ION NETWORKS INC
Form 10QSB
August 14, 2007

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

# FORM 10-QSB

**[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

OR

**[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ____________ to ____________

Commission File No.: 0-13117

**ION NETWORKS, INC.**

(Exact Name of Small Business Issuer in Its Charter)

| | |
|---|---|
| Delaware | 22-2413505 |
| -------- | ---------- |
| (State or Other Jurisdiction of Incorporation or Organization) | (IRS Employer Identification Number) |

120 Corporate Boulevard, South Plainfield, NJ 07080

(Address of Principal Executive Offices)

(908) 546-3900

(Issuer's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the proceeding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes X No __.

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

There were 32,785,565 shares of Common Stock outstanding as of August 10, 2007.

**Transitional Small Business Disclosure Format:**

**Yes __ No X**

**ION NETWORKS, INC. AND SUBSIDIARY**

**FORM 10-QSB**

**FOR THE QUARTER ENDED JUNE 30, 2007**

**PART I. FINANCIAL INFORMATION**

**PART II. OTHER INFORMATION**

## PART I. FINANCIAL INFORMATION

### ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein have been prepared by the registrant without audit pursuant to the rules and regulations of the Securities and Exchange Commission. Although the registrant believes that the disclosures are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. It is suggested that these financial statements be read in conjunction with the audited financial statements and the notes thereto included in the registrant's report on Form 10-KSB for the year ended December 31, 2006 as filed with the Securities and Exchange Commission.

**ION NETWORKS, INC. AND SUBSIDIARY**

**CONDENSED CONSOLIDATED BALANCE SHEET**

June 30, 2007

(Unaudited)

**Assets**

| | | |
|---|---|---|
| Current assets | | |
| Cash and cash equivalents | $ | 10,978 |
| Accounts receivable, less allowance for doubtful accounts of $36,417 | | 312,624 |
| Inventories, net | | 428,198 |
| Prepaid expenses and other current assets | | 14,779 |
| Total current assets | | 766,579 |
| Property and equipment, net | | 28,330 |
| Capitalized software, net | | 1,383,901 |
| Deferred financing costs, net | | 6,027 |
| Other assets | | 12,911 |
| Total assets | $ | 2,197,748 |

**Liabilities and Stockholders Equity**

| | | |
|---|---|---|
| Current liabilities | | |
| Accounts payable | $ | 368,362 |
| Accrued expenses | | 162,961 |
| Accrued payroll and related liabilities | | 106,430 |
| Revolving credit facility | | 222,837 |
| Capital lease payable | | 2,568 |
| Deferred income | | 160,643 |
| Notes payable related parties | | 50,000 |
| Other current liabilities | | 10,000 |
| Total current liabilities | | 1,083,801 |

| | | |
|---|---|---|
| Long-term liabilities | | |
| Accrued interest related party | | 15,814 |
| Capital lease payable, net of current portion | | 695 |
| Total long-term liabilities | | 16,509 |
| Total liabilities | | 1,100,310 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders Equity | | |
| Preferred stock par value $.001 per share; authorized 1,000,000 shares; 200,000 shares designated Series A; 155,557 shares issued and outstanding (aggregate liquidation preference $280,003) | | 156 |
| Common stock par value $.001 per share; authorized 50,000,000 shares; 32,785,565 shares issued and outstanding | | 32,786 |
| Additional paid-in capital | | 45,854,230 |
| Deferred compensation | | (62,676) |
| Accumulated deficit | | (44,727,058) |
| Total stockholders equity | | 1,097,438 |
| | | |
| Total liabilities and stockholders equity | $ | 2,197,748 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**ION NETWORKS, INC. AND SUBSIDIARY**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

| | For the Three Months Ended June 30, 2007 | For the Three Months Ended June 30, 2006 | For the Six Months Ended June 30, 2007 | For the Six Months Ended June 30, 2006 |
|---|---|---|---|---|
| Net sales | $ 635,609 | $ 1,113,345 | $ 1,578,571 | $ 1,744,411 |
| Cost of sales | 252,627 | 415,277 | 662,963 | 673,516 |
| Gross margin | 382,982 | 698,068 | 915,608 | 1,070,895 |
| Research and development | 82,576 | 153,271 | 167,498 | 304,407 |
| Selling, general and administrative expenses | 627,207 | 635,866 | 1,284,012 | 1,319,588 |
| Depreciation expense | 5,376 | 3,725 | 10,469 | 7,871 |
| Restructuring and other credits | - | (81,000) | - | (81,000) |
| Total operating expenses | 715,159 | 711,862 | 1,461,979 | 1,550,866 |
| Loss from operations | (332,177) | (13,794) | (546,371) | (479,971) |
| Other income | 1,340 | - | 1,340 | - |
| Interest (expense) related party | - | - | - | (1,696) |
| Interest income/(expense) (1) | (15,587) | (13,529) | (31,596) | (22,989) |
| Loss before income taxes | (346,424) | (27,323) | (576,627) | (504,656) |
| Income tax expense | - | 512 | 3,052 | 512 |
| Net loss | $ (346,424) | $ (27,835) | $ (579,679) | $ (505,168) |

| | | | | |
|---|---|---|---|---|
| Per share data: | | | | |
| Net loss per share | | | | |
| Basic and diluted | $ (0.01) | $ (0.00) | $ (0.02) | $ (0.02) |
| Weighted average number of common shares outstanding | | | | |
| Basic and diluted | 32,785,565 | 31,798,765 | 32,785,565 | 30,023,291 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**ION NETWORKS, INC. AND SUBSIDIARY**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

| | For the Six Months Ended June 30, 2007 | For the Six Months Ended June 30, 2006 |
|---|---|---|
| Cash flows from operating activities | | |
| Net loss | $ (579,679) | $ (505,168) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 165,487 | 105,847 |
| Non-cash stock-based compensation | 106,142 | 101,941 |
| Restructuring and other credits | - | (81,000) |
| Provision for doubtful accounts | 20,142 | - |
| Provision for inventory reserve | (6,749) | (3,177) |
| Interest on convertible debt related party | - | 1,696 |
| Deferred rent | 1,648 | - |
| Amortization of deferred financing costs | 18,081 | 18,153 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 116,062 | 349,434 |
| Inventories | 126,597 | (84,169) |
| Prepaid expenses and other current assets | 12,538 | 8,825 |
| Other assets | 10,085 | - |
| Accounts payable | 111,428 | (206,007) |
| Accrued expenses | (9,005) | (22,829) |
| Accrued payroll and related liabilities | (13,461) | (177,919) |
| Deferred income | 8,251 | 13,250 |
| Net cash provided by (used in) operating activities | 87,567 | (481,123) |

| | | |
|---|---|---|
| Cash flows from investing activities | | |
| Acquisition of property and equipment | (1,379) | (4,328) |
| Capitalized software expenditures | (327,045) | (243,004) |
| Net cash used in investing activities | (328,424) | (247,332) |
| | | |
| Cash flows from financing activities | | |
| Principal payments on debt and capital leases | (1,254) | (6,196) |
| Advances from related parties | 50,000 | - |
| Borrowings from revolving credit facility | - | 365,000 |
| Repayment of revolving credit facility | (62,847) | (265,000) |
| Deferred financing costs | - | (2,698) |
| Proceeds from the exercise of warrants | - | 498,882 |
| Net cash (used in) provided by financing activities | (14,101) | 589,988 |
| | | |
| Net decrease in cash and cash equivalents | (254,958) | (138,467) |
| | | |
| Cash and cash equivalents beginning of period | 265,936 | 196,342 |
| | | |
| Cash and cash equivalents end of period | $ 10,978 | $ 57,875 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**ION NETWORKS, INC. AND SUBSIDIARY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007

(Unaudited)

## NOTE 1 BASIS OF PRESENTATION AND MANAGEMENT S LIQUIDITY PLANS

*Basis of Presentation*

ION Networks, Inc. and subsidiary (the "Company"), a Delaware corporation founded in 1999 through the combination of two companies -- MicroFrame, a New Jersey Corporation (the predecessor entity to the Company, originally founded in 1982), and SolCom Systems Limited, a Scottish corporation located in Livingston, Scotland (originally founded in 1994), designs, develops, manufactures and sells network and information security and management products to corporations, service providers and government agencies. The Company's hardware and software suite of products are designed to form a secure auditable portal to protect IT and network infrastructure from internal and external security threats. ION's products operate in the IP, data center, telecommunications and transport, and telephony environments and are sold by a direct sales force and indirect channel partners mainly throughout North America and Europe.

The condensed consolidated balance sheet as of June 30, 2007, and the condensed consolidated statements of operations and cash flows for the three and six months ended June 30, 2007 and 2006, have been prepared by the Company without audit. In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to make the Company's financial position, results of operations and cash flows at June 30, 2007 and for the three and six months ended June 30, 2007 and 2006 not misleading have been made. The results of operations for the three and six months ended June 30, 2007 and for the three and six months ended June 30, 2007 and 2006 are not indicative of a full year or any other interim period.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the audited financial statements and notes thereto included in the report on Form 10-KSB for the year ended December 31, 2006, filed with the Securities and Exchange Commission.

*Management s Liquidity Plans*

The Company incurred a net loss of $579,679 for the six months ended June 30, 2007, which includes $271,629 of non-cash charges resulting from $165,487 of depreciation and amortization and $106,142 of stock-based compensation. The Company has a working capital deficiency of $317,222 at June 30, 2007. The Company continues to have a delicate cash position. Management believes it is necessary for it to continue to strictly manage expenditures and to increase product revenues. In addition, the Company has historically received proceeds from the sale of its New Jersey Net Operating Losses during the fourth quarter of previous years. While no assurance can be made that the Company will again receive such proceeds, if the Company is approved for this program again in 2007, it expects to use the proceeds received under this program for general working capital purposes.

The Company, beginning in the summer of 2003 undertook a financial and operating restructuring plan designed to reduce the amount of cash flows used in its operating activities. The Company s operational restructuring initiatives included, among other things, streamlining operations by reducing employee headcount and cutting overhead expenses. The Company next focused on refreshing its product line and incurred capital expenditures of approximately $1,800,000 related to new product development during 2004-2007. In the second half of 2006, the Company turned its attention to revenue generating activities on selling products that are intended to generate higher profit margins. In the first quarter of 2007, the Company signed a two-year agreement with an outsourcing sales firm to assist in the growth of revenues primarily focused in the enterprise sector. In the second quarter of 2007, the Company signed an agreement with another outsourcing sales firm to assist in the growth of revenues primarily focused in the government sector.

The Company entered into a $2.5 million revolving credit facility with Bridge Bank on September 9, 2005. This facility has a two-year term, expiring in September 2007. The Company is in default of certain financial covenants as June 30, 2007. This default can result in the Company not being permitted to borrow under the revolving credit facility in the future and may result in the loan becoming due and payable in full. Rather than seeking waivers to these defaults, the Company and Bridge Bank, N.A. have begun negotiations on a new facility. The Company must successfully negotiate a renewal to its financing arrangement with Bridge Bank, as it has not secured any commitments for new financing at this time nor can it provide any assurance that new capital (if needed) will be available to it on acceptable terms, if at all. However, the Company believes that because of the asset-backed nature of this financing facility, and its history of minimal accounts receivable write-offs, that it should be able to either renew the facility with Bridge Bank or find a suitable replacement. The Company s ability to continue operations will be materially adversely affected if it is unable to borrow from the revolving credit facility or obtain a new facility with satisfactory financial and other terms.

The Company believes that its strategy of streamlining the business around its core competency of providing secure access management solutions is enabling it to operate under a more efficient cost structure than in the past. The Company is continuing its financial and operational restructuring initiatives and will continue to implement its strategic business plan. Although the Company believes that it will have sufficient liquidity to sustain its operations for the next twelve months based on its current revenue projections and its ability to manage its costs, there is no assurance that such projections will be met and will be sufficient. If such an event occurs, in order to sustain operations over the next twelve months, the Company would need to raise additional capital or take other measures, in the event outside sources of capital are not available.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Principles of Consolidation*

The accompanying condensed consolidated financial statements include the accounts of ION Networks, Inc. and Subsidiary. All material inter-company balances and transactions have been eliminated in consolidation.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

The significant estimates include the allowance for doubtful accounts, allowance for inventory obsolescence, capitalized software including estimates of future gross revenues, and the related amortization lives, deferred tax asset valuation allowance and depreciation and amortization lives.

*Reclassifications*

Certain amounts in the financial statements for the three and six months ended June 30, 2006 have been reclassified to conform to the presentation of the financial statements for the three and six months ended June 30, 2007. There was no change in previously reported net loss.

*Capitalized Software*

The Company capitalizes computer software development costs in accordance with the provisions of Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86"). SFAS No. 86 requires that the Company capitalize computer software development costs upon the establishment of the technological feasibility of a product, to the extent that such costs are expected to be recovered through future sales of the product. Management is required to use professional judgment in determining whether development costs meet the criteria for immediate expense or capitalization. These costs are amortized to cost of sales by the greater of the amount computed using (i) the ratio that current gross revenues from the sales of software bear to the total of current and anticipated future gross revenues from the sales of that software, or (ii) the straight-line method over the estimated useful life of the product. As a result, the carrying amount of the capitalized software costs may be reduced materially in the near term.

The Company records impairment losses on capitalized software and other long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. The Company s cash flow estimates are based on historical results adjusted to reflect its best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. While the Company believes that its estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect the Company s estimates.

The Company capitalized $327,045 and $234,004 of software development costs for the six months ended June 30, 2007 and 2006, respectively. Amortization expense totaled $72,131 and $60,465 for the three months ending June 30, 2007 and 2006, respectively. Amortization expense totaled $155,018 and $97,976 for the six months ending June 30, 2007 and 2006, respectively. Amortization expense is included in Cost of Sales in the Statement of Operations.

*Net Loss Per Share of Common Stock*

Basic net loss per share is computed by dividing net loss attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share reflects the potential dilution that could occur if securities or other instruments to issue common stock were exercised or converted into common stock. Potentially dilutive securities of 9,840,189 and 8,067,118 at June 30, 2007 and 2006 are excluded from the computation of diluted net loss per share, as their inclusion would be antidilutive.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Share Based Payment ( FAS 123R ), using the modified prospective transition method and therefore has not restated prior periods' results. Stock-based compensation expense for all share-based payment awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of FAS 123R. The Company recognizes these compensation costs over the requisite service period of the award, which is generally the option vesting term. For the three months ended June 30, 2007 and 2006, the Company incurred stock based compensation expense of $47,161 and $50,465, respectively. For the six months ended June 30, 2007 and 2006, the Company incurred stock based compensation expense of $106,142 and $101,941, respectively. As of June 30, 2007, the fair value of unvested options totaled $96,702.

The fair value of share-based payment awards was estimated using the Black-Scholes option pricing model with the following assumptions and weighted average fair values as follows:

| | **Six months ended June 30,** | |
|---|---|---|
| | **2007** | **2006** |
| Risk-free interest rate | 4.52%-5.05% | 5.03%-5.10% |
| Dividend yield | N/A | N/A |
| Expected volatility | 202-224% | 214% |
| Expected life in years | 5 | 5 |
| Expected forfeiture rate (through term) | 0% | 75.9% |

A summary of option activity for the six months ended June 30, 2007 is as follows:

| Options | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at January 1, 2007 | 6,794,856 | $0.27 | 3.56 years | |
| Granted | 216,500 | $0.07 | 5.00 years | |
| Canceled | (186,324) | $0.45 | 3.23 years | |
| Expired | (154,000) | $0.70 | - | |
| Outstanding at June 30, 2007 | 6,671,032 | $0.25 | 3.17 years | $15.00 |
| Exercisable at June 30, 2007 | 5,094,181 | $0.27 | 2.95 years | $15.00 |

The weighted-average grant-date fair value of options granted during the six months ended June 30, 2007 and 2006 amounted to $0.07 and $0.11 per share, respectively.

*Revenue Recognition*

The Company recognizes revenue from product sales of hardware and software to end-users, value added resellers (VARs) and original equipment manufacturers (OEMs) upon shipment if no significant vendor obligations exist and collectibility is probable. The Company does not offer customers the right to return products, however the Company records warranty costs at the time revenue is recognized. Management estimates the anticipated warranty costs but actual results could differ from those estimates.

In addition, the Company sells internally developed stand-alone finished software packages ( PRIISMS Software ), which permit end-users to monitor, secure and administer voice and data communications networks. The software packages permit the customer to utilize the PRIISMS software pursuant to the terms of the license. Other than during an initial ninety-day warranty period from the date of shipment, the purchaser is not entitled to upgrades/enhancements or services that can be attributable to a multi-element arrangement. In addition, the customer does not have any rights to exchange or return the software. Since the software package sale does not require significant production, modification or customization, the Company recognizes revenue at such time the product is shipped and collectibility is probable in accordance with the accounting guidance under Statement Position 97-2, Software Revenue Recognition.

The Company sells separate customer maintenance contracts and maintenance revenue is recognized on a straight-line basis over the period the service is provided, generally one year. On some occasions, maintenance is provided on a time and material basis in which case revenue is recognized upon shipment of the repaired item.

*Income Taxes*

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 ( FIN 48 ). FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more likely than not to be sustained upon examination by taxing authorities. Differences between tax positions taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to the interpretation are referred to as unrecognized benefits . A liability is recognized (or amount of net operating loss

8

carry forward or amount of tax refundable is reduced) for an unrecognized tax benefit because it represents an enterprise s potential future obligation to the taxing authority for a tax position that was not recognized as a result of applying the provisions of FIN 48.

In accordance with FIN 48, interest costs related to unrecognized tax benefits are required to be calculated (if applicable) and would be classified as Interest expense, net in the consolidated statements of operations. Penalties would be recognized as a component of Selling, general and administrative expenses.

In many cases the Company s tax positions are related to tax years that remain subject to examination by relevant tax authorities. The Company files income tax returns in the United States (federal) and in various state and local jurisdictions. In most instances, the Company is no longer subject to federal, state and local income tax examinations by tax authorities for years prior to 2003.

The adoption of the provisions of FIN 48 did not have a material impact on the Company s consolidated financial position and results of operations. As of June 30, 2007, no liability for unrecognized tax benefits was required to be recorded.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers projected future taxable income and tax planning strategies in making this assessment. At present, the Company does not have a sufficient history of income to conclude that it is more likely than not that the Company will be able to realize all of its tax benefits in the near future and therefore a valuation allowance was established in the full value of the deferred tax asset.

A valuation allowance will be maintained until sufficient positive evidence exists to support the reversal of any portion or all of the valuation allowance net of appropriate reserves. Should the Company continue to be profitable in future periods with supportable trends, the valuation allowance will be reversed accordingly.

**NOTE 3 - INVENTORIES**

Inventories, net of allowance for obsolescence of $46,755 at June 30, 2007, consists of the following:

| | | |
|---|---|---|
| Raw materials | $ | 233,707 |
| Finished goods | | 194,491 |
| | $ | 428,198 |

**NOTE 4 REVOLVING CREDIT FACILITY**

On September 21, 2005, the Company entered into the asset based Revolving Credit Facility for $2.5 million with Bridge Bank, N.A. The Revolving Credit Facility has a two-year term, which upon maturity, requires payment of the outstanding principal and interest balance. The Revolving Credit Facility provides for advances of up to $2.0 million against 80% of eligible accounts receivables and an additional $500,000 against inventory capped at 30% of eligible accounts receivables. The annual interest rate is prime plus 1.75% (10.00% at June 30, 2007), with a minimum prime rate of 6.25%. Certain assets of the Company secure the Revolving Credit Facility, and the Company is subject to certain financial and restrictive covenants, as defined in the agreement. As of June 30, 2007, the outstanding balance on the Revolving Credit Facility was $222,837. The Company failed to comply with certain financial covenants in the Revolving Credit Facility at June 30, 2007. (See Note 1).

**NOTE 5 STOCKHOLDERS EQUITY**

*Warrants*

On January 26, 2007, the Company entered into an agreement with a consultant. In connection with this agreement, the Company issued fully vested warrants with a two year term to purchase 1,500,000 shares of the Company s Common Stock at $0.10 per share for a total value of $133,709 based on the Black-Scholes model.

On May 1, 2007, the Company amended a previous agreement made on January 26, 2007 with a consultant. In connection with this amendment, the Company received back 562,500 fully vested warrants with a two year term to purchase 562,500 shares of the Company s Common Stock at $0.10 per share for a total value of $50,141 based on the Black-Scholes model. The remaining value of $37,606 was taken out of deferred compensation.

*Options*

On February 28, 2007, the Company granted board members immediately exercisable options to purchase an aggregate of 9,000 shares of common stock with an exercise price of $0.10 for a total value of $599, based on the Black-Scholes model, under a previously stock holder approved option plan.

On May 9, 2007, the Company granted board members immediately exercisable options to purchase an aggregate of 4,500 shares of common stock with an exercise price of $0.07 for a total value of $311, based on the Black-Scholes model, under a previously stock holder approved option plan.

On May 9, 2007, the Company granted an employee 200,000 options to purchase common stock, of which 34% vest on the first anniversary of the option grant date and 8.25% vest each quarter there after, with an exercise price of $0.07 for a total value of $13,157, based on the Black-Scholes model, under a previously stock holder approved option plan.

On June 7, 2007, the Company granted board members immediately exercisable options to purchase an aggregate of 3,000 shares of common stock with an exercise price of $0.045 for a total value of $148, based on the Black-Scholes model, under a previously stock holder approved option plan.

**NOTE 6 SALES CONCENTRATIONS**

Historically, the Company has been dependent on several large customers each year, but they are not necessarily the same every year. For the three months ended June 30, 2007, the Company s net sales came from three significant customers consist of 25%, 16% and 11%, compared to the three months ended June 30, 2006, when the Company s had two significant customers which consisted of 31%, and 13% of net sales. For the six months ended June 30, 2007, the Company s net sales came from three significant customers consist of 15%, 14% and 10%, compared to the six months ended June 30, 2006, when the Company s had three significant customers which consisted of 24%, 20% and 12% of net sales. In general, the Company cannot predict with certainty, which large customers will continue to place orders. The loss of any of these customers or a significant decline in sales volumes from any of these customers could have a material adverse effect on the Company's financial position, results of operations and cash flows.

**NOTE 7 COMMITMENTS**

The Company extended a lease on May 11, 2006 for approximately 7,000 square feet for its principal executive offices at 120 Corporate Blvd., South Plainfield, New Jersey for an additional 5 years. The agreement provides for an escalating base rent of $4,665 per month effective August 2006 through July 2007, $4,815 per month effective August 2007 through July 2008, and an additional increase of $145 per year every August thereafter through August 2010. The Company has the option to terminate the lease effective July 31, 2009 with six months written notice to the Landlord.

The Company also leases certain equipment under agreements which are classified as capital leases. Each of the capital lease agreements expire within five years and have purchase options at the end of the lease term.

**NOTE 8 RELATED PARTY TRANSACTIONS**

In June 2007, certain Board members and an officer of the Company advanced an aggregate of $50,000 through the issuance of promissory notes due the earlier of the receipt of any proceeds from the sale of State of New Jersey Net Operating Losses or six months from the date of the note. The interest rate on the note is prime plus 1.75% per annum.

**NOTE 9 SUBSEQUENT EVENT**

On July 17, 2007, the Company received in aggregate of $50,000 from two investors through the issuance of promissory notes due the earlier of the receipt of any proceeds from the sale of State of New Jersey Net Operating Losses or six months from the date of the note. The interest rate on the note is 20% per annum. In conjunction with these notes, the Company granted to the note holders warrants to purchase an aggregate of 50,000 shares of common stock for $0.05 per share.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION**

Cautionary Statement Under The Private Securities Litigation Reform Act of 1995

A number of statements contained in this report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the applicable statements. You can identify forward-looking statements by our use of words such as may , will , should , could , expects , plans , intends , anticipates , believes , potential , or continue or the negative or other variations of these words, or other comparable words or phrases. These statements include, but are not limited to, statements regarding the Company s ability to gain further market recognition and the Company s cost reduction efforts. These risks and uncertainties include, but are not limited to, uncertainty as to the acceptance of the Company s products; risks related to technological factors; potential manufacturing difficulties; uncertainty of product development; uncertainty of obtaining or maintaining adequate financing; dependence on third parties; dependence on key personnel and changes in the Company s sales force and management; the risks associated with the expansion of the Company s sales channels; competition; a limited customer base; risk of system failure, security risks and liability risks; risk of requirements to comply with government regulations; vulnerability to rapid industry change and technological obsolescence; and general economic conditions. Unless otherwise required by applicable law, the Company assumes no obligation to update any such forward-looking statements, or to update the reasons why actual results could differ from those projected in the forward-looking statements.

**OVERVIEW**

Historically, a significant portion of our revenues have been derived from sales to relatively few customers, and we expect this trend to continue. We do not have purchase contracts with any of our customers that obligate them to continue to purchase our products, and they could cease purchasing products from us at any time. A delay in purchase or cancellation by any of our customers could cause quarterly revenues to vary significantly. In addition, during a given quarter, a significant portion of our revenues may be derived from the sale of a relatively small number of systems. Accordingly, a small change in the number of systems we sell may also cause significant changes in our operating results. Because fluctuations in the timing of orders from our customers or in the number of individual systems we sell could cause our revenues to fluctuate significantly in any given quarter or year, we do not believe that period-to-period comparisons of our financial results are necessarily meaningful, and they should not be relied upon as an indication of our future performance.

**RESULTS OF OPERATIONS**

*For the three months ended June 30, 2007 compared to the same period in 2006:*

Net sales for the three months ended June 30, 2007, were $635,609 compared to net sales of $1,113,345 for the same period in 2006, a decrease of $477,736 or 42.9%. The decrease in revenue for second quarter of 2007 compared to the same period last year was due primarily to a decrease in hardware and software sales from $932,146 to $444,350 a decrease of $487,796. Net sales for the three months ended June 30, 2007 was severely impacted by one major customer who in the same period of 2006 purchased a total of $347,050 while in the same period of 2007 purchased only $500. The Company believes that this decreased level of sales activity is due to the customer s working down its inventory levels rather than any specific dissatisfaction with ION s products.

Cost of sales for the three months ended June 30, 2007 was $252,627 compared to $415,277 for the same period in 2006. Cost of sales as a percentage of net sales for the three months ended June 30, 2007 increased to 39.7% from 37.3% for the same period in 2006. Gross margins decreased to 60.3% from 62.7% in the three months ending June 30, 2007 compared to the same period last year. The 2.4% gross margin reduction was primarily the result of an increase in the charge for capitalized software amortization expenses to $72,131 during the three months ended June 30, 2007 compared to $60,465 for the same period in 2006, while revenues declined sharply. Capitalized software amortization expense more than doubled to 11.3% of revenue in 2007 as compared to 5.4% of revenue in 2006, due to a decline in revenue and the bringing on line of certain new products which have become available for sale.

Research and development expenses ( R&D ) for the three months ended June 30, 2007 was $82,576 compared to $153,271 for the same period in 2006 or a decrease of $70,695. The decrease in R&D expenses was due primarily to decreased payroll related expenses for salaries, benefits and incentive compensation of $75,082 and increased capitalization of software expenses related to new product development of $23,920, offset in part by an increase in professional fees of $27,297. The decline in payroll expenses is primarily due to the reduction of headcount, in this department, from 8 employees in 2006 to 6 employees in 2007 and the increase in professional fees reflects the Company s decision to outsource more operating functions.

Selling, general and administrative expenses ("SG&A") for the three months ended June 30, 2007 were $627,207 compared to $635,866 for the same period in 2006, a decrease of $8,659.

There were no restructuring and other credits for the three months ended June 30, 2007 compared to $81,000 benefit for the three months ended June 30, 2006. During the three months ended June 30, 2006, the Company reversed $60,000 of professional services and $21,000 of shareholder relations related expenses from disputed accruals.

Depreciation expense was $5,376 for the three months ended June 30, 2007 compared to $3,725 in the same period in 2006.

Net loss for the three months ended June 30, 2007 amounted to $346,424 compared to $27,835 for the same period in 2006. The increase in net loss of $318,589 was due primarily to lower net sales of $477,736, which led to a reduction in gross margin from $698,068 in 2006 to $382,982 in 2007 or a decrease of $315,086.

*For the six months ended June 30, 2007 compared to the same period in 2006:*

Net loss for the six months ended June 30, 2007 and 2006 were $579,679 and $505,168, respectively, an increased loss of $74,511 due primarily to a reduction in gross margin of $155,287 offset in part by a decrease in operating expenses of $88,887 and interest and other expense of $5,571.

Net sales for the six months ended June 30, 2007 $1,578,571 compared to net sales of $1,744,411 for the same period in 2006, a decrease of $165,840 or 9.5%. Revenues for the six months ended June 30, 2007 were lower compared to the same period of 2006 primarily due to decreased sales of software of $138,640 and appliances of $48,506 offset in part by an increase in professional services of $35,937. One major customer who in the same period of 2006 purchased a total of $356,050 while in the same period of 2007 purchased only $221,000 or a decline of $135,050 significantly impacted net sales for the six months ended June 30, 2007. The Company believes that this decreased level of sales activity is due to the customer s working down its inventory levels rather than any specific dissatisfaction with ION s products.

Cost of sales for the six months ended June 30, 2007 was $662,963 compared to $673,516 for the same period in 2006. Cost of sales as a percentage of net sales for the six months ended June 30, 2007 increased to 42.0% from 38.6% for the same period in 2006, resulting in gross margins decreasing to 58% from 61.4% as compared to the prior year. The decrease in gross margin as a percentage of revenue is due primarily to the impact of amortization expense increasing to $155,018 or 9.8% of net sales for the six months ended June 30, 2007 from $97,976 or 5.6% of net sales for the same period in 2006, as well as a decrease in higher margin software revenues as a percentage of total revenues.

Research and development expenses for the six months ended June 30, 2007 was $167,498 compared to $304,407 for the same period in 2006 or a decrease of $136,909. The decrease in R&D expenses was due primarily to decreased payroll related expenses for salaries, benefits and incentive compensation of $157,428 and an increase in capitalization of software expenses related to new product development of $55,368, offset in part by professional fees of $72,703. The decline in payroll expenses is primarily due to the reduction of headcount in this department, from 8 employees in 2006 to 6 employees in 2007 and the increase in professional fees reflects the Company s decision to outsource more operating functions.

SG&A for the six months ended June 30, 2007 were $1,284,012 compared to $1,319,588 for the same period in 2006, a decrease of $35,576. The decrease in SG&A expenses was due primarily to decreased payroll related expenses for salaries, benefits and incentive compensation of $98,532 and increased capitalization of software expenses of $28,673, offset in part by an increase in professional fees of 93,996. The decline in payroll expenses is primarily due to the reduction of headcount, in this department, from 14 employees in 2006 to 12 employees in 2007 and the increase in professional fees reflects the Company s decision to outsource more operating activities.

There were no restructuring and other credits for the six months ended June 30, 2007, compared to a benefit of $81,000 in the six months ended June 30, 2006. During the six months ended June 30, 2006, the Company reversed $60,000 of professional services and $21,000 of shareholder relation related expenses from disputed accruals.

Depreciation expense was $10,469 for the six months ended June 30, 2007 compared to $7,781 in the same period in 2006.

**FINANCIAL CONDITION AND CAPITAL RESOURCES**

The Company incurred a net loss of $579,679 for the six months ended June 30, 2007, which includes $271,629 of non-cash charges resulting from $165,487 of depreciation and amortization and $106,142 of stock-based compensation. The Company has a working capital deficiency of $317,222 at June 30, 2007. The Company continues to have a delicate cash position. Management believes it is necessary for it to continue to strictly manage expenditures and to increase product revenues. In addition, the Company has historically received proceeds from the sale of its New Jersey Net Operating Losses during the fourth quarter of previous years. While no assurance can be made that the Company will again receive such proceeds, if the Company is approved for this program again in 2007, it expects to use the proceeds received under this program for general working capital purposes.

The Company, beginning in the summer of 2003 undertook a financial and operating restructuring plan designed to reduce the amount of cash flows used in its operating activities. The Company s operational restructuring initiatives included, among other things, streamlining operations by reducing employee headcount and cutting overhead expenses. The Company next focused on refreshing its product line and incurred capital expenditures of approximately $1,800,000 related to new product development during 2004-2007. In the second half of 2006, the Company turned its attention to revenue generating activities on selling products that are intended to generate higher profit margins. In the first quarter of 2007, the Company signed a two-year agreement with an outsourcing sales firm to assist in the growth of revenues primarily focused in the enterprise sector. In the second quarter of 2007, the Company signed an agreement with another outsourcing sales firm to assist in the growth of revenues primarily focused in the government sector.

The Company entered into a $2.5 million revolving credit facility with Bridge Bank on September 9, 2005. This facility has a two-year term, expiring in September 2007. The Company is in default of certain financial covenants as June 30, 2007. This default can result in the Company not being permitted to borrow under the revolving credit facility in the future and may result in the loan becoming due and payable in full. Rather than seeking waivers to these defaults, the Company and Bridge Bank, N.A. have begun negotiations on a new facility. The Company must successfully negotiate a renewal to its financing arrangement with Bridge Bank, as it has not secured any commitments for new financing at this time nor can it provide any assurance that new capital (if needed) will be available to it on acceptable terms, if at all. However, the Company believes that because of the asset-backed nature of this financing facility, and its history of minimal accounts receivable write-offs, that it should be able to either renew the facility with Bridge Bank or find a suitable replacement. The Company s ability to continue operations will be materially adversely affected if it is unable to borrow from the revolving credit facility or obtain a new facility with satisfactory financial and other terms.

The Company believes that its strategy of streamlining the business around its core competency of providing secure access management solutions is enabling it to operate under a more efficient cost structure than in the past. The Company is continuing its financial and operational restructuring initiatives and will continue to implement its strategic business plan. Although the Company believes that it will have sufficient liquidity to sustain its operations for the next twelve months based on its current revenue projections and its ability to manage its costs, there is no assurance that such projections will be met and will be sufficient. If such an event occurs, in order to sustain operations over the next twelve months, the Company would need to raise additional capital or take other measures, in the event outside sources of capital are not available.

Net cash provided by operating activities during the six months ended June 30, 2007 was $87,567 compared to net cash used by operating activities of  $481,123 in the same period in 2007, a difference of $568,690. Improved cash amounts were provided by increasing accounts payable and accrued payroll and related expenses and decreasing inventory, in the amounts of $317,435, $164,458 and $210,766, respectively, offset in part by a smaller decline in accounts receivable of $233,372 and a slightly larger net loss of $74,511.

Net cash used in investing activities during the six months ended June 30, 2007 was $328,424 compared to during the same period in 2006 of $247,332. Capitalized software expenditures for the six months ended June 30, 2007 were $327,045, an increase of $84,041 from $243,004 for the same period in 2006. The Company has accelerated its development of its next generation software.

Net cash used by financing activities during the six months ended June 30, 2007 was $14,101 compared to net cash provided by financing activities during the six months ended June 30, 2006 of $589,988. During 2006, the Company received $498,882 in proceeds from the sale of warrants and borrowed the net amount of $100,000 from the revolving credit facility, while in 2007 the Company repaid $62,847 on the revolving credit facility and received an advance from certain members of the Board of Directors of $50,000.

*Off-Balance Sheet Arrangements*

As of August 10, 2007, we did not have any off-balance sheet debt nor did we have any transactions, arrangements, obligations (including contingent obligations) or other relationships with any unconsolidated entities or other persons that may have a material current or future effect on financial conditions, changes in financial conditions, result of operations, liquidity, capital expenditures, capital resources, or significant components of revenue or expenses.

**ITEM 3. CONTROLS AND PROCEDURES**

Prior to the filing of this report, the Company s management carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's controls and procedures were effective as of the end of the period covered by this report to ensure that information required to be disclosed by the Company in the reports filed by it under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer of the Company, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in the Company's internal control over financial reporting that occurred during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The Company is not currently involved in any legal proceedings other than routine litigation incidental to the business.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On August 14, 2007, the Company granted two warrants to purchase 25,000 shares of common stock each at an exercise price of $0.05 per share to two investors. The warrants will expire on August 14, 2009.

The aforementioned securities were issued in reliance on the exemption provided by Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 promulgated thereunder, and in reliance on the investors' representations as to their status as accredited investors, and that they were acquiring the warrants for investment purposes and not with a view of any sale or distribution. In addition, certificates evidencing the warrants bear a 1933 Act legend.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

### ITEM 5. OTHER INFORMATION

None.

14

**ITEM 6. EXHIBITS**

| | | |
|---|---|---|
| 31.1 | * | Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(a) |
| 31.2 | * | Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14(a) |
| 32.1 | * | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, of Chief Executive Officer |
| 32.2 | * | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, of Chief Financial Officer |

* Filed herewith

## SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 14, 2007

**ION NETWORKS, INC.**

*/S/ Norman E. Corn*

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*Norman E. Corn, Chief Executive Officer*

*/S/ Patrick E. Delaney*

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*Patrick E. Delaney, Chief Financial Officer*

16

**Exhibit Index**

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18