

Edgar Filing: SSP SOLUTIONS INC - Form 10QSB/A

SSP SOLUTIONS INC  
Form 10QSB/A  
September 16, 2003

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

AMENDMENT NO. 1  
TO  
FORM 10-QSB

(Mark One)

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended MARCH 31, 2003

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-26227

SSP SOLUTIONS, INC.  
(Exact name of small business issuer as specified in its charter)

DELAWARE 33-0757190  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)

17861 CARTWRIGHT ROAD, IRVINE, CALIFORNIA 92614  
(Address of principal executive offices)

(949) 851-1085  
(Issuer's telephone number, including area code)

NOT APPLICABLE.  
(Former name, former address and former fiscal year,  
if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

The number of shares outstanding of the registrant's only class of common stock, \$.01 par value, was 27,836,733 on September 15, 2003.

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

PURPOSE OF AMENDMENT

The registrant hereby refiles its condensed consolidated financial statements solely to delete the final paragraph of footnote 9 to those condensed consolidated financial statements.

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PART I  
FINANCIAL INFORMATION

Item 1. Financial Statements

Condensed Consolidated Balance Sheets as of December 31, 2002 and March 31, 2003 (unaudited)

Condensed Consolidated Statements of Operations for the three month periods ended March 31, 2002 and 2003 (unaudited) .....

Condensed Consolidated Statements of Cash Flows for the three month periods ended March 31, 2002 and 2003 (unaudited).....

Notes to Condensed Consolidated Financial Statements (unaudited).....

PART II  
OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K.....

Signatures.....

Exhibits Filed with this Report.....

PART I  
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SSP SOLUTIONS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE DATA)

	Decem
	2
	-----
ASSETS (note 5)	
Current assets:	
Cash and cash equivalents .....	\$
Investment in trading securities .....	
Accounts receivable (net of allowance for doubtful accounts of \$187 as of December 31, 2002 and March 31, 2003) .....	
Inventories .....	
Prepaid expenses .....	
Other current assets .....	-----
Total current assets .....	
Property and equipment, net .....	

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Other assets .....  
 Equity investment in affiliate .....  
 Goodwill .....

-----  
 \$  
 =====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:  
 Current installments of long-term debt (note 5) .....  
 Accounts payable .....  
 Accrued liabilities .....  
 Deferred revenue .....

\$  
 -----

Total current liabilities .....

Commitments and contingencies (notes 1,4,5,6,and 7)  
 Subsequent events (note 10)

Shareholders' equity:  
 Preferred stock, \$0.01 par value; Authorized 5,000,000 shares; no  
 shares issued or outstanding .....  
 Common stock, \$0.01 par value; Authorized 100,000,000 shares; issued or issuable  
 24,821,235 and 25,067,576 shares at December 31, 2002 and  
 March 31,2003, respectively .....  
 Additional paid-in capital .....  
 Note receivable from shareholder .....  
 Deferred compensation .....  
 Accumulated deficit .....

(  
 -----  
 -----  
 \$  
 =====

Total shareholders' equity .....

See accompanying notes to condensed consolidated financial statements

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SSP SOLUTIONS, INC. AND SUBSIDIARIES  
 CONDENSED STATEMENTS OF OPERATIONS  
 (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)  
 (UNAUDITED)

	Three Months Ended March 31,	
	2002	2003
	-----	-----
Revenues:		
Product .....	\$ 1,071	\$ 1,0
Service .....	537	1,0
License .....	119	1,2
	-----	-----

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Total revenues .....	1,727	3,3
	-----	-----
Cost of Sales:		
Product .....	503	2
Service .....	229	3
License .....	53	4
	-----	-----
Total cost of sales .....	785	1,0
	-----	-----
Gross margin .....	942	2,2
Operating Expenses:		
Selling, general and administrative .....	2,065	1,5
Research and development .....	1,639	1,1
Research and development - Wave Systems Corp. ....	833	
Amortization of goodwill and other intangibles .....	23	
	-----	-----
Total operating expenses .....	4,560	2,6
	-----	-----
Operating (loss) .....	(3,618)	(4)
	-----	-----
Non-operating Expenses (Income):		
Unrealized loss on trading securities .....	1	
Interest expense, net .....	125	2
Non-cash interest and financing expense .....	--	5
Loss from equity investee .....	--	2
Other (income) expense, net .....	14	
	-----	-----
Total non-operating expenses (income) .....	140	1,0
	-----	-----
Operating loss before income taxes .....	(3,758)	(1,5
Provision for income taxes .....	3	
	-----	-----
Loss from continuing operation .....	(3,761)	(1,5
Loss from discontinued operations .....	(266)	
Loss on disposal of discontinued operations (less no applicable taxes)	--	(
Net Loss .....	\$ (4,027)	\$ (1,6
	=====	=====
Loss per share of common stock, basic and diluted .....	\$ (.19)	\$ (.1
	=====	=====
Loss per share from discontinued operations, basic and diluted ...	(.01)	
	=====	=====
Loss per share from continuing operations, basic and diluted .....	(.18)	(.1
	=====	=====
Shares used in per share computations--basic and diluted .....	20,651	25,0
	=====	=====

See accompanying notes to condensed consolidated financial statements

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SSP SOLUTIONS, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (IN THOUSANDS)  
 (UNAUDITED)

	Three Months March 3 2002 -----
Cash flows from operating activities:	
Net loss .....	\$ (4,027)
Adjustments to reconcile net loss to net cash used in operating activities:	
Operating activities:	
Non-cash interest .....	--
Loss from equity investee .....	--
Common stock issued for rent expense .....	--
Common stock issued for interest expense .....	--
Provision for losses on receivables .....	12
Depreciation and amortization .....	108
Deferred compensation .....	104
Unrealized loss on trading securities .....	1
Changes in assets and liabilities:	
Accounts receivable .....	2,907
Inventories .....	66
Prepaid expenses .....	201
Other current assets .....	(55)
Other assets .....	17
Accounts payable .....	(1,715)
Accrued liabilities .....	410
Deferred revenue .....	(52)
	-----
Net cash (used in) continuing operating activities .....	(2,023)
Net cash provided by discontinued operations .....	238
Net cash (used in) operating activities .....	(1,785)
	-----
Cash flows used in investing activities:	
Investment in equity investee .....	--
Purchases of property and equipment .....	(2)
Proceeds from sale of trading securities .....	917
	-----
Net cash provided by (used in) investing activities .....	915
	-----
Cash flows from financing activities:	
Principal repayment .....	--
Stock options exercised .....	60
Borrowings on revolving note payable .....	1,103
Repayment or insurance financing .....	(173)
Principal payments (increases) on revolving line of credit .....	(2,262)
Principal payments on note payable to related party .....	(392)
	-----
Net cash (used in) provided by in financing activities ..	(1,664)
	-----
Net (decrease) in cash .....	(2,534)
Cash and cash equivalents and beginning of period .....	3,257
	-----
Cash and cash equivalents at end of period .....	\$ 723
	=====

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Supplemental disclosures of cash flow information

Cash paid during the period for:

Interest .....	\$	92
Income taxes .....		3

See accompanying notes to condensed consolidated financial statements

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SSP SOLUTIONS, INC. AND SUBSIDIARIES  
 CONDENSED STATEMENTS OF CASH FLOWS (CONTINUED)  
 (IN THOUSANDS)  
 (UNAUDITED)

		Three Months March 31 2002 -----	-----
Supplemental disclosure of non-cash financing activities information:			
Deferred Compensation .....	\$	303	\$
Payment of rent in common stock .....		--	
Warrants issued to note holders .....		--	
Payment of interest in common stock .....		--	

See accompanying notes to condensed consolidated financial statements.

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SSP SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 MARCH 31, 2003  
 (UNAUDITED)  
 (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

(1) GENERAL INFORMATION

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of the management of SSP Solutions, Inc. (the "Company"), the accompanying unaudited condensed consolidated financial statements contain all adjustments (which are normal recurring accruals) necessary to present fairly the financial position as of March 31, 2003; the results of operations for the three months ended March 31, 2002 and 2003; and the statements of cash flows for the three months ended March 31, 2002 and 2003. Interim results for the three months ended March 31, 2003, are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. The interim financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2002, included in the Company's Form 10-K/A, filed in April 2003.

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These condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has incurred significant operating losses, has used cash in operating activities, has an accumulated deficit, and deficit working capital. The Company currently anticipates that existing resources will not be sufficient to satisfy contemplated working capital requirements for the next twelve months.

### DETAILS OF THE DISPOSAL

Through December 31, 2002, the Company had operated in two business segments: information security solutions and network solutions businesses. During the three month period ended March 31, 2003 the Company discontinued its network solution segment, which was conducted through Pulsar, as the Company determined that this segment would not return to operating profits in a reasonable time period. The total estimated cost to exit the segment at March 31, 2003 is \$106 of which \$9 has been incurred by March 31, 2003 and the estimated remaining exit cost of \$97 was accrued at March 31, 2003. The network solution segment assets did not require an impairment write down as there was no remaining book value of assets in existence at the date the decision to exit the business was made. As a result, there is no gain or loss on the discontinued operation relating to the network solution facility segment. In addition, as a result of the discontinuance of the network solution segment, the Company now only operates in one reporting segment.

### REVENUE RECOGNITION

Revenue from some data security hardware products contains embedded software. However, the embedded software is incidental to the hardware product sale. Data security license revenue is recognized upon delivery if an executed license exists, a delivery as defined under the license has occurred, the price is fixed and determinable, and collection is probable. Prior to 2002, post-contract customer support revenue was not separately identified and priced. Therefore, sufficient vendor specific objective evidence could not be established for the value or cost of such services. Furthermore, prior to 2002, revenue for the entire license, including bundled post-contract customer support was recognized ratably over the life of the license. Commencing in 2002, software delivered under a license requires a separate annual maintenance contract that governs the conditions of post-contract customer support. Post-contract customer support services can be purchased under a separate contract on the same terms and at the same pricing, whether purchased at the time of sale or at a later date. Revenue from these separate maintenance support contracts is recognized ratably over the maintenance period.

Revenue from cost-plus-award-fee support and development contracts is recognized on the basis of hours incurred plus other reimbursable contract costs incurred during the period. Prior to 2002, any award fee earned under a cost-plus-award-fee contract was not recognized until the award fee notice was received. Beginning in 2002, for a cost-plus-award-fee support contract, the Company exercised the contract clause to bill and collect one-half of the award

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fee ratably over the term of the contract. Revenue is recognized concurrently with the billings based on the performance of the contract requirements and reasonable assurance of collection. Based upon historical results, the Company has received final awards in excess of one-half of the full award fees. A post-contract period performance review conducted by the customer determines the

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remaining amount of the award fee to be received, which amount is then recognized as earned revenue together with interest paid on the unpaid balance. Award fees under development contracts are recognized when confirmed by the customer.

Revenue from network deployment products is recognized upon transfer of title, generally upon verification of delivery to the customer, which represents evidence delivery has occurred, under a sales order represented by a government purchase order that contains a fixed purchase price. When the Company fulfills the elements of the government purchase order, collection of the revenue recorded is reasonably assured.

Service and license revenues from the Company's high assurance token fixed-price contract were recognized in accordance with SOP 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." The Company recognized this revenue on a percentage of completion method, based on total cost incurred to total estimated cost (cost-to-cost percentage of completion).

The Company's revenue recognition policies are in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin No. 101.

### NEW ACCOUNTING PRONOUNCEMENTS

In May 2003, the Financial Accounting Standards Board ("FASB") issued Statement No.150, entitled "Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity." Statement No. 150 established the accounting guidance related to how an "issuer" classifies/measures certain financial instruments where those instruments have characteristics of both liabilities and equity. The guidance in Statement No.150 requires reclassification of certain financial instruments from the equity section of the balance sheet to the liability section of the balance sheet. Specifically Statement No.150 requires three classes of freestanding financial instruments to be classified as liabilities: mandatorily - redeemable financial instruments, obligations to repurchase equity shares by transferring assets, and certain obligations to insure a variable number of shares. Statement No. 150 is effective for financial instruments entered into after May 31, 2003 and otherwise effective at the beginning of the first interim period beginning after June 15, 2003 (July 1, 2003 for SSP) and is to be implemented by reporting a cumulative effect of a change in accounting principles for financial instruments created before the May 15, 2003 issuance of Statement No.150. The Company expects no material changes to its financial statements upon adoption of Statement No.150.

### LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2003, the Company had deficit working capital of \$6,901, and the Company had incurred a loss from operations for the three months then ended. The Company expects to continue to incur substantial additional losses in 2003. Given the March 31, 2003 cash balance and the projected operating cash requirements, the Company anticipates that existing capital resources will not be adequate to satisfy cash flow requirements through December 31, 2003. The Company will require additional funding. The Company's cash flow estimates are based upon achieving certain levels of sales, reductions in operating expenses and liquidity available under its accounts receivable financing, new debt and/or equity financing. Should sales be less than forecast, expenses be higher than forecast or the liquidity not be available through additional financings of debt and/or equity, the Company will not have adequate resources to fund its operations. During 2002, the Company incurred defaults, other than for the payment of principal and interest, under both the Company's accounts receivable financing and the Company's long-term convertible notes. The Company was not able to obtain waivers for defaults on the long-term convertible notes and has



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therefore classified such notes as short-term on the balance sheet as of December 31, 2002 and March 31, 2003. The Company does not expect future fixed obligations to be paid from operations and the Company intends to satisfy fixed obligations from additional financings, use of the accounts receivable financing, extending vendor payments and issuing stock as payment on obligations.

The Company's current financial condition is the result of several factors, including the fact that operating results were below expectations.

The Company currently has a need for a substantial amount of capital to meet its liquidity requirements. The amount of capital that the Company will need in the future will depend on many factors including, but not limited, to:

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- o the ability to extend terms received from vendors
- o the market acceptance of products and services
- o the levels of promotion and advertising that will be required to launch new products and services and attain a competitive position in the market place
- o research and development plans
- o levels of inventory and accounts receivable
- o technological advances
- o competitors' responses to our products and services
- o relationships with partners, suppliers and customers
- o projected capital expenditures
- o reduction in the valuation of marketable investment securities
- o downturn in economy
- o defaults on financing which will impact the availability of borrowings

In addition to the Company's current deficit working capital situation, current operating plans show a shortfall of cash during 2003. The Company intends to mitigate its position through one or more of the following:

- o Additional equity capital -- The Company will seek additional equity capital, if available. Equity capital will most likely be issued at a discount to market, and require the issuance of warrants causing a dilution to current shareholders. In addition, providers of new equity capital may require additional concessions in order for them to provide needed capital to the Company.
- o Additional convertible debt -- Depending upon the market conditions, the Company may issue an additional debt instrument. The types of instruments available in the market would likely contain a provision for the issuance of warrants and may also be convertible into equity.

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- o Off balance sheet financing -- The Company's operations are not relatively capital intensive. However, should the Company need to add equipment or decide to expand the facilities, the Company may use an operating lease transaction to acquire the use of capital assets. An operating lease would not appear on the Company's balance sheet and would be charged as an expense as payments accrue. The Company plans to use third party financing for a subsidiary whereby the subsidiary would become less than wholly-owned.
- o Receivables financing - Effective in October 2002, the Company executed a new factoring agreement with Bay View Funding ("BVF") for the financing of the Company's accounts receivable. The Company also terminated its remaining agreement with Wells Fargo Business Credit ("WFBC"). The Company plans to continue to generate cash by financing receivables in conjunction with its BVF agreement.
- o Sale of investments - The Company will sell its remaining investments to generate cash. The market value of trading securities was approximately \$60 at March 31, 2003.
- o Negotiate with vendors - The Company has successfully negotiated extended payment terms with a number of vendors. The Company will continue to negotiate term-out agreements with vendors to extend the payment terms of existing accounts payable.

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- o Advance payments - Under current or future contracts the Company may obtain cash deposits toward work to be performed or products to be delivered. In addition, the Company may offer early payment discounts to customers whose receivables are not financed under the BVF agreements.
- o Deferral of cash payments - The Company may defer cash payments through suspension of development projects.
- o Issuance of stock as payment for existing and future obligations - The Company may pay some of its accrued liabilities or accounts payable through the issuance of common stock. During the three months ended March 31, 2003, the Company issued 34,600 shares of its common stock for payments relating to its facility lease.
- o Issuance of stock to pay interest - The Company may issue common stock to pay interest on long-term debt. During the three months ended March 31, 2003, the Company issued 211,700 shares of its common stock in the payment of interest expense.
- o Reductions in work force - The Company has reduced its workforce and decreased the cash compensation paid to the remaining workforce. The Company may be forced to make further reductions in the future if sales plans are not achieved.
- o If the Company does not receive adequate financing, the Company could be forced to merge with another company or cease operations.

Ultimately, the Company's ability to continue as a going concern is dependent upon its ability to successfully launch its new products, grow

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revenue, attain operating efficiencies, sustain a profitable level of operations and attract new sources of capital.

While the Company has a history of selling products in government markets, new products that are just entering production after years of development have no sales history. Additionally, the Company is entering commercial markets with products and is still developing acceptance of Company product offerings. Considerable uncertainty currently exists with respect to the adequacy of current funds to support the Company's activities beyond March 31, 2003. This uncertainty will continue until a positive cash flow from operations is achieved. Additionally, the Company is uncertain as to the availability of financing from other sources to fund any cash deficiencies.

In order to reduce this uncertainty, the Company continues to evaluate additional financing options and may therefore elect to raise capital, from time to time, through equity or debt financings in order to capitalize on business opportunities and market conditions and to insure the continued marketing of current product offerings together with development of new technology, products and services. There can be no assurance that the Company can raise additional financing in the future.

Based upon forecasted sales and expense levels, the Company currently anticipates that existing cash, cash equivalents, investments, term-out arrangements with vendors and the current availability under our BVF factoring agreement will not be sufficient to satisfy Company contemplated cash requirements for the next twelve months. However, the Company's forecast is based upon certain assumptions, which may differ from actual future outcomes. The Company has incurred defaults under its financing agreements in the past. The BVF agreement states among other things that a default occurs if the Company is generally not paying debts as they become due or if the Company is left with unreasonably small capital. The Company has notified BVF of its failure to make certain payments on a timely basis and have requested a waiver of such default. The Company therefore may not be able to draw funds in the future, which would affect the Company's ability to fund its operations. Additionally, without a substantial increase in sales or a reduction in expenses, the Company will continue to incur operating losses.

### STOCK-BASED COMPENSATION FOR EMPLOYEES AND NON-EMPLOYEES

The Company accounts for its employee stock option plans using the intrinsic value method. When stock options are granted to employees with exercise prices less than the fair value of the underlying common stock at the date of grant, the difference is recognized as deferred compensation expense, which is amortized over the vesting period of the options.

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The Company accounts for stock options issued to non-employees using the fair value method. The associated cost is recorded in the same manner as if cash were paid.

At March 31, 2003, the Company had three stock-based employee compensation plans. The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations. The following table illustrates the effect on net loss and earnings per share if the Company had applied the fair value recognition provisions of Statement No. 123:

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	THREE MONTHS END MARCH 31, 2002	
	-----	-----
Net loss, as reported .....	\$ 4,027	\$
Add: Stock compensation cost reported in accordance with APB No. 25 .....	--	
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect .....	373	
	-----	-----
Pro forma net loss .....	\$ 4,400	\$
	=====	=====
Earnings per share		
Net loss per share as reported -- basic and diluted ....	\$ (.19)	\$
	=====	=====
Pro forma net loss per share -- basic and diluted .....	\$ (.21)	\$
	=====	=====

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions in 2002 and 2003: risk-free interest rate of 3.92%; dividend yield of 0.00%; and volatility of 129% for both periods. The Black-Scholes model, as well as other currently accepted option valuation models, was developed to estimate the fair value of freely-tradable, fully-transferable options without vesting restrictions, which significantly differ from the Company's stock option plans. These models also require highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated fair value on the grant date.

A summary of the status of the Company's warrants as of March 31, 2003 and changes during the three months ending March 31, 2003 is presented below (shares in thousands):

	MARCH 31, 2003 ----	
WARRANTS -----	NUMBER OF UNDERLYING SHARES -----	WEIGHTED- AVERAGE EXERCISE PRICE -----
Outstanding at beginning of year	4,081	\$2.82
Granted	505	\$1.02
Cancelled	--	\$ --
Exercised	--	\$ --
	-----	
Outstanding at end of year	4,586	\$2.63
	=====	
Warrants exercisable at year-end	4,586	
Weighted-average fair value of warrants granted during the year	\$0.60	

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The following table summarizes information about warrants outstanding at March 31, 2003 (shares in thousands):

RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING	WARRANTS OUTSTANDING		WARRANTS EXERCISABLE	
		WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED-AVERAGE EXERCISE PRICE
\$0.60 - \$16.39	4,216	2.4	\$ 1.26	4,216	\$ 1.26
\$16.40 - \$18.15	370	1.2	\$ 18.15	370	\$ 18.15
	4,586	2.3	\$ 2.63	4,586	\$ 2.63

OPTIONS

A summary of the status of the Company's stock option plans as of March 31, 2003 and changes during the three months ending March 31, 2003 is presented below (shares in thousands):

OPTIONS	MARCH 31, 2003	
	NUMBER OF UNDERLYING SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
Outstanding at beginning of year	2,039	\$2.40
Granted	515	\$0.60
Cancelled	(117)	\$2.75
Exercised	--	--
Outstanding at end of year	2,437	\$2.00
Options exercisable at year-end	1,110	\$2.12
Weighted-average fair value of options granted during the year	\$0.93	

The following table summarizes information about stock options outstanding at March 31, 2003 (shares in thousands):

RANGE OF EXERCISE PRICES	OPTIONS OUTSTANDING		OPTIONS EXERCISABLE	
	NUMBER OUTSTANDING AT	WEIGHTED-AVERAGE REMAINING	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT

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PRICES -----	3/31/03 -----	CONTRACTUAL LIFE -----	EXERCISE PRICE -----	3/31/03 -----
\$0.60 - \$1.51	1,418	9.8	\$1.02	537
\$1.52 - \$2.43	446	7.9	\$2.06	353
\$2.43 - \$3.34	337	8.1	\$3.02	101
\$3.35 - \$4.26	71	7.9	\$3.67	40
\$4.27 - \$6.09	3	7.9	\$4.81	1
\$6.10 - \$7.00	115	9.4	\$6.82	49
\$7.01 - \$8.83	29	6.6	\$8.75	18
\$8.84 - \$9.75	18	6.7	\$9.75	11
	-----	---	-----	-----
	2,437	9.1	\$2.00	1,110
	=====			=====

The weighted average remaining contractual life of stock options outstanding at March 31, 2003 was 9.1 years.

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BIZ ACQUISITION

In accordance with Statement No. 142, the Company had up until June 30, 2002 to complete the initial test for impairment as of January 1, 2002, the adoption date of Statement No. 142. In accordance with the transition provisions of Statement No. 142, the Company conducted the first step of the impairment tests. The Company assessed the fair value of its two reporting units by considering their projected cash flows, using risk-adjusted discount rates. Given consideration of relevant factors, the Company concluded that, as of December 31, 2001, an impairment write-down of \$36,299 was required related to the BIZ acquisition. Subsequently, the Company reviewed the assumptions used in the original analysis as of March 31, 2002, June 30, 2002, September 30, 2002 concluded that such analyses continued to be adequate and that no additional write-down was required. In accordance with Statement No. 142, the Company stopped amortizing goodwill in 2002. Accordingly, the Company does not anticipate there to be any amortization expense for the next five years related to intangible assets. The following table provides a reconciliation of the reported net loss adjusted for amortization charges for each respective three month period:

	THREE MONTHS ENDED MARCH 31	
	2002	2003
	-----	-----
Reported net (loss) .....	\$ (4,027)	\$ (1,618)
Add back goodwill amortization:	(23)	--
	-----	-----
Adjusted net loss .....	\$ (4,004)	\$ (1,618)
	=====	=====
Basic earnings per share:		
Reported net (loss) .....	\$ (.19)	\$ (.06)
Add back goodwill amortization:	--	--
	-----	-----
Adjusted net loss .....	\$ (.20)	\$ (.06)
	=====	=====

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The Company performed an assessment of the fair value of the goodwill of its information security products and services reporting unit as of December 31, 2002 using a multi-period discounted cash flow method, a variation of the income forecast approach. The process is used to determine the fair value of an asset by estimating its future cash flows and then discounting the cash flows to present day utilizing a discount rate that reflects the time value of money and the risk inherent in the asset. The present value of the cash flows was determined using a discount rate of 30%, which was found to be the weighted average cost of capital for the Company. The results of the analysis indicated that there was no impairment as of the valuation date of December 31, 2002.

The Company is required to perform reviews for impairment at least annually that may result in future write-downs. Tests for impairment between annual tests may be required if events occur or circumstances change that would more likely than not reduce the fair value of the net carrying amount.

As the markets for the Company's products are characterized by rapidly changing technology, evolving industry standards, and the frequent introduction of new products and enhancements, it is reasonably possible in the near-term that the estimates of the anticipated future gross revenues, the remaining estimated economic life, or both will be reduced. Reasonably possible is defined as more than remote but less than likely. As a result, the remaining goodwill of \$25,930 at December 31, 2002, may be reduced within the next year.

### (2) INVESTMENTS

The Company has an investment that is classified as trading securities. The securities are comprised of Class A Common Stock of Wave Systems Corp., par value \$0.01, received in the BIZ acquisition. As of March 31, 2003, the Company had 57 shares with an aggregate value of \$60. For the three months ended March 31, 2002 and 2003, the Company recorded realized loss on trading securities of \$1 and \$0, respectively.

### (3) INVENTORIES

A summary of inventories follows:

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	DECEMBER 31, 2002	MARCH 31, 2003
	-----	-----
Raw materials .....	\$ 23	\$ 57
Work-in-process .....	82	43
Finished goods .....	133	185
	-----	-----
	\$ 238	\$ 285
	=====	=====

### (4) EQUITY INVESTMENT IN AFFILIATE

In January 2002, the Company formed a wholly-owned subsidiary, now known as SSP Gaming, LLC, a Nevada limited liability company ("SSP Gaming"). The entity was formed to conduct all business and any required financing activities relative to the gaming industry. In June 2002, SSP Gaming and the Venetian Casino Resort, LLC, a Nevada limited liability company based in Las Vegas, Nevada, ("Venetian"), executed an operating agreement to form Venetian Interactive, LLC, a Nevada limited liability company ("VI"). The purpose of VI

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is to provide management services, consulting services, financial services, intellectual property licensing services, and equipment to the online gaming industry in venues where such activity complies with all regulatory requirements, and to develop and operate Venetian branded casino sites.

To begin the process of developing online casino sites, engage vendors to construct the sites and obtain the required licenses in the regulated venues where such operations are authorized, VI began hiring employees in July 2002, including one employee from the Company who was subsequently terminated by VI in January 2003. The VI staff has forecast development and operational costs, which are updated as new information becomes available. A VI related entity, V.I. Ltd., was awarded both an Interactive Gaming License and an Electronic Betting Center License by the Alderney Gambling Control Commission. The licenses permit V.I. Ltd. to conduct Internet gaming activities under the name "Venetian Interactive." The Venetian Casino site is currently under development and is anticipated to go live before the end of the third quarter of 2003.

The current VI development budget estimates costs of \$4,000 to bring the Venetian Casino to live status, and an additional \$2,200 to support startup operations. Since beginning development in July 2002, VI has expensed all operating costs and capitalized third party software development costs incurred under a fixed price contract. As of March 31, 2003 development costs capitalized totaled \$955. The VI operating agreement calls for SSP Gaming to fund two-thirds of the development costs and for Venetian to fund the remaining one-third of the costs. As of March 31, 2003, SSP had invested \$800 in SSP Gaming, with those funds being invested in VI. In the three months ended March 31, 2003, SSP Gaming recorded \$269 as loss from equity investee, which represents its pro rata portion of the VI net loss. This amount is included in non-operating expenses in the condensed consolidated statement of operations for the three months ended March 31, 2003, and as a reduction of the equity investment in affiliate.

The following represents summarized financial information for the VI:

### BALANCE SHEET MARCH 31, 2003 (UNAUDITED)

	-----		-----
Current Assets	\$ --	Current Liabilities	\$ --
Site Development	955	Members' Equity	955
	-----		-----
Total Assets	\$ 955	Total Members' Equity & Liabilities	\$ 955
	=====		=====

### STATEMENT OF OPERATIONS THREE MONTHS ENDED MARCH 31, 2003 (UNAUDITED)

	-----	
Selling, general & admin		\$404
		-----
Net Loss		(\$404)
		=====

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SSP Gaming's ownership interest decreases over time based upon the distribution of cashflow from VI. The operating agreement provides for SSP



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Gaming to receive two-thirds of the distributable cashflow until SSP Gaming receives the return of the full amount of capital invested in VI. After receiving the return of its invested capital, SSP Gaming is to receive the following portions of distributable cashflow: 50% of the first \$2,000, 40% of the next \$2,000 and 20% thereafter. Based upon forecasted operations, the ownership and distribution percentage held by SSP Gaming should be reduced to the 20% level within the first two full years of operation. Venetian and SSP Gaming each are to appoint three managers to oversee general management of VI, with an additional Manager appointed by mutual consent of the parties. Members owning at least 75% of the percentage interests of VI must approve defined major decisions. Based upon this forecasted scenario and the fact that Venetian will have voting control upon achieving forecasted operations, the Company deems control to be temporary, and therefore, the Company is accounting for SSP Gaming's interest in VI using the equity method, and is not consolidating VI operating results into the records of SSP Gaming. The operating agreement commits SSP Gaming to fund up to \$2,000. As of March 31, 2003, SSP Gaming had funded \$800.

SSP Gaming is currently in negotiations with financial sources to provide interim and long-term funding to satisfy the VI investment requirements. If the negotiations are successful, SSP Gaming would become a less than wholly-owned subsidiary. If the negotiations are not successful, SSP Gaming's percentage interest in the VI may be reduced and amounts invested by SSP in SSP Gaming will be at risk.

In January 2003, the FASB issued Interpretation 46, "Consolidation of Variable Interest Entities, and Interpretation of ARB No.51." Interpretation 46 addresses consolidation by business enterprises of variable interest entities which have one or both of the following characteristics: (1) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional support from other parties, which is provided through other interests that will absorb some or all of the expected losses of the entity; (2) the equity investors lack one or more of the following essential characteristics of a controlling financial interest: (a) the direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights, (b) the obligation to absorb the expected losses of the entity if they occur, which makes it possible for the entity to finance its activities, or (c) the right to receive the expected residual returns of the entity, if they occur, which is the compensation for the risk of absorbing expected losses. Interpretation 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains and interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Company is currently assessing the impact of Interpretation 46. The Company has, however, identified VI as an entity that may be required to be consolidated beginning in the third quarter of 2003. As of March 31, 2003, relative to VI the Company recorded a net investment in affiliate carried with other assets on its condensed consolidated balance sheet of approximately \$283. The Company currently adjusts the carrying value of the investment in affiliate for any losses incurred by the entity through earnings. While this entity may be considered a variable interest entity, the Company has not yet determined if it will need to be consolidated.

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### (5) LONG-TERM DEBT

A summary of long-term debt follows:

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	DECEMBER 31 2002
	-----
Secured convertible promissory notes with an interest rate of 10% per annum, interest payable quarterly, due December 31, 2005 .....	\$ 5,796
Secured convertible promissory notes with an interest rate of 30% per annum, interest payable quarterly, due November 14, 2003 .....	500
Secured promissory note with an interest rate of 15% per annum, interest payable quarterly, due on or before December 31, 2005 .....	--
Secured promissory notes at various interest rates from 15% to 60% per annum, interest payable quarterly, due in July 2003 .....	--
Note payable related to restructuring of facilities leases due in installments on or before September 19, 2003, without interest .....	425
Promissory note due July 18, 2003 with interest at 6.75% per annum, interest payable at maturity .....	429
Promissory note due July 18, 2003 without interest .....	27
Note payable secured by interest in SSP Gaming, payable in monthly installments of \$15,000, including interest at 6% per annum .....	196
Bay View Funding accounts receivable financing, discount rate of 1.25% of the receivables factored, interest payable upon payment of receivable ...	259
	-----
	7,632
	-----
Less unamortized value of warrants related to debt issued .....	4,806
	-----
Long-term debt, net of debt discounts of \$4,806 at December 31, 2002 and \$4,578 at March 31, 2003 .....	2,826
Less current installments .....	2,826
	-----
Long-term debt, net of debt discounts of \$4,806 at December 31, 2002 and \$4,578 at March 31, 2003 .....	\$ --
	=====

The Company is in default on notes relative to the timely payment of obligations as they come due. The noteholders have not granted waivers of the default. This means the noteholders have the right to declare the Company in default and call all of their debt due and immediately payable. With the potential of the notes being called for payment, the Company classified the related debt as short-term debt in the condensed consolidated balance sheet as of December 31, 2002 and March 31, 2003.

SECURED SUBORDINATED CONVERTIBLE NOTES

On April 16, 2002, the Company raised \$5,000 in cash through the issuance of \$4,000 in 10% secured convertible promissory notes ("10% Convertible Notes"), \$653 in unsecured non-convertible promissory notes ("Non-convertible Notes", \$153 held by co-chairman Kris Shah and \$500 held by co-chairman Marvin Winkler) and the pre-payment of a \$500 note receivable due to the Company from Kris Shah, less a discount of \$153. In connection with the issuance of the 10% Convertible Notes, the Company incurred approximately \$626 of issuance costs, which primarily consisted of amortization of warrant costs, investment banking fees and legal and other professional fees. These notes mature December 31, 2005 and bear interest at a rate of 10% per annum to be paid quarterly in cash, or at the Company's discretion, in common shares based upon the trailing 30-day average prior to the interest due date. The \$4,000 in 10% Convertible Notes are convertible, in whole or in part, at the option of the holder into an aggregate of 4,000,000 shares of the Company's common stock at any time prior to maturity, at a conversion price of \$1.00 per share, subject to adjustment under certain

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conditions, and have detachable warrants exercisable for three years to purchase up to an additional 2,400,000 shares at \$1.30 per share, subject to adjustment under certain conditions. In conjunction with the closing of the sale of the 10% Convertible Notes, \$1,750 of principal and \$46 of accrued interest of the Subordinated Notes were exchanged for the 10% Convertible Notes and detachable warrants to purchase 1,077,667 shares at \$1.30 per share.

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The 10% Convertible Notes automatically convert prior to maturity if the Company's common shares trade at or above \$3.00 per share with average volume of 100,000 shares per day for 20 consecutive trading days. The Company is subject to restrictive covenants related to the Convertible Notes and Non-convertible Notes that prevent the Company from pledging intellectual property as collateral. In June 2002, Kris Shah and Marvin Winkler exchanged their Non-convertible Notes, together with accrued interest, for 119,000 and 391,000 shares, respectively, of the Company's common stock based upon an above-market exchange price of \$1.30 per common share.

The 10% Convertible Notes contain a beneficial conversion feature. When a convertible security contains a conversion price that is less than the quoted trading price of a company's common stock at the date of commitment, then the difference between the conversion price and the common stock price is called a beneficial conversion feature. Emerging Issues Task Force ("EITF") Issue No. 00-27, which amends EITF Issue No. 98-5, requires both recordation of a discount to recognize the intrinsic value of the conversion feature and amortization of the amount recorded over the term of the security.

Of the aggregate \$5,796 in 10% Convertible Notes issued, the Company allocated approximately \$2,644 to the value of the warrants and the remaining \$3,152 to the beneficial conversion feature of the debt instruments, which were ascribed to these components on a pro rata basis of fair values calculated for the warrants using a Black Scholes valuation model and the intrinsic value of the beneficial conversion feature. These amounts have been recorded as discounts from the face value of the debt, with an equal increase to additional paid-in capital. Based on EITF No. 00-27, the governing accounting pronouncement, the discounts are being amortized over the period from the date of issuance to the maturity date of the notes. Amortization of the discounts totaled \$1,107 for the year ended December 31, 2002.

In connection with issuances of the 10% Convertible Notes and warrants, the Company incurred approximately \$741 of debt issuance costs comprised of legal and professional fees, in addition to \$182 in value calculated for the 110,000 warrants issued to the underwriter in the transaction. These costs, which are included in other assets, are being amortized over the term of the 10% Convertible Notes. Amortization of these costs totaled \$142 for the year ended December 31, 2002.

As of December 31, 2002, the Company was in violation of certain provisions of the 10% Convertible Notes. These violations are related to the Company's failure to pay debts and obligations as they become due. During the first quarter of 2003, the Company requested waivers for each of the aforementioned violations for past and for anticipated future events of default through June 30, 2003, but has not been granted such waivers. While waivers have been granted in the past, the holders of the 10% Convertible Notes have not granted such waivers and may declare the principal and unpaid interest immediately due and payable.

On April 16, 2002, with the exception of Mr. Winkler and Mr. Shah, the

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holders of the Subordinated Notes converted their Subordinated Notes into 10% Subordinated Notes . In June 2002, Mr. Winkler and Mr. Shah exchanged their Non-convertible Notes and their Subordinated Notes, together with accrued but unpaid interest, for shares of the Company's common stock at an above market per shares price of \$1.30.

### SECURED PROMISSORY NOTES

On January 22, 2003, the Company issued to Richard P. Kiphart a \$500 promissory note that bears interest at a rate of 15% per year, with a minimum interest charge of \$50. Accrued interest is payable quarterly in arrears beginning March 31, 2003. Principal and accrued but unpaid interest are due upon the earlier of December 31, 2005 and the Company's closing of a \$5,000 or more in equity or debt financing. Mr. Kiphart has the right to exchange the principal and outstanding interest on the note for securities that the Company issues in such an equity or debt financing. If the Company does not repay the note prior to June 30, 2003, the Company will be required to issue to Mr. Kiphart a three-year warrant to purchase up to 125,000 shares of common stock at an exercise price of \$1.30 per share and to register for resale the shares of common stock underlying the warrant. The note is secured by all of the unencumbered assets of SSP and its subsidiaries, including without limitation, intellectual property assets and any and all receivables due to the Company from SSP Gaming.

### SECURED PROMISSORY NOTES

On March 18, 2003 and March 19, 2003, the Company issued to each of Crestview Capital Fund II, L.P. and Richard P. Kiphart \$100 promissory notes that are secured by all of the Company's assets, including SSP Gaming and any

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rights belonging to SSP Gaming. In addition, on March 28, 2003, Marvin Winkler agreed to pledge 350,000 shares of common stock held by JAW Financial, L.P., an entity controlled by Mr. Winkler, as security for the notes the Company issued on March 18, March 19 and March 28, 2003. The notes bear interest in an amount equal to the following percentage of the principal balance: 10%, if the notes are repaid within 30 days; 12%, if the note are repaid within 60 days; 15%, if the notes are repaid within 90 days; and 20%, if the notes are repaid at maturity. Principal and interest under the notes are due upon the sooner of 120 days from the dates of the notes and the Company's raising of at least \$3,500 in equity or debt financing. Each note was accompanied by a five-year warrant to purchase up to 50,000 shares of common stock at an exercise price of \$0.60. The Company will be required to issue to each holder warrants to purchase up to an additional 50,000 shares of common stock upon repayment of the notes, depending upon the date of repayment. The exercise price of the warrants and the number of shares underlying the warrants are subject to anti-dilution adjustments in connection with dividends or distributions of assets to holders of our common stock and subdivisions or combinations of our common stock. The warrants contain a cashless exercise provision. The shares of common stock underlying the warrants bear registration rights.

On March 28, 2003, the Company issued to Richard P. Kiphart, Crestview Capital Fund II, L.P., Kris Shah and Marvin Winkler promissory notes in the aggregate principal amount of \$440, of which \$180 was funded prior to March 31, 2003. The notes are secured by all of the Company's assets and the assets of SSP Gaming. In addition, Mr. Winkler agreed to pledge 350,000 shares of common stock held of record by JAW Financial, L.P. as security for the notes the Company issued on March 18, March 19 and March 28, 2003. The notes bear interest at the

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rate of 18% per year, with interest payable in cash monthly in arrears. The Company is required to use the proceeds of the notes only for payment of operating expenses. Principal and accrued but unpaid interest under the notes are due upon the sooner of July 26, 2003 and the Company's raising of \$3,500 in equity or debt financing. The notes were accompanied by five-year warrants to purchase up to an aggregate of 230,000 shares of common stock. The exercise price of the warrants has not yet been fixed. The exercise price will be equal to the greater of \$0.70 per share or the conversion price of securities the Company may issue in a proposed financing, not to exceed \$1.30 per share. The exercise price of the warrants and the number of shares underlying the warrants will be subject to anti-dilution adjustments in connection with dividends or distributions of assets to holders of the Company's common stock and subdivisions or combinations of the Company's common stock. The warrants contain a cashless exercise provision.

### NOTE PAYABLE FOR RESTRUCTURING FACILITY LEASE

In restructuring existing facility lease agreements, the Company agreed to pay \$500 in installments without interest. The first payment of \$75 was made as scheduled in December 2002, with additional payments scheduled of \$100 due in March 2003, \$150 due in June 2003 and a final payment of \$175 due in September 2003. The Company has not made the \$100 payment that was due in March 2003. (Note 10).

### NOTE TO REPURCHASE INTEREST IN SSP GAMING

In October 2002, the Company entered into a mutual settlement and release regarding the default by a party that had contracted to finance the investment of SSP Gaming, a then wholly-owned subsidiary. The party defaulted under the financing agreement. To preserve the underlying business relationships, the Company and the other party executed an agreement whereby the Company repurchased the party's interest by issuing a note for \$250, the amount invested by the party, and agreed to repay such amount by making an initial \$40 payment and additional monthly payments of \$15 per month, including interest at 6%, until paid in full. The note is secured by the Company's interest in SSP Gaming, and includes an acceleration clause whereby the then principal balance will be paid upon separate SSP Gaming financing of \$2,000 or more.

### SECURED CONVERTIBLE NOTE

In November 2002, the Company issued three one-year notes totaling \$500, bearing interest at 30% per annum ("Secured Convertible Notes"), which have detachable warrants exercisable for five years to purchase up to an additional 500,000 shares (depending upon the date of repayment) at \$1.30 per share subject to adjustment under certain conditions. SSP Gaming used the proceeds for investment into the joint venture with Venetian. After they have been outstanding for more than six months, the Secured Convertible Notes may be converted into the Company's common stock at a conversion price of \$1.30 per share. The Secured Convertible Notes are due upon a Company financing of \$3,500 or more, and are secured behind the Secured Subordinated Convertible Notes described above.

The fair value of the detachable warrants associated with the Secured Convertible Notes were estimated at \$154 using the Black Scholes valuation model, based on the following assumptions: risk-free interest rate of 4.85%;

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dividend yield of 0.00%; and volatility of 119%. The amounts have been recorded

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as discounts from the face value of the debt with an equal increase to additional paid-in capital. The relative fair value of the warrants have been allocated as a debt discount and is being amortized over the period from the date of issuance to the maturity date of the Secured Convertible Notes. Amortization of the discounts totaled \$38 for the year ended December 31, 2002.

### PROMISSORY NOTES

In April 2002, the Company issued two promissory notes due in July 2003 as payment for goods sold by Pulsar's network solutions business. The note, with an original balance of \$679, bears interest at 6.75% per annum, with interest payable at maturity. The note in the amount of \$27 does not bear interest.

In March 2003, the Company executed documents to settle the action brought against the Company by Integral Systems, Inc. As part of the settlement, the Company entered into a Forbearance Agreement dated March 12, 2003 with Integral Systems that would allow Integral Systems to enter a judgment against the Company should the Company default in the \$20 per month payments due under the agreement. The Company also issued to Integral Systems a warrant exercisable for three years to purchase 150,000 at an exercise price of \$1.30 per common share. Additionally, if the Company does not payoff the agreed to obligation, at a discount, by June 30, 2003, we agreed to place 400,000 of our common stock in a third party escrow as additional security for our performance under the Forbearance Agreement.

### ACCOUNTS RECEIVABLE FINANCING

During November 2001, both the Company and its wholly-owned subsidiary, Pulsar, entered into separate financing agreements with Wells Fargo Business Credit, Inc. ("WFBC"), which provided for the factoring of accounts receivable. The agreements contained no limit on the dollar volume of receivable financing, but provided for WFBC's approval of credit limits for non-government customers. The agreements contained a discount rate of 1.25% of the gross receivable factored, which would be increased by .0625% per day for accounts that extended beyond the 30-day period from the date the account was purchased. At the time of purchase, terms called for WFBC to advance 85% of the gross receivable, with the balance remitted after collection of the invoice less the discount and any other charges. The combined agreements contained minimum quarterly fees and discounts totaling \$63. In July 2002, the Company signed amendments to the financing agreements, which increased the discount rate charged to 1.95% of the gross receivable and revised the daily rate to .063% for accounts extending beyond 30 days. The minimum quarterly fees and discounts were also reduced to \$15. All other terms and conditions remained. During the third quarter of 2002, the Company terminated the WFBC agreement related to Pulsar.

In October 2002, the Company terminated its remaining financing arrangement with WFBC and entered into a new financing arrangement with Bay View Funding ("BVF"). The new factoring agreement contains a maximum advance of \$750, and was for an initial term of three months, which at the Company's option, is renewable for additional three-month periods, which has been renewed by the Company. The agreement contains a factoring fee, which is based on 1.25% of the gross face value of the purchased receivable for every thirty day period from the date of purchase by BVF until the invoice is paid in full. For invoices outstanding more than the thirty day period, a finance fee will be charged at the rate of .063% of the gross face value of the purchased receivable for every one day period beyond the 30th day from the original date of purchase. At the time of purchase, terms call for BVF to advance 85% of the gross receivable, with the balance remitted after collection of the invoice less the factoring and finance fee, if applicable. The agreement contains certain representations, warranties and covenants and requires a monthly minimum fee, including the factoring and financing fees, of .25% of the maximum advance of \$750, or approximately \$2 per month. The BVF states among other things that a default

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occurs if we do not pay debts as they become due or if maintain unreasonably small capital. We have notified BVF of our failure to make certain payments on a timely basis and have therefore recently requested a waiver of such default.

Gross receivables transferred to WFBC and WFBC/BVF amounted to \$2,105 and \$2,873 in 2001 and 2002, respectively. The Company is obligated to repurchase certain accounts receivable under the program and, therefore, the transaction does not qualify as a sale.

Factored receivables included in the accounts receivable balance as of December 31, 2002 and March 31, 2003 were \$314 and \$371, respectively

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### (6) RELATED PARTY TRANSACTIONS

#### KRDS REAL PROPERTY LEASE

In 1999, the primary shareholders of Litronic, Inc. formed KRDS, Inc., (KRDS) for the sole purpose of purchasing real estate property. KRDS's operations primarily consisted of a mortgage obligation, interest, depreciation and rental income from the Company related to the real estate property.

In February 2000, KRDS leased a building to the Company for its corporate headquarters. The lease expires in February 2007. The facility has an annual rent of approximately \$429. In April 2002, the Company and KRDS entered into an agreement whereby upon 60 days' notice, either party may cancel the remaining balance of the facility lease with no future liability. Neither party has exercised the exit clause.

#### NOTE RECEIVABLE FROM SHAREHOLDER

The note receivable from shareholder consists of a note acquired as part of the BIZ acquisition. The \$500 note was received by BIZ from the Company's co-chairman, Kris Shah, in conjunction with the issuance of BIZ common shares prior to the BIZ acquisition, and therefore was shown as a reduction of shareholders' equity until paid. The note had a stated interest rate of 5% per annum and was due on July 24, 2005. On April 12, 2002, in a transaction approved the Company's board of directors, Mr. Shah prepaid the note by paying to the Company \$347, and the Company recorded a discount of \$153 which was charged against income in the second quarter of 2002. The discount was computed based upon a present value calculation using a discount rate of 20%.

#### FACILITIES RELATED PARTY LEASING

During 2001, the Company arranged for the lease of two buildings approximating 63 square feet that were under construction and were subsequently completed. In October 2002, the Company restructured its lease obligations with landlord, Research Venture, LLC, for the two buildings located in the Spectrum area of Irvine, California. This restructuring and settlement provided the basis for revising the estimate of costs relative to resolving the liability incurred under the original leases. In 2001 the Company recorded an estimated liability of \$2,171, which was net of then anticipated offsetting sublease income. As a result of the restructuring and settlement, the Company increased stockholders' equity by \$1,650 through the issuance of common stock valued for financial reporting purposes at \$956 and recorded a gain of \$700 for the year ended December 31, 2002. The settlement required the Company to issue 959,323 shares of common stock, pay \$500 in cash over a one-year period, cancel the lease on one building approximating 23 square feet, and take occupancy of the other

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building under a seven-year operating lease for the facility with approximately 40 square feet for an initial monthly rental rate of \$55, plus common area costs beginning in December 2002. The monthly rental rate on the seven-year lease is scheduled to increase to \$73, plus common area costs, at the beginning of the third year. The Company records rent expense on a straight-line basis. At the Company's option, a portion of the rental rate may be paid either in stock or in cash during the first two years of the lease under certain circumstances through conversion of a \$360 subordinated convertible promissory note that the Company issued as prepaid rent. In August 2002, Mr. Shah surrendered his 25% ownership interest in the entity that owns the two buildings. At the time of surrendering his interest, the buildings were encumbered by one or more construction loans for which the lender required personal guarantees for renewal of the financing. As there was little, if any, equity in the project and Mr. Shah was unwilling to personally guarantee the loans, Mr. Shah chose to surrender his membership interest.

### (7) CONCENTRATION OF CREDIT RISK AND SIGNIFICANT CUSTOMERS

Financial instruments that potentially subject the Company to concentration of credit risk are trade receivables. Credit risk on trade receivables is limited as a result of the Company's customer base and their dispersion across different industries and geographic regions. As of December 31, 2002 and March 31, 2003, accounts receivable included \$133 and \$895, respectively, due from the U.S. government and related agencies. Sales to the U.S. government and related agencies accounted for 19% and 50% of total revenues for the three months ended March 31, 2002 and 2003, respectively.

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The Company had sales that represented 25%, 12%, and 10% of the total revenues for the three months ended March 31, 2002. The Company had sales that represented 41%, 11%, and 10% of total revenues for the three months ended March 31, 2003. No other customers accounted for more than 10% of total Revenues during the three months ended March 31, 2002 and March 31, 2003. Trade accounts receivable totaled \$165 and \$1,148 from these major customers as of December 31, 2002 and March 31, 2003, respectively.

Some key components used in the manufacture of the Company's products can only be obtained from single sources.

### (8) LOSS PER SHARE

The calculation of diluted net loss per share excludes potential common shares if the effect is anti-dilutive. Potential common shares are composed of incremental shares of common stock issuable upon the exercise of stock options and warrants. The following table sets forth potential common shares that were excluded from the diluted net loss per share calculation for the three months ended March 31, 2002 and 2003 because they are anti-dilutive for the periods indicated (shares in thousands):

	2002	2003
	----	----
Warrants.....	394	4,586
Stock options.....	1,535	2,437
	-----	-----
	1,929	7,023
	=====	=====



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### (9) CONTINGENT LIABILITIES

Because the Company provides engineering and other services to various government agencies, it is subject to retrospective audits, which may result in adjustments to amounts recognized as revenues, and the Company may be subject to investigation by governmental entities. Failure to comply with the terms of any governmental contracts could result in civil and criminal fines and penalties, as well as suspension from future government contracts. The Company is not aware of any adjustments, fines or penalties, which could have a material adverse effect on its financial position or results of operations.

The Company has cost reimbursable type contracts with the federal government. Consequently, the Company is reimbursed based upon the direct expenses attributable to the contract, plus a percentage based upon overhead, material handling, and general administrative expenses. The overhead, material handling, and general administrative rates are estimates. Accordingly, if the actual rates as determined by the Defense Contract Audit Agency are below the Company's estimates, a refund for the difference would be due to the federal government. It is management's opinion that no material liability will result from any contract audits.

The Company is involved from time to time in various litigation matters that arise in the ordinary course of business. The Company is unable to estimate a potential loss or potential range of loss associated with any of the pending claims described herein.

In November 2000, the Company executed an Alliance Agreement with Electronic Data Systems Corporation ("EDS") for the marketing of Company products to EDS customers ("Alliance"). The Alliance calls for a joint working relationship between the two companies, which is non-exclusive and has a term of ten (10) years. In February 2001, the Company and EDS executed an engagement letter for EDS to provide certain information technology and consulting services for both the Company's organizational structure and for a specific customer project.

On August 27, 2001, EDS and the Company executed a letter of intent and temporary working agreement whereby EDS supplied software and hardware for re-sale to Pulsar customers ("Pulsar Agreement"). Under the Pulsar Agreement, as of December 31, 2002, \$1,049 remained outstanding and unpaid to EDS for purchases of hardware and software and is recorded in accounts payable in the consolidated balance sheet. The Company stopped doing business with EDS and as a result, we are subject to a monthly charge of \$44. This amount will be charged against operations as incurred.

The Company and EDS executed a Master Services Agreement ("MSA") dated as of November 14, 2001, whereby beginning December 1, 2001 and ending December 31, 2006, the Company and EDS established a strategic teaming relationship to implement, sell and deliver a set of secure transaction processing offerings based upon a Trust Assurance Network ("TAN"). The MSA task order ("Task Order")

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requires that the Company to pay a monthly fee of \$44 for account, test and lab management services beginning January 1, 2002. The obligations for these services could have terminated beginning January 1, 2003 by giving ninety (90) days prior written notice and payment of \$400, or beginning January 1, 2004 by giving ninety (90) days prior written notice and payment of \$200. Further, the Task Order provides for EDS to provide TAN hosting and implementation in exchange for an implementation fee of \$45 payable October 1, 2002. Once

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installation of the production environment TAN is complete, EDS agrees to host the TAN in exchange for a monthly service fee of \$59 for thirty-six (36) months and \$60 per month for the remaining months of the MSA. The Company could have but did not delay implementation of the TAN by paying a fee of \$200 prior to January 31, 2003. The Company may terminate the Task Order without cause by paying \$400 after January 1, 2004 and providing ninety (90) days prior written notice. In the event the Company is unable to obtain intellectual property rights or licensing consents that may be required, if any, prior to January 1, 2003, and the parties determine there are no software alternatives, then after giving ninety (90) days prior written notice the Company may terminate the Task Order by paying \$450. As of March 31, 2003, \$353 remained outstanding and unpaid to EDS relative to the Task Order. The Company has not made any payments since December 31, 2002 relative to the balance outstanding as of that date.

The Company is currently in discussions with EDS regarding the restructuring of its relationship with EDS relative to the MSA and Task Order. EDS has not provided services as outlined in the agreements and there is no prospect of such services being required in the near future. However, the Company cannot predict the outcome of these discussions as they pertain to the fees associated with early termination of the contract, and portions of the charges may be incurred.

On January 16, 1998, G2 Resources Inc. ("G2") filed a complaint against Pulsar Data Systems, Inc. ("Pulsar") in the Fifteenth Judicial Circuit in Palm Beach County, Florida. G2 claimed that Pulsar breached a contract under which G2 agreed to provide services related to the monitoring of government contracts available for bid and the preparation and submission of bids on behalf of Pulsar. The contract provided that Pulsar pay G2 \$500 in 30 monthly installments of \$16 and an additional fee of 2% of the gross dollar amount generated by awards. In its complaint, G2 alleged that Pulsar failed to make payments under the contract and claimed damages in excess of \$525 plus interest, costs and attorneys fees. In the course of discovery G2 asserted that its losses/costs arising out of its claim amounted to approximately \$10,300. Pulsar asserted that G2 failed to perform the services required under the contract and Pulsar filed a claim for compensatory damages, interest and attorneys fees against G2. Classical Financial Services, LLC intervened in the case. Classical claimed that G2 assigned its accounts receivable to Classical under a financing program and that Pulsar breached its obligations to Classical by failing to make payments under the contract with G2. Pulsar asserted defenses to Classical's claim. On April 20, 2001, a court hearing was held and G2's complaint against Pulsar was dismissed without prejudice on the basis of no prosecution activity for more than 12 months. On May 22, 2001, G2 filed a new complaint against Pulsar. In August 2002 the case was moved from Division AF to Division AH of the Fifteenth Judicial Circuit in Palm Beach County Court, Civil Division. The Company believes that the claims made by G2 and Classical against Pulsar are without merit and intends to vigorously defend against these claims.

In May 2002, Contemporary Services Corporation filed an action against the Company alleging breach of contract, fraud, negligent misrepresentation and violation of California Corporations Code section 25400. The action relates to a term sheet agreement that the Company entered into with the plaintiff in October 2001 in connection with a potential strategic relationship between the plaintiff and the Company. The Company filed an answer and cross-complaint. While the Company continued to believe we would prevail at trial, in February 2003, we reached an agreement to settle the case for less than \$50,000, which will be jointly paid by the Company's insurance carrier and the Company. The Company's estimated portion of the settlement has been accrued in the results of the year ended December 31, 2002.

In July 2002, Synnex Technology ("Synnex") filed a lawsuit against the Company in the Superior Court of Orange County, alleging that the Company failed to pay \$120,986 for products purchased by us for resale. The Company and Synnex

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agreed to settle the matter by payment of ten equal installments of \$12,099, pursuant to a stipulation for entry of judgment that is to be held by counsel for Synnex and not filed with the court absent breach by the Company. The last payment is due on or before June 9, 2003, at which time the action will be dismissed.

In restructuring existing facility lease agreements, the Company agreed to pay \$500 in installments without interest. The first payment of \$75 was made as scheduled in December 2002, with additional payments scheduled of \$100 due in March 2003, \$150 due in June 2003 and a final payment of \$175 due in September 2003. The Company has not made the full \$100 payment that was due in March 2003,

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which means the Company is currently in default under the settlement facilities settlement agreement and the landlord could enter a stipulated judgment. Also, if we are delisted from The Nasdaq National Market, Research Venture, LLC would be entitled to entry of a stipulated judgment against the Company in the maximum aggregate amount of \$3,100, less consideration the Company pays prior to any entry of the judgment.

During the second quarter of 2001 Microsoft notified the Company regarding the alleged sales of unlicensed copies of Microsoft Office. The software in question was purchased from a major computer hardware manufacturer and was resold to one of the Company's customers in a package that included both hardware and software. The Company is currently investigating the matter, and does not anticipate that the outcome will have a material impact on its results of operations, financial condition or liquidity.

The Company currently holds multiple contracts with the federal government for the resale of network deployment products. In particular, three of these contracts permit the Company to provide goods and services to various federal government agencies. An administrative agency recently informed the Company that one of the contracts would not be renewed unless purchase activity was conducted under the contract. The Company is negotiating with a party for the sale of the contract. It is possible the other contracts may not be renewed or may be cancelled by the federal government due to the Company's inability to perform as required under the contracts.

The Company is currently in negotiations with the various government agencies that it contracts with to initiate and implement the corrective measures necessary to insure the uninterrupted continuity of the contracts. Although there is no assurance that the contracts will be renewed or that they will not be cancelled, the Company has reason to believe they will be renewed. However, if the contracts are not renewed or if they are cancelled, then a significant portion of the Company's revenues will be lost which would have a significant impact on the Company's financial condition, results of operations and liquidity.

As of March 31, 2003, accounts payable totaled \$4,405. Of that amount, \$2,987 is aged at least 90 days. Unless payment is made or satisfactory payment plans agreed to, it is likely that the vendors will eventually initiate legal actions to collect the amounts owed to them. Currently, the Company has the intent to satisfy its vendor obligations through a combination of payment negotiations, which include extending the terms over time, partial payments of the obligations due as payment in full and converting obligations to long term notes payable.

(10) SUBSEQUENT EVENTS

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On April 1, 2003, the Company issued to Richard P. Kiphart a \$240,000 promissory note that bears interest at a rate of 18% per annum. Principal and accrued but unpaid interest are due upon the earliest of July 31, 2003 or the Company obtaining \$3.5 million in equity or debt financing. The note also contains a provision to issue a warrant to purchase 120,000 shares of common stock at an exercise price equal to the greater of \$.70 or the conversion price of a proposed financing, not to exceed \$1.30 per share.

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### PART II OTHER INFORMATION

#### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

Exhibit Number -----	Description -----
10.1	Waiver and Acknowledgment dated January 28, 2003 among Crestview Capital Fund, L.P., Crestview Capital Fund II, L.P., Crestview Offshore Fund, Inc., Robert Geras, Richard P. Kiphart and Nefilim Associates, LLC, LLC Wave Systems Corp. (1)
10.2	Second Amended and Restated Operating Agreement of SSP Gaming, LLC dated April 7, 2003 by SSP Solutions, Inc., the sole member of SSP Gaming, LLC (1)
10.3	Forbearance Agreement dated March 12, 2003 between SSP Solutions, Inc. and Integral Systems, Inc., effective September 1, 2002 (1)
10.4	Employment Agreement dated March 6, 2003 between SSP Solutions, Inc. and Kris Shah (1) (#)
10.5	Employment Agreement dated March 6, 2003 between SSP Solutions, Inc. and Marvin J. Winkler (1) (#)
10.6	Promissory Note dated January 22, 2003 in the principal amount of \$500,000 made by SSP Solutions, Inc. in favor of Richard P. Kiphart (1)
10.7	Form of Promissory Notes dated March 18, 2003 and March 19, 2003, respectively, made by SSP Solutions, Inc. in favor of Crestview Capital Fund, L.P. and Richard P. Kiphart, respectively, each in the principal amount of \$100,000 (1)
10.8	Form of Warrants to Purchase Common Stock dated March 18, 2003 and March 19, 2003, respectively, issued by SSP Solutions, Inc. in favor of Crestview Capital Fund L.P. and Richard P. Kiphart, respectively, each in the amount of 100,000 shares (1)

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- 10.9 Form of Promissory Notes dated March 28, 2003 made by SSP Solutions, Inc. in favor of Richard P. Kiphart, Crestview Capital Fund II, L.P., Marvin J. Winkler and the Kris and Geraldine Shah Family Trust, respectively, in the principal amounts of \$240,000, \$160,000, \$10,000 and \$30,000, respectively (1)
- 10.10 Form of Warrants to Purchase Common Stock dated March 28, 2003 issued by SSP Solutions, Inc. in favor of Crestview Capital Fund L.P., Richard P. Kiphart, Marvin J. Winkler and the Kris and Geraldine Shah Family Trust, respectively, in the amounts of 120,000, 80,000, 5,000 and 15,000 shares, respectively (1)
- 10.11 Warrant to Purchase Common Stock dated March 12, 2003 by SSP Solutions, Inc. to Integral Systems, Inc. (1)
- 31.1 Certifications required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officers and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(#) Management contract or compensatory plan, contract or arrangement required to be filed as an exhibit.

(1) Filed as an exhibit to the initial filing of our Form 10-K for the year ended December 31, 2002 (file no. 000-26227) and incorporated herein by reference.

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(b) Reports on Form 8-K.  
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On January 30, 2003, we filed a Form 8-K for January 27, 2003 to report the appointment of Gregory J. Clark and Ron R. Goldie to our board of directors. The Form 8-K contained Item 5 - Other Events, and Item 7 - Financial Statements and Exhibits. The exhibits to the Form 8-K consisted of two press releases relating to the director appointments.

### 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: September 15, 2003 SSP SOLUTIONS, INC.

By: /s/ MARVIN J. WINKLER  
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Marvin J. Winkler  
CO-CHAIRMAN OF THE BOARD OF DIRECTORS,  
DIRECTOR AND CHIEF EXECUTIVE OFFICER  
(PRINCIPAL EXECUTIVE OFFICER)

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By: /s/ THOMAS E. SCHIFF

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Thomas E. Schiff  
EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER  
(PRINCIPAL FINANCIAL OFFICER)

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EXHIBITS FILED WITH THIS REPORT

Exhibit Number -----	Description -----
31.1	Certifications required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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