preferred face amount and dividends, 17,500 shares of common stock underlying an A-1 warrant and 17,500 shares of common stock underlying an A-2 warrant.

(67) Represents the maximum aggregate number of shares of common stock that may be issued upon conversion of Series A Preferred face amount and dividends and upon exercise of A-1 and A-2 warrants without waiver of beneficial ownership limitations. If beneficial ownership limitations had not been in effect, the selling security holder would have beneficially owned a total of 4,625,704 shares of common stock, or 14.16% of our outstanding common stock, all of which were underlying derivative securities (including 2,033,451 shares underlying derivative securities held by selling security holder SDS Merchant Fund, L.P.), when calculated in accordance with Rule 13d-3.

(68) Includes 1,982,913 shares of common stock underlying Series A Preferred face amount and dividends, 428,275 shares of common stock underlying an A-1 warrant and 428,275 shares of common stock underlying an A-2 warrant.

(69) Includes 435,674 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by each of Elizabeth Leonard as chief operating officer and Michael Finklestein as president.

(70) Includes 497,725 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant.

(71) Includes 435,674 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares is held by Joshua Silverman as partner. Mr. Silverman disclaims beneficial ownership of the shares held by Vertical Ventures, LLC.

(72) Includes 70,924 shares of common stock underlying Series A Preferred face amount and dividends, 17,500 shares of common stock underlying an A-1 warrant and 17,500 shares of common stock underlying an A-2 warrant. Also includes 105,924 shares of common stock underlying derivative securities held by selling security holder West End Convertible Fund L.P. Power to vote or dispose of the shares beneficially owned is held by each of Ethan Benovitz, Daniel Saks and Jaime Hartman as managing members.

(73) Includes 81,025 shares of common stock underlying Series A Preferred face amount and dividends, 17,500 shares of common stock underlying an A-1 warrant and 17,500 shares of common stock underlying an A-2 warrant.

(74) Includes 70,924 shares of common stock underlying Series A Preferred face amount and dividends, 17,500 shares of common stock underlying an A-1 warrant and 17,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is

held by each of Ethan Benovitz, Daniel Saks and Jaime Hartman, as managing members of WEC Partners, LLC, which is the general partner of West End Convertible Fund L.P.

(75) Includes 101,319 shares of common stock underlying Series A Preferred face amount and dividends, 25,000 shares of common stock underlying an A-1 warrant and 25,000 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by each of Evan Schemenauer, Jennifer Kelly and Arthur Jones as directors.

(76) Includes 395,146 shares of common stock underlying Series A Preferred face amount and dividends, 97,500 shares of common stock underlying an A-1 warrant and 97,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by J. David Hassan as director.

(77) Includes 451,425 shares of common stock underlying Series A Preferred face amount and dividends, 97,500 shares of common stock underlying an A-1 warrant and 97,500 shares of common stock underlying an A-2 warrant.

(78) Includes 435,674 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant. As investment manager under a management agreement, Castle Creek Partners, LLC may exercise dispositive and voting power over the shares offered by Castle Creek Technology Partners LLC. Daniel Asher is the managing member of Castle Creek Partners, LLC. Castle Creek Partners, LLC and Mr. Asher disclaim beneficial ownership of the shares owned by Castle Creek Technology Partners, LLC.

(79) Includes 497,725 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant.

(80) Includes 435,674 shares of common stock underlying Series A Preferred face amount and dividends, 107,500 shares of common stock underlying an A-1 warrant and 107,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares is held by Michael A. Roth and Brian J. Stark, who are the founding members and direct the management of Staro Asset Management L.L.C., which entity acts as investment manager and has sole power to direct the management of SF Capital Partners Ltd. SF Capital Partners Ltd. is affiliated with two NASD-member firms.

(81) Includes 20,264 shares of common stock underlying Series A Preferred face amount and dividends, 5,000 shares of common stock underlying an A-1 warrant and 5,000 shares of common stock underlying an A-2 warrant.

(82) Includes 23,150 shares of common stock underlying Series A Preferred face amount and dividends, 5,000 shares of common stock underlying an A-1 warrant and 5,000 shares of common stock underlying an A-2 warrant.

(83) Includes 20,264 shares of common stock underlying Series A Preferred face amount and dividends, 5,000 shares of common stock underlying an A-1 warrant and 5,000 shares of common stock underlying an A-2 warrant.

Power to vote or dispose of the shares is held by Alan E. Ennis as owner.

(84) Includes 121,583 shares of common stock underlying Series A Preferred face amount and dividends, 30,000 shares of common stock underlying an A-1 warrant and 30,000 shares of common stock underlying an A-2 warrant.

(85) Includes 138,900 shares of common stock underlying Series A Preferred face amount and dividends, 30,000 shares of common stock underlying an A-1 warrant and 30,000 shares of common stock underlying an A-2 warrant.

(86) Includes 60,792 shares of common stock underlying Series A Preferred face amount and dividends, 15,000 shares of common stock underlying an A-1 warrant and 15,000 shares of common stock underlying an A-2 warrant.

(87) Includes 69,450 shares of common stock underlying Series A Preferred face amount and dividends, 15,000 shares of common stock underlying an A-1 warrant and 15,000 shares of common stock underlying an A-2 warrant.

(88) Includes 30,396 shares of common stock underlying Series A Preferred face amount and dividends, 7,500 shares of common stock underlying an A-1 warrant and 7,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares beneficially owned is held by each of Roger Lockhart and Divina Lockhart as trustees. Mr. Lockhart is employed by ViewTrade Financial.

(89) Includes 101,319 shares of common stock underlying Series A Preferred face amount and dividends, 25,000 shares of common stock underlying an A-1 warrant and 25,000 shares of common stock underlying an A-2 warrant.

(90) Includes 233,035 shares of common stock underlying Series A Preferred face amount and dividends, 57,500 shares of common stock underlying an A-1 warrant and 57,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares is held by Myles S. Jerdan as president.

(91) Includes 266,225 shares of common stock underlying Series A Preferred face amount and dividends, 57,500 shares of common stock underlying an A-1 warrant and 57,500 shares of common stock underlying an A-2 warrant.

(92) Includes 70,924 shares of common stock underlying Series A Preferred face amount and dividends, 17,500 shares of common stock underlying an A-1 warrant and 17,500 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares is held by Philip R. Clark as owner.

(93) Includes 40,528 shares of common stock underlying Series A Preferred face amount and dividends, 10,000 shares of common stock underlying an A-1 warrant and 10,000 shares of common stock underlying an A-2 warrant. Mr. Gebhardt is a member of the American Stock Exchange.

(94) Includes 111,451 shares of common stock underlying Series A Preferred face amount and dividends, 27,500 shares of common stock underlying an A-1 warrant and 27,500 shares of common stock underlying an A-2 warrant.

(95) Includes 127,325 shares of common stock underlying Series A Preferred face amount and dividends, 27,500 shares of common stock underlying an A-1 warrant and 27,500 shares of common stock underlying an A-2 warrant.

(96) Includes 40,528 shares of common stock underlying Series A Preferred face amount and dividends, 10,000 shares of common stock underlying an A-1 warrant and 10,000 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares is held by Mr. Jacobson as partner.

(97) Includes 30,396 shares of common stock underlying Series A Preferred face amount and dividends, 7,500 shares of common stock underlying an A-1 warrant and 7,500 shares of common stock underlying an A-2 warrant. Mr. McCandless is affiliated with a registered broker-dealer.

(98) Includes 30,396 shares of common stock underlying Series A Preferred face amount and dividends, 7,500 shares of common stock underlying an A-1 warrant and 7,500 shares of common stock underlying an A-2 warrant. Also includes 50,720 shares of common stock underlying derivative securities held by selling security holder Hudson Valley Capital Management, LLC Mr. Doller is an associate of Kimball & Cross.

(99) Includes 34,725 shares of common stock underlying Series A Preferred face amount and dividends, 7,500 shares of common stock underlying an A-1 warrant and 7,500 shares of common stock underlying an A-2 warrant.

(100) Includes 40,528 shares of common stock underlying Series A Preferred face amount and dividends, 10,000 shares of common stock underlying an A-1 warrant and 10,000 shares of common stock underlying an A-2 warrant. Power to vote or dispose of the shares is held by Julius Roma as owner.

(101) Represents the maximum aggregate number of shares of common stock that may be issued upon conversion of Series A Preferred face amount and dividends and upon exercise of A-1 and A-2 warrants without waiver of beneficial ownership limitations. If beneficial ownership limitations had not been in effect, the selling security holder would have beneficially owned a total of 2,033,451 shares of common stock, or 6.76% of our outstanding common stock, all of which were underlying derivative securities, when calculated in accordance with Rule 13d-3.

(102) Includes 1,364,225 shares of common stock underlying Series A Preferred face amount and dividends, 294,650 shares of common stock underlying an A-1 warrant and 294,650 shares of common stock underlying an A-2 warrant.

(103) Voting and dispositive power is held by Kris and Geraldine Shah as trustees. Mr. Shah is our co-chairman, president, chief operating officer and secretary.

(104) JAW Financial, L.P. shares voting and dispositive power over these shares with JAW Lending, Inc., the general partner of JAW Financial, L.P., and Marvin J. Winkler, an executive officer and 50% shareholder of JAW Lending, Inc. Mr. Winkler is our co-chairman and chief executive officer.

(105) Represents shares of common stock underlying a warrant. Power to vote

or dispose of the shares is held by Steven R. Chamberlain as chairman, Gary A. Prince as director of mergers and acquisitions and Elaine M. Parfitt as executive vice president and chief financial officer.

(106) Power to vote or dispose of the shares beneficially owned by Research Venture, LLC is held by Jack J. Kessler, as managing member, and Jeffrey Soffer, as member.

(107) Represents shares of common stock underlying a warrant.

(108) Represents shares of common stock underlying a warrant. Power to vote or dispose of the shares is held by Gordon Roth as chief financial officer and chief operating officer.

(109) Power to vote or dispose of the shares is held by Gerard T. Feeney as chief financial officer and Steven Sprague as chief executive officer.

(110) Includes 800,000 shares of common stock underlying placement agent warrants and 163,000 shares of common stock underlying exchange agent warrants. Power to vote or dispose of the shares is held by Cass Gunther Adelman, Esq., as managing member of Burnham Hill Holdings, LLC. Ms. Adelman's spouse, Jason Adelman, is a managing director of BHP and is a member of Burnham Hill Holdings, LLC.

(111) Includes 49,204 shares of common stock underlying placement agent warrants and 9,599 shares of common stock underlying exchange agent warrants. Ms. Bergman is chief operating officer of Pali Capital, Inc.

(112) Includes 49,204 shares of common stock underlying placement agent warrants and 9,599 shares of common stock underlying exchange agent warrants. Mr. Reifler is chief executive officer of Pali Capital, Inc.

(113) Includes 20,681 shares of common stock underlying placement agent warrants. Mr. Singer is an employee of BHP.

(114) Includes 5,830 shares of common stock underlying placement agent warrants. Power to vote or dispose of the shares is held by John Clifford as chief financial officer.

(115) Includes 50,720 shares of common stock underlying placement agent warrants. Hudson Valley Capital Management, LLC is an affiliate of Kimball & Cross. Power to vote or dispose of the shares beneficially owned is held by Charles W. Doller, III as managing member. Mr. Doller is an employee of Hudson Valley Capital Management LLC, and he operates a branch office of a registered broker-dealer.

(116) Includes 1,750 shares of common stock underlying placement agent warrants. Mr. Shufeldt is employed by Kimball & Cross.

(117) Includes 27,040 shares of common stock underlying placement agent warrants. Mr. Herman is employed by ViewTrade Financial.

(118) Includes 7,600 shares of common stock underlying placement agent warrants. Mr. Callahan is employed by ViewTrade Financial.

(119) Includes 12,960 shares of common stock underlying placement agent warrants. Mr. Ford is employed by ViewTrade Financial.

(120) Includes 900 shares of common stock underlying placement agent warrants. Mr. Pietro is employed by ViewTrade Financial.

(121) Includes 4,000 shares of common stock underlying placement agent warrants. Mr. Ware is employed by ViewTrade Financial.

(122) Includes 6,000 shares of common stock underlying placement agent warrants. Mr. St. Clair is employed by ViewTrade Financial.

(123) Includes 1,500 shares of common stock underlying placement agent warrants. Also includes 45,396 shares of common stock underlying derivative securities held by selling security holder Roger & Divina Lockhart C.R.U.T. Mr. Lockhart is employed by ViewTrade Financial.