ESYNCH CORP/CA
Form 10QSB
August 19, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2002

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

For the transition period from _________ to ________

Commission file number 0-26790

eSynch Corporation
------------------
(Exact name of small business issuer as specified in its charter)

| | |
|---|---|
| DELAWARE | 87-0461856 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

3511 W. Sunflower Ave. # 250
Santa Ana, CA 92704
(Address of principal executive offices)

(714) 258-1900
(Issuer's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: at August 9, 2002: 66,823,929

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

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THIS FILING INCLUDES UNAUDITED FINANCIAL STATEMENTS THAT HAVE NOT BEEN REVIEWED IN ACCORDANCE WITH ITEM 310(b) OF REGULATION S-B PROMULGATED BY THE SECURITIES AND EXCHANGE COMMISSION.

ESYNCH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
(UNAUDITED)

| | June 30,2002 | Dec. 31, 2001 |
|---|---|---|
| ASSETS | | |
| Current Assets | | |
| Cash | $6,743 | $ 4,783 |
| Accounts receivable, net of $27,534 and $80,504 allowance for bad debt respectively | 31,758 | 41,779 |
| Notes receivable net of allowance for bad debt. | 1,036 | - |
| Prepaid expenses and other current assets | - | - |
| Total Current Assets | 39,537 | 46,562 |
| Property and equipment, net of accumulated depreciation | 186,087 | 363,966 |
| Other assets, net of accumulated amortization | 158,578 | 250,602 |

| | | |
|---|---|---|
| Total Assets. | $384,202 | $ 661,130 |

LIABILITIES AND STOCKHOLDERS' DEFICIT

| | | |
|---|---|---|
| Current Liabilities | | |
| Accounts payable1, | 305,801 | 1,148,646 |
| Accounts payable - related party | 100,832 | 59,359 |
| Accrued liabilities. | 2,730,008 | 2,567,858 |
| Accrued preacquisition liability | 49,108 | 60,273 |
| Notes payable - current portion | 148,400 | 77,150 |
| Notes payable - related party | 575,000 | 521,250 |
| Capital lease obligation, current portion | 197,107 | 197,107 |
| Preferred dividends payable | 597,586 | 537,477 |
| Total Current Liabilities | 5,703,842 | 5,169,120 |
| Stockholders' Deficit | | |
| Preferred Stock - $0.001 par value; 400,000 shares authorized | | |
| Redeemable Preferred Stock - Series J, $0.001 par value; 275 shares authorized; 61.5 and 73.5 shares issued and outstanding; liquidation preference $615,000 and $735,000 | 460,000 | 600,000 |
| Redeemable Preferred Stock - Series K, $0.001 par value; 250 shares authorized; 25.5 and 42.5 shares issued and outstanding; liquidation preference $225,000 and $425,000 | 48,000 | 690,000 |
| Redeemable Preferred Stock - Series L, $0.001 par value; 210 shares authorized; no shares outstanding | - | - |
| Redeemable Preferred Stock - Series M, $0.001 par value; 220 shares authorized; 196.9 and 196.9 shares issued and outstanding; liquidation preference $1,969,000 and $1,969,000 | 2,616,862 | 2,616,862 |
| Common stock - $0.001 par value; 250,000,000 shares authorized; 63,323,929 and 36,914,742 shares issued and outstanding | 66,324 | 36,915 |
| Additional paid-in capital | 44,781,910 | 43,717,015 |
| Receivable from shareholder | | 10,000 |
| Accumulated deficit | (53,292,736) | (51,768,782) |
| Total Stockholders' Deficit | (5,319,640) | (4,507,990) |
| Total Liabilities and Stockholders' Deficit | $384,202 | $ 661,130 |

See the accompanying notes to the condensed consolidated financial statements.

ESYNCH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2002 | 2001 | 2002 | 2001 |
| Revenues | | | | |
| Revenue | $ 42,864 | $ 74,978 | $ 143,551 | $ 203,007 |
| Cost of products sold | 6,741 | 41,650 | 72,630 | 65,615 |
| Gross Profit | 36,123 | 33,328 | 70,921 | 137,392 |
| Operating and Other Expenses | | | | |
| General and administrative. | 767,969 | 899,975 | 1,137,219 | 1,724635 |
| Research and development | 15,000 | 82,720 | 30,111 | 199,025 |
| Stock issued for services . | 161,550 | 156,200 | 247,150 | 290,890 |
| Stock based compensation- | | 106,359 | 45,900 | 480,258 |
| Interest expense, net | 21,090 | 114,156 | 10,131 | 161,328 |
| Total Operating and Other Expenses | 965,609 | 1,773,756 | 1,470,511 | 3,693,671 |
| Net Loss | ( 929,486) | (1,740,428) | (1,399,590) | (3,556,279) |
| Extraordinary Gain | 503 | - | 8,349 | - |
| Preferred Dividend | (98,129) | (48,286) | (132,713) | (429,612) |
| Loss Applicable to Common Shares | $(1,027,112) | $(1,788,714) | $(1,523,954) | $(3,985,891) |
| Basic and Diluted Loss per Common Share | $ (0.02) | $ (0.09) | $ (0.03) | $ (0.25) |
| Weighted average number of common shares used in per share calculations | 57,364,496 | 19,430,726 | 52,127,875 | 15,882,593 |

ESYNCH CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Ended June 30, | |
|---|---|---|
| | 2002 | 2001 |
| Cash Flows from Operating Activities | | |
| Net Loss | $(1,391,242) | $(3,556,279) |

| | | |
|---|---|---|
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 272,273 | 251,144 |
| Amortization of goodwill | - | 837,535 |
| Reversal of allowance for bad debt | - | (306,929) |
| Write-off of acquired liabilities | - | (285,656) |
| Stock Issued for services and stock based compensation | 293,050 | 771,148 |
| Stock issued for interest | - | 59,191 |
| Additional compensation for modification of warrants | - | 20,344 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 8,986 | 3,309 |
| Other receivables | - | 12,962 |
| Prepaid expenses and other current assets | - | (25,987) |
| Accounts payable | 187,463 | 298,074 |
| Accrued liabilities | 389,900 | 251,791 |
| Net Cash Used in Operating Assets | (239,570) | (1,669,353) |
| Cash Flows From Investing Activities | | |
| Acquisition of property and equipment | (2,370) | (6,776) |
| Net Cash Used in Investing Activities | (2,370) | (6,776) |
| Cash Flows From Financing Activities | | |
| Stock issued for cash | - | 1,385,000 |
| Proceeds from issuance of Preferred shares, net of costs | 108,900 | 113,644 |
| Proceeds from the exercise of options and warrants | - | 86,400 |
| Proceeds from warrants issued in connection with Series M Preferred | - | 63,356 |
| Proceeds from shareholder receivable | 10,000 | - |
| Proceeds from borrowing | 125,000 | 40,000 |
| Payments on capital lease | - | (12,271) |
| Net Cash Provided by Financing Activities | 243,900 | 1,676,129 |
| Net Increase in Cash | 1,960 | - |
| Cash at Beginning of Period | 4,783 | - |
| Cash at End of Period | $ 6,743 | $ - |

ESYNCH CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
ORGANIZATION AND NATURE OF OPERATIONS -

The primary activities of eSynch Corporation ("eSynch" or the "Company") have consisted of developing and marketing media rights management solutions, video-on-demand services and video streaming through the Internet, software sales through the Internet, video encoding, compression and authoring, raising capital, and acquiring businesses.

In November 1998, as a result of shareholder action the Company was renamed eSynch Corporation from Innovus Corporation. A predecessor company, Intermark Corporation ("Intermark") was reorganized into Innovus Corporation in August 1998. In November 1998, eSynch acquired SoftKat Inc. ("SoftKat"). In May 1999, SoftKat was sold to a third-party. On April 1, 1999, eSynch acquired Kiss Software Corporation ("Kissco") and on September 20, 1999, eSynch acquired Oxford Media Corporation ("Oxford").

eSynch designs, develops, markets and supports intelligent digital media solutions and services, including media rights management, audio and video encryption, delivery, tracking and measurement tools, and streaming media services. The Company has developed a suite of software and related components designed for the digital rights management and delivery of live and on-demand audio and video through cable, satellite and the Internet. The Company provides turnkey solutions, offering services necessary to provide secure streaming media including software development and implementation of e-commerce applications, production, encoding, decoding and encryption, client-side metrics, reporting, content management, pay-per-view streaming, hosting and archiving. The Company's software helps businesses deliver high-quality video content to their customers. The Company also develops PC utility products, primarily for the Internet user.

PRINCIPLES OF CONSOLIDATION - The accompanying consolidated financial statements include the accounts of eSynch for all periods presented and the accounting of its subsidiaries from the dates of their acquisition. All inter-company transactions and balances have been eliminated in consolidation.

USE OF ESTIMATES - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

INTERIM UNAUDITED FINANCIAL INFORMATION - The accompanying condensed financial statements have been prepared by the Company and are not audited. In the opinion of management, all adjustments necessary for a fair presentation have been included and consist only of normal recurring adjustments except as disclosed herein. The financial position and results of operations presented in the accompanying financial statements are not necessarily indicative of the results to be generated for the remainder of 2002.

These financial statements have been condensed pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures normally included in financial statements have been condensed or omitted. These financial statements should be read in connection with annual financial statements included in the Company's Form 10-KSB dated April 16, 2002.

BUSINESS CONDITION - The financial statements have been prepared on the basis of the Company continuing as a going concern. The Company has a $5,664,305 working capital deficit at June 30, 2002, has incurred losses from operations and negative cash flows from operating activities and has accumulated a deficit at June 30, 2002 in the amount of $53,292,736. Management's plan to mitigate the impact of these conditions is to obtain additional equity financing through the issuance of the Company's common stock, convertible preferred stock or warrants. However, realization of the proceeds from these potential transactions is not assured. These financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or amounts and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern.

CONCENTRATION OF RISK AND MAJOR CUSTOMERS - The Company operates exclusively in the software industry, accordingly, segment information relating to operations in different industries is not presented in these financial statements. The concentration of business in the highly competitive software industry subjects the Company to concentrated market risk. Sales to any major customer in 2002 and 2001 were not significant.

FAIR VALUES OF FINANCIAL INSTRUMENTS - The amounts reported as cash, accounts payable, notes payable, and liabilities relating to assets to be sold are considered to be reasonable approximations of their fair values. The fair value estimates were based on market information available to management at the time of the preparation of the financial statements.

LOSS PER SHARE - The Company computes basic and diluted loss per share in accordance with Statement of Financial Accounting Standards No. 128, ("SFAS 128"), Earnings Per Share. Basic loss per common share is computed by dividing net loss available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted loss per share is calculated to give effect to stock warrants, options and convertible notes payable except during loss periods when those potentially issuable common shares would decrease the loss per share. There were 183,776,071 and 21,859,056 potentially issuable common shares outstanding at June 30, 2002 and 2001, respectively, which were excluded from the calculation of diluted loss per share as they would have decreased the loss per share.

REVENUE RECOGNITION - The Company recognizes service revenue upon performance of the service. For software products sold by the Company, revenue is recognized when delivered except for products sold through distributors for which revenue is recognized upon receipt of payment.

NOTE 2 -ACCRUED LIABILITIES

The pre-acquisition liabilities are a reserve for potential liabilities assumed at the time of the acquisition of Innovus and Intermark. During the three months ended June 30, 2002 the Company wrote off $1,317 of these pre-acquisition liabilities due to the expiration of legal obligations which has been included in general and administrative expenses.

Included in accrued liabilities at June 30, 2002 and December 31, 2001 are $1,225,309 and $891,161, respectively, in obligations to state and federal governments for payroll taxes from the current years and from previous years and estimated interest and penalties owing on such tax obligations. At June 01, 2002 the Company has accrued salaries of $587,670, some of these employees have filed labor actions against the Company for payments of these salaries. Additionally, during 2001 the Company withheld 401K contributions from employees' wages however these employee contributions were not contributed to the plan. At June 30, 2002, amounts due to the plan were $42,011.

NOTE 3 -NOTES PAYABLE RELATED PARTY

Notes payable - related party includes $450,000 loaned to the Company by a past director during the quarter ended June 30, 2000. This obligation is currently due and payable.

NOTE 4 -COMMITMENTS AND CONTINGENCIES

CAPITAL LEASE - The Company entered into a lease for computer equipment during the year ended December 31, 2000. The lease is for thirty-six months and requires a monthly payment of $7,413. During the year ended December 31, 2001 the Company entered into an additional lease for computer equipment. The lease is for thirty-six months and requires a minimum monthly payment of approximately $1,171. The leases have been treated as capital leases and the related obligations have been included in current liabilities.

LITIGATION - In September, 1999 a lawsuit was filed by C-Group, Inc. in United States District Court, District of Maryland, against Intermark seeking $99,110 for goods that were claimed to be purchased by Intermark. In October, 1999, the plaintiff amended the complaint and reduced the amount of the claim to $81,326. In March 2001 a judgment was entered against Intermark in the amount of $133,658 related to the claim against Intermark which included $52,332 related to a claim against Softkat. The Company was not properly notified and the judgment will be appealed. As of June, 2001 the Company accrued $133,658.

On April 3, 2001, a lawsuit was filed by BFree Ltd. in Superior Court, County of Orange, California, against the Company as successor to Innovus Corporation, seeking $25,544 for goods and services claimed to have been provided to Innovus during 1997. The claim is included in pre-acquisition liabilities on the accompanying balance sheets. Subsequent to December 31, 2001 the Company entered into a settlement agreement with Bfree Ltd. Under the agreement the Company is to pay $4,000 in monthly increments of $500 starting on March 15, 2002. The amount bears interest at 10%.

On July 18, 2001, David P. Noyes, the Company's former Chief Financial Officer, filed a claim with the Labor Commissioner, State of California, for wages due under an employment contract seeking $96,572. Mr. Noyes was terminated for cause by the Company in November 2000. Subsequent to December 31, 2001 the Labor Commission found that David P. Noyes had been terminated with cause. However, the Labor Commission awarded David P. Noyes $11,695 for un-reimbursed expenses and $1,544 for accrued interest on those expense. The Company accrued these amounts during the year ended December 31, 2001.

On July 26, 2001, Bixby Land Company, the Company's landlord, filed an unlawful detainer action to recover delinquent rent and penalties in the amount of approximately $125,000. On November 1st, 2001 the Company relocated its corporate offices to 29 Hubble Irvine, CA 92618. In October a settlement agreement with Bixby Land Company was reached regarding a settlement of the Company's liability of $808,134 with respect to a lease obligation for the Tustin facility. The settlement agreement provided that the Company would be release from all future payments under the terms of the lease if the Company made payments totaling $100,000 and transferred the Company's existing $60,010 security deposit to the landlord. The Company did not make the required payments under the settlement agreement. In October 2001, Bixby received a judgment against the Company for $136,058. As of December 31, 2001, the Company accrued the $136,058 and expensed the security deposit. Additionally in conjunction with this event the Company has written off the total net asset value of its leasehold improvements of $51,174.

On July 27, 2001, the Company filed a complaint against eLiberation Corporation, which was subsequently amended January 3, 2002. The Company seeks compensatory damages in the amount of $39,671. The company received a settlement agreement consisting of cancellation of the cross complaint and $52,000 in payments to eSynch, the total of which are due by October 15th, 2002.

On August 9, 2001, an action was filed in California Superior Court, County of Orange, against the Company, certain officers and its current Directors by Donald C. Watters, the Company's former president, chief operating officer and director, claiming breaches of contract, good faith and fair dealing, and fiduciary duty, and adverse employment action in violation of public policy. Mr. Watters is seeking general damages of not less than $2,780,000, punitive damages, interest, attorney's fees and court costs. Mr. Watters was terminated by the Company for cause. The Company believes that the claims are without merit and intends to vigorously defend the action and thus nothing has been accrued as of December 31, 2001.

On August 10, 2001, a lawsuit was filed by Kforce.com seeking to collect approximately $43,000 to be owed under a consulting services agreement. During 2001, the Company stipulated a judgment in favor of Kforce.com. The judgment is fully accrued in the Company's financial statements as of December 31, 2001.

In September, 2001 a lawsuit was filed by Technopolis Communications, Inc. in the Superior Court of California, County of Orange, against Innovus Corporation, dba eSynch Corporation, seeking $35,733 for services claimed to have been provided to eSynch. The case is currently in the discover stage and a mandatory settlement conference date has been set. As of December 31, 2001 the Company has accrued $50,000.

On April 8, 2002 Adams Business Media filed a request for entry of default for $11,000 for advertising services. The request was not contested. This amount has been included in the account payable liability account.

On April 17, 2002 a request for Entry of Default was filed by Information Leasing Corporation for $179,364. The request was not contested. This amount was fully accrued in Capital Lease Obligations - Current Portion as of March 31, 2002.

On May 21, 2002 Internap filed a request for entry of default with no specified amount. The request was not contested. As of June 30, 2002 the Company carried a balance of $17,798 for this vendor in accounts payable.

On May 31, 2002 Reuters Newsmedia filed a request for entry of default with no specified amount. The Company believes the summons was not properly served and the request is therefore invalid. As of June 30, 2002 the Company carried a balance of $70,000 for this vendor in accounts payable.

PAYROLL AND PAYROLL TAX LIABILITIES - Included in accrued liabilities at June 30, 2002 and December 31, 2001 are $1,225,309 and $891,161, respectively, in obligations to state and federal governments for payroll taxes from the current years and from previous years and estimated interest and penalties owing on such tax obligations. At June 01, 2002 the Company has accrued salaries of $587,670, some of these employees have filed labor actions against the Company for payments of these salaries. Additionally, during 2001 the Company withheld 401K contributions from employees' wages however these employee contributions were not contributed to the plan. At June 30, 2002, amounts due to the plan were $42,011.

NOTE 5 - STOCKHOLDERS' EQUITY

During the three months ended June 30, 2002, the Company issued Common Stock as follows: 5,310,000 shares for services in the amount of $161,550 which was charged to stock issued for services expense. Also, 5,000,000 shares were issued as stock for compensation valued at $137,500 and charged against accrued liabilities.

During the three months ended June 30, 2002, holders of Series J Convertible Preferred Stock converted a total of 5 preferred shares valued at $50,000 and received 1,724,311 common shares including accrued dividends in the amount of $9,908. No other conversions were made during the three month period.

During the three months ended March 31, 2002, the Company issued Common Stock as follows: 2,120,000 shares for compensation in the amount of $85,600 which was charged to stock issued for services expense.

During the three months ended March 31, 2002, holders of Series J Convertible Preferred Stock converted a total of 9 preferred shares valued at $90,000 and received 3,254,876 common shares including accrued dividends in the amount of $17,696. During the period, holders of Series K Convertible Preferred Stock converted a total of 25.2 preferred shares valued at $252,000 and received 9,000,000 common shares including accrued dividends in the amount of $45,000.

During the three months ended March 31, 2002 various officers of the Company contributed their services to the Company. The value of these services was deemed to be $90,250 based upon the officers current wages. The $90,250 was reflected as an increase to additional paid in capital during the three months ended March 31, 2002. The Company does not have an obligation to pay the officers related to these services.

NOTE 6 - STOCK OPTIONS AND WARRANTS

The Company has issued stock options to employees and consultants under a stock-based compensation plan and under individual contracts. Under the 1999 Stock Incentive Plan, which was approved by the shareholders in November 1999, the Company may grant options to its employees and consultants for up to 3,000,000 shares of common stock. In limited cases, the exercise price of options granted under the plan and some individual contracts may be below the market price of the Company's stock on the date of grant. Options generally vest from immediately to over three years and are exercisable for up to five to ten years.

During the three months ended June 30, 2002, options to purchase 3,390,000 shares of common stock were exercised for $33,900 by non-employees.

During the three months ended March 31, 2002 the Company granted options to purchase a total of 3,000,000 shares of common stock at an exercise price of $0.025 to a consultant of the Company. The options vest on the grant date and expire in 120 days. The options were valued at $45,900 using the Black-Scholes option pricing model with the following weighted-average assumptions; 4.96% risk-free interest rate, 0% expected dividend yield, 149% volatility and 0.05 years. All amounts were expensed during the three months ended March 31, 2002. Subsequent to March 31, 2002, options to purchase 3,000,000 shares of common stock were exercised resulting in proceeds of $75,000.

NOTE 7 - SUPPLEMENTAL CASH FLOW INFORMATION

During the three months ended June 30, 2002, the Company converted $50,000 of Series J Preferred stock, for a net issuance of 1,724,311 shares of common stock, including interest shares. The Company accrued $56,769 of dividends on the preferred stock and converted $9,908 of dividend into shares of common stock.

During the three months ended March 31, 2002, the Company converted $90,000 of Series J Preferred stock, $252,000 of Series K Preferred stock. The Company accrued $66,036 of dividends on the preferred stock and converted $62,696 of preferred dividends into shares of common stock. During the three months ended March 31, 2002 officers of the Company contributed services valued $90,250 to the Company.

NOTE 8 -SUBSEQUENT EVENTS

ITEM 1 - ACQUISITION

As reflected in the 8-K filed July 13, 2002, Pursuant to an Escrow Agreement and Irrevocable Proxy (the "Agreement") effective as of July 31, 2002, between eSynch and NACIO SYSTEMS, INC., a California corporation ("Nacio"), eSynch purchased from Nacio all of the issued and outstanding shares of common stock of Nacio. Nacio is California based and provides high-reliability hosting, commercial-grade Internet connectivity and outsourcing solutions and support services for businesses that rely on the Internet for daily operations. On March 12, 2002, Nacio filed for voluntary Chapter 11 bankruptcy in the United State Bankruptcy Court, Northern District of California, Santa Rosa Division (the "Court"), Chapter 11 Case No. 02-10596. The transaction will be consummated upon completion of Nacio's plan of reorganization. eSynch intends to continue in this line of business. eSynch will acquire one hundred percent (100%) ownership interest in Nacio in exchange for 30,000,000 shares of eSynch's common stock.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

The following discussion should be read in conjunction with the financial statements and notes thereto found elsewhere herein. The discussion assumes that the reader is familiar with or has access to the Company's financial statements for the year ended December 31, 2001 found in the Company's Form 10-KSB dated April 16, 2002.

The financial statements have been prepared on the basis of the Company continuing as a going concern. The Company has incurred losses from operations and negative cash flows from operating activities and has accumulated a negative tangible net worth at June 30, 2002 in the amount of $5,319,640.

RESULTS OF OPERATIONS

During the three and six months ended June 30, 2002, sales were $42,864 and $143,551 compared to $74,978 and $203,007 for the comparable periods of the prior year. The decrease in sales is attributable to the continued refocusing of the Company's business from software product sales to digital rights management, video streaming and production services. The cost of products sold in the three and six months ended June 30, 2002 were $6,741 and $72,630 compared to $41,650 and $65,615 for the comparable periods of the prior year.

Operating losses for the three and six months ended June 30, 2002 were $929,486 and $1,399,590 compared to an operating losses of $1,740,428 and $3,556,279 for the comparable periods of the prior year. The operating results for the reported periods reflect management's continued efforts to maximize potential and contain costs while it repositions the Company for revenue growth.

The Company incurred net interest expense of $21,090 and $10,131 during the three and six months ended June 30, 2002 compared to $114,156 and $161,328 for the comparable periods of the prior year.

During the three and six months ended June 30, 2002, the Company spent $15,000 and $30,111 on research and development related to digital rights management technology and other product initiatives launched and under development in the periods reported. The Company spent $82,720 and $199,025 in the comparable periods of the prior year.

The Company incurred stock issued for services expense of $161,550 and $247,150 during the three and six months ended June 30, 2002 compared to $156,200 and $290,890 for the comparable periods of the prior year.

The Company incurred stock based compensation expense of $0 and $45,900 during the three and six months ended June 30, 2002 compared to $106,359 and $480,258 for the comparable periods of the prior year.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2002, the Company had cash of $6,744 of cash and had a deficit in working capital (current liabilities in excess of current assets) of $5,664,305.

The Company has been relying upon sale of common stock, the issuance of the preferred stock, convertible debentures and short term notes to fund continuing operations. During the 3 months ended June 30, 2002, the Company issued 3,390,000 common shares upon the exercise of stock options with net proceeds to the Company of $33,900.
The Company estimates that during the quarter it was using approximately $135,000 more cash each month than was generated by operations.

RISK FACTORS

Statements regarding the Company's plans, expectations, beliefs, intentions as to future sales of software, future capital resources and other forward-looking statements presented in this Form 10-QSB constitute forward looking information within the meaning of the Private Securities Litigation Reform Act of 1995. There can be no assurance that actual results will not differ materially from expectations. Investors are cautioned not to ascribe undue weight to such statements. In addition to matters affecting the Company's industry generally, factors which could cause actual results to differ from expectations include, but are not limited to (i) sales of the Company's software which may not rise to the level of profitability; (ii) due to the rapidly changing and intensely competitive nature of the industry, competitors may introduce new products with significant competitive advantages over the Company's products; (iii) the Company may not have sufficient resources, including any future financing it is able to obtain, to sustain marketing and other operations; (iv) the Company may be unable to attract and retain sufficient management and technical expertise, or may lose key employees; (v) the Company's contractual or legal efforts to protect its confidential information or intellectual property may be inadequate or ineffective to provide protection, and the Company may be unable financially to pursue legal remedies that may be available; (vi) the Company's selection, due diligence, execution, and integration of acquisitions may not prove effective or reasonable; (vii) the Company may suffer in material respects from the direct or indirect effects of the "Year 2000" problem on public utilities, telecommunications networks, customers, vendors, service providers, and the economy or financial markets generally; (viii) the Company may suffer from other technical or communications problems, such as power outages, system failures, system crashes, or hacking; and (ix) the Company may be subjected to unknown risks and uncertainties, or be unable to assess risks and uncertainties as may exist.

PART II OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

- In September, 1999 a lawsuit was filed by C-Group, Inc. in United States District Court, District of Maryland, against Intermark seeking $99,110 for goods that were claimed to be purchased by Intermark. In October, 1999, the plaintiff amended the complaint and reduced the amount of the claim to $81,326. In March 2001 a judgment was entered against Intermark in the amount of $133,658 related to the claim against Intermark which included $52,332 related to a claim against Softkat. The Company was not properly notified and the judgment will be appealed. As of June, 2001 the Company accrued $133,658.

On April 3, 2001, a lawsuit was filed by BFree Ltd. in Superior Court, County of Orange, California, against the Company as successor to Innovus Corporation, seeking $25,544 for goods and services claimed to have been provided to Innovus during 1997. The claim is included in pre-acquisition liabilities on the accompanying balance sheets. Subsequent to December 31, 2001 the Company entered into a settlement agreement with Bfree Ltd. Under the agreement the Company is to pay $4,000 in monthly increments of $500 starting on March 15, 2002. The amount bears interest at 10%.

On July 18, 2001, David P. Noyes, the Company's former Chief Financial Officer, filed a claim with the Labor Commissioner, State of California, for wages due under an employment contract seeking $96,572. Mr. Noyes was terminated for cause by the Company in November 2000. Subsequent to December 31, 2001 the Labor Commission found that David P. Noyes had been terminated with cause. However, the Labor Commission awarded David P. Noyes $11,695 for un-reimbursed expenses and $1,544 for accrued interest on those expense. The Company accrued these amounts during the year ended December 31, 2001.

On July 26, 2001, Bixby Land Company, the Company's landlord, filed an unlawful detainer action to recover delinquent rent and penalties in the amount of approximately $125,000. On November 1st, 2001 the Company relocated its corporate offices to 29 Hubble Irvine, CA 92618. In October a settlement agreement with Bixby Land Company was reached regarding a settlement of the Company's liability of $808,134 with respect to a lease obligation for the Tustin facility. The settlement agreement provided that the Company would be release from all future payments under the terms of the lease if the Company made payments totaling $100,000 and transferred the Company's existing $60,010 security deposit to the landlord. The Company did not make the required payments under the settlement agreement. In October 2001, Bixby received a judgment against the Company for $136,058. As of December 31, 2001, the Company accrued the $136,058 and expensed the security deposit. Additionally in conjunction with this event the Company has written off the total net asset value of its leasehold improvements of $51,174.

On July 27, 2001, the Company filed a complaint against eLiberation Corporation, which was subsequently amended January 3, 2002. The Company seeks compensatory damages in the amount of $39,671. The company received a settlement agreement consisting of cancellation of the cross complaint and $52,000 in payments to eSynch, the total of which are due by October 15th, 2002.

On August 9, 2001, an action was filed in California Superior Court, County of Orange, against the Company, certain officers and its current Directors by Donald C. Watters, the Company's former president, chief operating officer and director, claiming breaches of contract, good faith and fair dealing, and fiduciary duty, and adverse employment action in violation of public policy. Mr. Watters is seeking general damages of not less than $2,780,000, punitive damages, interest, attorney's fees and court costs. Mr. Watters was terminated by the Company for cause. The Company believes that the claims are without merit and intends to vigorously defend the action and thus nothing has been accrued as of December 31, 2001.

On August 10, 2001, a lawsuit was filed by Kforce.com seeking to collect approximately $43,000 to be owed under a consulting services agreement. During 2001, the Company stipulated a judgment in favor of Kforce.com. The judgment is fully accrued in the Company's financial statements as of December 31, 2001.

In September, 2001 a lawsuit was filed by Technopolis Communications, Inc. in the Superior Court of California, County of Orange, against Innovus Corporation, dba eSynch Corporation, seeking $35,733 for services claimed to have been provided to eSynch. The case is currently in the discover stage and a mandatory settlement conference date has been set. As of December 31, 2001 the Company has accrued $50,000.

On April 8, 2002 Adams Business Media filed a request for entry of default for $11,000 for advertising services. The request was not contested. This amount has been included in the account payable liability account.

On April 17, 2002 a request for Entry of Default was filed by Information Leasing Corporation for $179,364. The request was not contested. This amount was fully accrued in Capital Lease Obligations - Current Portion as of March 31, 2002.

On May 21, 2002 Internap filed a request for entry of default with no specified amount. The request was not contested. As of June 30, 2002 the Company carried a balance of $17,798 for this vendor in accounts payable.

On May 31, 2002 Reuters Newsmedia filed a request for entry of default with no specified amount. The Company believes the summons was not properly served and the request is therefore invalid. As of June 30, 2002 the Company carried a balance of $70,000 for this vendor in accounts payable.

ITEM 2 - CHANGES IN SECURITIES AND USE OF PROCEEDS:

(a) The following securities were issued by the Company during the three months ended June 30, 2001 without registration under the Securities Act of 1933:

(i) 1,920,000 shares of Common Stock for services.
(ii) 3,390,000 shares of Common Stock upon the exercise of stock options.

The cash proceeds from these issuances were used for general corporate purposes.

The Company believes the transactions were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

(b) The following registration statement was filed by the Company during the three months ended June 30, 2001.

(i) On May 24, 2002 the Company filed the Registration Statement on Form S-8.

(c) The following securities were issued by the Company during the three months ended March 31, 2002 without registration under the Securities Act of 1933: 1,000,000 shares issued for services.

ITEM 3 - EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

Those exhibits previously filed with the Securities and Exchange Commission as required by Item 601 of Regulation S-K, are incorporated herein by reference in accordance with the provisions of Rule 12b-32.