

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM SB-2

Registration Statement
Under

The Securities Act of 1933

USA TECHNOLOGIES, INC.
(Exact Name of Registrant as Specified in its Charter)

| | | |
|--|--|--------------------------------------|
| Pennsylvania | 7359 | 23-2679963 |
| (State or other jurisdiction of incorporation or organization) | (Primary Standard Industrial Classification Code Number) | (I.R.S. employer Identification No.) |

200 Plant Avenue
Wayne, Pennsylvania 19087
(Address of principal executive offices and zip code)

George R. Jensen, Jr.
Chief Executive Officer
USA Technologies, Inc.
200 Plant Avenue
Wayne, Pennsylvania 19087
(610) 989-0340
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Douglas M. Lurio, Esquire
Lurio & Associates, P. C.
1760 Market Street, Suite 1300
Philadelphia, PA 19103-4132
(215) 665-9300

Approximate date of proposed sale to the public: From time to time after this Registration Statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, check the following box: []

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

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

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

If the delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. []

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CALCULATION OF REGISTRATION FEE

| Title of each class of Securities to be Registered | Amount to be Registered | Proposed Maximum Offering Price Per Unit (1) | Proposed Maximum Aggregate Offering Price | Amount of Registration Fee |
|--|-------------------------|--|---|----------------------------|
| Common Stock, no par value | 50,000 shares | \$2.00 | \$100,000 | \$27.80 |
| Common Stock, no par value | 50,000 shares | \$3.00 | \$150,000 | \$41.70 |
| Common Stock, no par value | 150,000 shares | \$2.50 | \$375,000 | \$104.25 |
| Total | 250,000..... | | | \$173.75 ===== |

(1) Pursuant to Rule 457(g), the registration fee has been calculated at the higher of the exercise price of the warrants relating to the above Common Stock or the average of the bid and asked price within 5 business days prior to the date of the initial filing of the registration statement.

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

USA TECHNOLOGIES, INC.

250,000 shares of Common Stock

These shares of Common Stock are being sold by the Selling Shareholders listed below. The Company will not receive any part of the proceeds from the sale.

The Common Stock is listed on the OTC Electronic Bulletin Board under the symbol "USTT". The closing bid price for the Common Stock on July 30, 1999 was \$2.06 per share.

THIS INVESTMENT INVOLVES A HIGH DEGREE OF RISK. YOU SHOULD PURCHASE SHARES ONLY IF YOU CAN AFFORD A COMPLETE LOSS. SEE "RISK FACTORS" ON PAGE 6.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed on the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is August 4, 1999.

No person has been authorized to give any information or to make any representations other than those contained in this Prospectus and, if given or made, such information or representation must not be relied upon as having been authorized. This Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any securities other than the securities to which the Prospectus relates or an offer to sell or the solicitation of an offer to buy such securities in any circumstances in which such offer or solicitation is unlawful. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date hereof or that the information contained herein is current as of any time subsequent to its date.

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PROSPECTUS SUMMARY

The following information does not purport to be complete and is qualified in its entirety by and should be read in conjunction with the more detailed information and Financial Statements, including the notes thereto, appearing elsewhere in this Prospectus. Prospective investors should consider carefully the factors discussed below under "Risk Factors".

The Company

Our Company, USA Technologies, Inc., a Pennsylvania corporation, was founded in January 1992. We are an owner and licensor of automated, credit card activated control systems for use in connection with copying machines, debit card purchase/revalue stations, facsimile machines, personal computers, and computer printers. Our customers are hotels, university libraries, public libraries and retail locations. We generate revenues primarily from the sale of equipment utilizing its control systems, from retaining a percentage of the revenues generated from all credit card transactions conducted through its control systems, and from monthly administrative fees paid by various locations utilizing its control systems.

Each control system operates as follows:

- The consumer swipes a valid credit card through the control system.
- The control system transmits the request to the credit card processor.
- The credit card processor verifies that the credit card is valid and authorizes the transaction.
- The control system activates the equipment for use by the consumer.
- Once the consumer finishes using the equipment, the control system transmits a record of the transactions to our computer center.
- The transaction information collected from all of the installed control devices is transmitted by us to the credit card processor.
- The credit card processor electronically transfers the proceeds derived from these transactions, less the credit card processor's charge, to us.
- Finally, we forward a check to each location representing its share of the proceeds.

As of March 31, 1999, our Company had installed at commercial locations a total of 1,224 control systems. See "Business." As of March 31, 1999, 290 Business Express(TM) or MBE Business Express(TM) units containing 1,068 control systems have been installed in hotels located throughout the United States and Canada. The 1,224 control systems include both the purchases of equipment from the Company and the licensing of its control systems as well as the placement of equipment by the Company on a revenue-sharing basis and included only the licensing of its control systems.

Our executive offices are located at 200 Plant Avenue, Wayne, Pennsylvania 19087. The telephone number is (610) 989-0340. Our website is located at <http://www.usatech.com>.

Where to Get More Information

Our Company is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith files reports and other information with the Commission. Such reports, and other information filed by the Company can be inspected and copied at the public reference facilities maintained by the Commission at the Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549, and at the Commission's Regional Offices located at 7 World Trade Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of such material can also be obtained at prescribed rates from the Public Reference Section of the Commission, Washington, D.C. 20549 or by calling the Commission at 1-800-SEC-0330. In addition, registration statements and certain other filings made with the Commission through its Electronic Data Gathering, Analysis and Retrieval System are publicly available through the Commission's site on the Internet's World Wide Web, located at <http://www.sec.gov>.

We will provide a copy of any or all documents incorporated by reference herein (exclusive of exhibits unless such exhibits are specifically incorporated by reference therein), without charge, to each person to whom this Prospectus is delivered, upon written or oral request to USA Technologies, Inc., 200 Plant Avenue, Wayne, Pennsylvania 19087, Attn: George R. Jensen, Jr., Chief Executive Officer (telephone (610) 989-0340).

The Company will furnish record holders of its securities with annual reports containing financial statements audited and reported upon by its independent auditors, quarterly reports containing unaudited interim financial information, and such other periodic reports as the Company may determine to be appropriate or as may be required by law.

Securities

Securities Offered

Up to 250,000 shares of
Common Stock by the Selling
Shareholders.

On June 7, 1999, the Company effectuated a 1-for-10 reverse stock split of all of its issued and outstanding Common Stock. Pursuant thereto, on the effective date of the reverse split (i) each 10 shares of outstanding Common Stock were reduced to one share of Common Stock; (ii) the number of shares of Common Stock into which each outstanding warrant, purchase right or option is exercisable was proportionately reduced on a 10-to-1 basis; (iii) the exercise price of each outstanding warrant, purchase right, or option was proportionately increased on a 1-to-10 basis; (iv) the number of shares of Common Stock into which each share of Series A Preferred Stock is convertible was reduced from 10 shares to 1 share; (v) the conversion rate of the accrued and unpaid dividends on the Series A Preferred Stock was increased from \$1.00 to \$10.00 per share of Common Stock; and (vi) each share of Series B Preferred Stock was converted into 4 shares of Common Stock. All of the share numbers, share prices, exercise prices, and all other similar items contained in this Prospectus have been properly adjusted, on a retroactive basis, to reflect all of the foregoing.

Common Stock Outstanding as of
June 30, 1999

6,172,697 shares. On a fully converted basis, there would be 9,539,023 shares outstanding consisting of 250,000 shares issuable upon exercise of the Warrants by the Selling Shareholders ("Selling Shareholder Warrants"), 933,600 shares issuable upon the exercise of the Warrants to be issued in June 1999 ("1999-A Warrants"), 928,840 shares issuable upon exercise of 917,100 options to purchase Common Stock and 11,740 Common Stock Purchase Rights issued to certain employees, directors or consultants (collectively "Management Options"), 110,000 shares issuable upon exercise of the Warrants issued to affiliates and/or consultants to GEM Advisors, Inc. in June 1997, ("GEM Warrants"), 5,000 shares issuable upon the exercise of the Warrants issued August and September 1998 ("1998-B Warrants"), 4,000 shares issuable upon the exercise of the Warrants issued in January, February and March 1998 ("1998-A

Warrants"), 1,500 shares issuable upon exercise of the Warrants issued in April, May and June 1997 ("1997-Warrants"), 4,000 shares issuable upon exercise of the Warrants issued in January and February 1997 ("1996-B Warrants"), 86,800 shares issuable upon exercise of the Warrants issued in 1996 ("1996-A Warrants"), 67,300 shares issuable upon the exercise of the Warrants issued by the Company in 1995 ("1995-Warrants"), 640,577 shares issuable upon conversion of the Series A Convertible Preferred Stock ("Series A Preferred Stock"), and 334,709 shares issuable upon conversion of accrued and unpaid dividends on the Series A Preferred Stock. On August 1, 1999, approximately \$469,000 of additional dividends will accrue on the Series A Preferred Stock which are convertible into 481,070 additional shares of Common Stock.

Series A Preferred Stock Outstanding as of June 30, 1999

640,577 shares. Each share of Series A Preferred Stock, no par value, of the Company is convertible by the holder thereof at any time into 1 share of Common Stock. The holders of Series A Preferred Stock are entitled to an annual cumulative cash dividend of \$1.50 per share. At the time of conversion, all accrued and unpaid dividends are converted into Common Stock at the rate of \$10.00 per share. See "Description of Securities - Series A Convertible Preferred Stock."

RISK FACTORS

The securities described herein are speculative and involve a high degree of risk. Each prospective investor in the Common Stock should carefully consider the following risk factors inherent in and affecting the business of USA Technologies, Inc. and the Common Stock before investing in the Common Stock.

1. Limited Operating History; Significant Cumulative Operating Losses; Auditor Report Modification for Going Concern. From inception through March 31, 1999, our Company has generated funds primarily through the sales of its securities. The auditor's report at June 30, 1998 includes a modification that indicates that the Company's existence may be dependent on its ability to continue to raise capital and generate sufficient revenue from operations. See "Consolidated Financial Statements."

Our Company installed its first product, the Golfer's Oasis(TM) in June 1994. This product line did not achieve the anticipated market acceptance and was also very capital intensive. There are currently no units in operation and revenues through March 31, 1999 were nominal. The Copy Express(TM) was first installed in January 1995, and as of March 31, 1999, there were 45 units in operation. The Credit Card Vending Express(TM) was first installed in March 1995, and as of March 31, 1999, there were no units in operation. The Fax Express (TM) was first installed in February 1997 and as of March 31, 1999 there were 9 units in operation and net revenues were nominal. The Company's Debit Express(TM) was first installed in April 1995, and as of March 31, 1999, there were 33 units in operation and net revenues were nominal. The Public PC(TM) (formerly known as the Credit Card Computer Express(TM)) was first installed in April 1996, and as of March 31, 1999, there were 69 units in operation and net revenues were nominal. The Business Express(TM) was first installed in September 1996, and as of March 31, 1999, there were 290 Business Express(TM) or MBE Business Express(TM) units in operation (containing 1,068 control systems).

For its fiscal years ended June 30, 1998 and 1997 and for the nine month period ended March 31, 1999, our Company incurred operating losses of \$3,586,281, \$3,120,712, and \$2,138,780, respectively. From its inception on January 16, 1992 through March 31, 1999, we have incurred operating losses of \$15,070,932.

As of March 31, 1999, our Company had a negative working capital of approximately \$764,993, of which \$790,860 was invested in inventory. At March 31, 1999, we had cash of \$362,512. In subsequent months, additional cash has been generated by selling additional securities and through increased revenues primarily through resale of its equipment utilizing control systems. As of June 23, 1999, and following the closing of the recent private placement offering, we had approximately \$2,000,000 in cash. As of March 31, 1999, we installed 1,224 control devices at commercial locations. We have a limited operating history upon which an evaluation of future prospects can be made. Such future prospects must be considered in light of the risks, expenses and difficulties frequently encountered in the establishment of a new business. There is currently no historical basis upon which to assume that our Company's business will prove financially profitable or generate more than nominal operating revenues. In addition, there can be no assurances that we will be able to continue to sell additional securities. If the Company either fails to generate increased revenues or fails to sell additional securities, investors may lose all or a substantial portion of their investment.

2. Dependence Upon Key Personnel. Our Company is dependent on certain key management personnel, particularly its President and Chief Executive Officer, George R. Jensen, Jr. The loss of services of Mr. Jensen or other executive officers would have a materially adverse effect upon our Company's business. The Company entered into an employment agreement with Mr. Jensen that expires in June 2000. The Company also entered into one-year employment agreements with other executive officers, each of which contain non-compete agreements. We have also obtained a key man life insurance policy in the amount of \$2,000,000 on Mr. Jensen, and a key man life insurance policy in the amount of \$1,000,000 on our Vice President-Research and Development, Haven Brock Kolls, Jr. We do not have and do not presently intend to obtain key man life insurance coverage on any of our other executive officers.

3. Uncertainty of New Product Development; Unproven Commercial Viability. While a number of products or services such as gasoline and public telephones are currently provided through unattended, credit card activated terminals, the commercial viability of any of our products has not been established. Although commercial production and installation of our products has commenced on a limited basis, there can be no assurance that our products will be successful or cover all fixed expenses of the Company. In other words, there can be no assurance that the demand for our products will be sufficient to enable us to become profitable. Even if our current products would cover all expenses, there can be no assurance that they can evolve or be improved to meet the future needs of the market place. In any such event, investors may lose all or substantially all of their investment in our Company.

4. Dependence on Proprietary Technology; Patent Issues. Our Company's success is dependent in part on its ability to obtain patent protection for its products, maintain trade secret protection and operate without infringing the proprietary rights of others. To date, we have applications, and intend to file applications for additional patents covering its future products although there can be no assurance that we will do so. In addition, there can be no assurance that we will maintain or prosecute these applications. The United States Government granted us one patent during April 1997 and another patent during June 1997. Two other patents have received notices of allowance as of March 31, 1999. See "Business - Patents, Trademarks and Proprietary Information." There can be no assurance that any of the eleven remaining patent applications will be granted to us, that we will develop additional products that are patentable or do not infringe the patents of others, or that any patents issued to us will provide us with any competitive advantages or adequate protection for our products. In addition, there can be no assurance that any patents issued to us will not be challenged, invalidated or circumvented by others. There can be no assurance that any of our products would not infringe the patents of others. If any of the products are found to have infringed any patent, there can be no assurance that we will be able to obtain licenses to continue to manufacture and license such product or that we will not have to pay damages as a result of such infringement. Even if a patent application is granted for any of our products, there can be no assurance that the patented technology will be a commercial success or result in any profits to us. See "Business-Legal Proceedings."

5. Competition. There are companies presently offering automated, credit card activated control systems in connection with facsimile machines, personal computers, debit card purchase/revalue stations, and use of the Internet and e-mail which are in direct competition with our Company's products, including the Business Express(TM) and Public PC(TM). See "Business-Competition." In addition, the businesses which have developed unattended, credit card activated control systems currently used in connection with gasoline dispensing, public telephones, prepaid telephone cards, ticket dispensing machines, or vending machines are capable of developing control systems in direct competition with our Company. Many of these businesses are well established, have substantially greater resources than our Company and have established reputations for success in the development, sale and service of high quality products. Such competition may result in lower percentages of gross revenues being retained by our Company in connection with its devices, or otherwise may reduce potential profits or result in a loss of some or all of its customer base. To the extent that our competitors are able to offer more attractive technology, our ability to compete could be materially and adversely affected. We are also aware of several businesses which make available use of the Internet and use of personal computers to hotel guests in their hotel rooms on an as-needed basis. Although these services are not credit card activated, such services would compete with the Company's Business Express(TM), and the location may not order the Business Express(TM), or if ordered, the hotel guest may not use it.

6. Dependence on Third-Party Suppliers. Our Company is dependent on third-party suppliers for the various component parts of its products. Although we believe there are alternative sources for these component parts, the failure of such suppliers to supply such component parts or the absence of readily available alternative sources could have a material adverse effect on our Company, including delaying the implementation of the Company's business plan to achieve profitability. See "Business-Procurement".

7. Cash Dividends Not Likely. There can be no assurance that the proposed operations of our Company will result in profitability. Any earnings which may be generated by our Company would be used, for the foreseeable future, to finance the growth of our business. Accordingly, while payment of dividends rests within the discretion of the Board of Directors, no cash dividends on the Common Stock or Series A Preferred Stock have been declared or paid by us to date, and the Company does not presently intend to pay cash dividends on the Common Stock or Series A Preferred Stock for the foreseeable future. Although we paid a special stock dividend in August 1995 consisting of one-third (1/3) of a share of Common Stock for each share of outstanding Preferred Stock, there can be no assurance that cash dividends will ever be paid on the Common Stock. Our Articles of Incorporation prohibit the declaration of any dividends on the Common Stock unless and until all unpaid and accumulated dividends on the Series A Preferred Stock have been declared and paid. Through June 30, 1999, the unpaid and cumulative dividends on the Series A Preferred Stock equal \$3,347,090. On August 1, 1999, approximately \$469,000 of additional dividends will become accrued and unpaid on our Series A Preferred Stock. The unpaid and accumulated dividends are either payable in cash by our Company when and if declared by the Board of Directors or may be converted into shares of Common Stock at the rate of \$10.00 per share. Through March 31, 1999, \$1,725,192 of unpaid and cumulative dividends on the Series A Preferred Stock were converted to 202,697 shares of Common Stock. See "Description of Securities - Series A Convertible Preferred Stock."

8. Need For Market Acceptance; Location Risk. There can be no assurance that demand for our Company's products will be sufficient to enable us to become profitable. Likewise, no assurance can be given that we will be able to install the credit card activated control systems at enough locations or sell equipment utilizing its control systems to enough locations to achieve significant revenues or that its operations can be conducted profitably. As of March 31, 1999, our Company installed 1,224 control devices at commercial locations and revenues have been small. Alternatively, the locations which would utilize the control systems may not be successful locations. In such event, our revenues would be adversely affected. We may in the future lose locations utilizing its products to competitors, or may not be able to install our products at competitor's locations. Moreover, even if our current products would prove to be commercially viable, there can be no assurance that they can evolve or be improved to meet the future needs of the market place.

9. No Current Established Trading Market; No Assurance of Active Public Market. The Common Stock is currently traded on the OTC Electronic Bulletin Board. Although there is trading in the Common Stock, there is no established trading market. Unless and until there is an established trading market for the Common Stock, holders of the Common Stock could find it difficult to dispose of, or to obtain accurate quotations as to the price of, the Common Stock. See "Description of Securities - Shares Eligible For Future Sale" and "Market For Common Stock."

10. Risks of Low-Priced Stocks. The Common Stock is subject to the so-called penny stock rules that impose additional sales practice requirements on broker-dealers who sell such securities to persons other than established customers and accredited investors (generally defined as an investor with a net worth in excess of \$1,000,000 or annual income exceeding \$200,000, or \$300,000 together with a spouse). For transactions covered by this rule, the broker-dealer must make a special suitability determination for the purchaser and must have received the purchaser's written consent to the transaction prior to sale. These regulations may adversely affect the ability of broker-dealers to sell the Common Stock.

The Commission has adopted regulations that define a penny stock to be any equity security that has a market price (as defined) of less than \$5.00 per share or an exercise price of less than \$5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require the delivery, prior to the transaction, of a disclosure schedule relating to the penny stock market. The broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market-maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market.

As of the date hereof, each share of Common Stock qualifies as a penny stock and is subject to the above regulations. The above regulations could adversely affect the market liquidity for the Common Stock and could limit the ability of broker-dealers to sell the Common Stock as well as the ability of holders of the Common Stock to sell the Common Stock in the secondary market.

11. Determination of Offering Price. The exercise price of the Selling Shareholder Warrants was determined arbitrarily by our Company and was not based upon book value, earnings, assets or any other recognizable standard of value. If profitable results are not achieved from operations, of which there can be no assurance, the value of our securities sold pursuant to this offering could well become considerably less than the offering price of such securities and could become worthless.

12. Shares Eligible for Future Sale. Of the 4,617,198 shares of Common Stock issued and outstanding as of March 31, 1999, 4,233,398 are freely transferable without restriction or further registration under the Act (other than shares held by "affiliates" of the Company), and the remaining 383,800 are "restricted securities", as that term is defined under Rule 144 promulgated under the Act, and under certain circumstances may be sold without registration pursuant to that Rule. Of the 660,027 shares of Preferred Stock issued and outstanding on March 31, 1999, 510,027 are freely transferable without restriction or further registration under the Act (other than shares held by "affiliates" of the Company), and the remaining 150,000 are "restricted securities." As of March 31, 1999, there are 67,300 shares of Common Stock issuable by the Company to the holders of the outstanding unexercised 1995 Warrants, 10,100 shares of Common Stock issuable to the holders of the outstanding 1998-B Warrants, 191,900 shares of Common Stock issuable to the holders of the outstanding 1999-A Warrants, 86,800 shares of Common Stock issuable by the Company to the holders of the outstanding unexercised 1996 Warrants, 4,000 shares of Common Stock issuable by the Company to the holders of the outstanding 1996-B Warrants, 1,500 shares of Common Stock issuable to the holders of the outstanding 1997 Warrants, 4,000 shares of Common Stock issuable to the holders of the outstanding 1998-A Warrants, 10,100 shares of Common Stock issuable to the holders of the outstanding 1998-B Warrants, 191,900 shares of Common Stock issuable to the holders of the outstanding 1999-A Warrants, 384,130 shares of Common Stock issuable to the holders of the Management Options, and 110,000 shares of Common Stock issuable upon the exercise of the GEM Warrants. Such Common Stock, if issued, will be freely tradeable under the Act. See "Description of Securities". We are unable to predict the effect that sales made under Rule 144 or otherwise may have on the market price of the Series A Preferred Stock, Warrants, or Common Stock underlying the Warrants prevailing at the time of any such sales. See "Description of Securities--Shares Eligible for Future Sale" and "Market for Securities".

13. Dilution, Issuance of Additional Securities By USA Technologies, Inc. As of March 31, 1999, the Company issued Management Options to acquire up to 384,130 shares of Common Stock, has issued GEM Warrants which are convertible into 110,000 shares of Common Stock, has issued 1998-A Warrants which are convertible into 4,000 shares of Common Stock, has issued 1998-B Warrants which are convertible into 10,100 shares of Common Stock, has issued 1999-A Warrants which are convertible into 191,900 shares of Common Stock, has issued 1997 Warrants which are convertible into 1,500 shares of Common Stock, has issued 1996-B Warrants which are convertible into 4,000 shares of Common Stock, has issued 1996 Warrants which are convertible into 86,800 shares of Common Stock, has issued 1995 Warrants which are convertible into 67,300 shares of Common Stock, has issued 660,027 shares of Preferred Stock which are convertible into 660,027 shares of Common Stock, has issued 383,800 shares of restricted Common Stock converted from 95,950 shares of Series B Preferred Stock, and has \$3,382,553 cumulative preferred dividends which are convertible into 338,255 shares of Common Stock. See "Description of Securities." In the event any or all of such securities are exercised or converted, the number of issued and outstanding shares of Common Stock would be increased. In such event, the percentage of Common Stock held by each holder of Common Stock prior to such exercise or conversion would be reduced and such exercise or conversion may have a dilutive effect on the market price of the Common Stock. If all of such securities would be exercised or converted into Common Stock, an additional 1,666,112 shares of Common Stock would be issued and outstanding as of March 31, 1999, for a total of 6,475,210 shares of Common Stock issued and outstanding. Our Company may in the future issue additional options, warrants or other securities convertible or exchangeable into Common Stock.

14. Year 2000 Compliance. Our Company has conducted a study of its business in order to determine whether its computer systems are in compliance with Year 2000 issues. In this regard, many existing computer programs use only two digits to identify a year in the date field. These programs were designed and developed without considering the impact of the upcoming change in the century. If not corrected, many computer applications could fail or create erroneous results by or at the Year 2000.

In connection with our study, we are concentrating on five areas of our business:

- (1) control system terminals;
- (2) office computers;
- (3) credit card processing systems and related accounting systems;
- (4) back-up, off-site recovery system and
- (5) non information technology systems.

The study should be completed on or before September 30, 1999. Based on the study to date, we estimate that we would incur costs of up to \$25,000 in order to be Year 2000 compliant. In reference to item two (2) above, we have already found all but two office computers to be compliant. These two computers do not process date sensitive data and therefore the Company believes they should not adversely affect operations.

Our Company is in the process of obtaining written assurances of compliance from all material third parties whose products may affect our operations.

The worst case scenario for the Company would be if the control systems in the field were all found to contain a Year 2000 problem causing inaccurate data transmissions to our main processing software. Preliminary analysis indicates the probability of this scenario actually happening is very low. The technology in the control units does not have to deal with any digits representing the year. If, however, it did happen, we anticipate utilizing the services of IBM Global Services to replace all defective units. We anticipate the cost of such services to be approximately \$150,000.

15. Ability to Service Debt; Subordination. As a result of our incurrence of indebtedness in connection with our recently completed private placement offering, we will be obligated to make substantial principal and interest payments to the holders of the Senior Notes. On December 31, 2001, we are obligated to repay the \$4,668,000 principal amount of the Senior Notes. Until the Senior Notes have been paid by us, the amount of the Senior Notes will be reflected as a liability on our financial statements. In addition, pending such repayment, our Company is required to make interest payments each calendar quarter in the amount of \$140,040, or in the amount of \$560,160 each year. The ability of our Company to satisfy its debt obligations will be dependent on its future performance and the success of its product lines. Such performance is subject to financial, business and market factors and other factors affecting our Company's business and operations.

We anticipate that the scheduled interest and principal payments required under the Senior Notes can be met from cash from operations, if any, as well as proceeds from other securities offerings. However, there can be no assurance that such interest and principal payments can be met.

The Senior Notes are unsecured and thus, in effect, will rank junior to any Senior Indebtedness, as defined therein. See "Description of Securities - 12% Senior Note." The payment of any amount owing in respect of the Senior Notes will be subordinated to prior payment in full of all existing and future Senior Indebtedness. In the event of the liquidation, dissolution, reorganization or similar proceedings with respect to the Company, assets of the Company will be available to pay obligations on the Senior Notes only after all of the Senior Indebtedness, as applicable, has been paid in full, and there can be no assurance that sufficient assets to pay amounts due on all or any of the Senior Notes will remain.

USE OF PROCEEDS

The Company will not receive any of the proceeds from the sales of the Common Stock by the Selling Shareholders. See "Selling Shareholders" for a list of those Shareholders entitled to receive net proceeds from the sales of the Common Stock. The Company would, however, receive gross proceeds upon exercise of the Selling Shareholder Warrants by the Selling Shareholders. There is no assurance that any or all of the Selling Shareholder Warrants will be exercised by the Selling Shareholders. The Selling Shareholders will receive all of the net proceeds from the sale of the Common Stock pursuant to this Prospectus. See "Description of Securities."

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

Introduction

Since January 1992, the Company has been engaged primarily in research and development activities focused on designing, developing, and marketing its credit card activated control systems. During the quarter ended June 30, 1998, the Company determined that it is no longer designated as a development stage enterprise as defined in Statement of Financial Accounting Standards No. 7 Development Stage Enterprises. The strategic alliances entered into during the year ended June 30, 1998 between the Company and MBE and between the MBE Joint Venture and IBM have provided the Company with the ability to complete its transition from a development stage enterprise to an enterprise focusing on marketing its products and its commercial operations. The Company has incurred operating losses during the years ended June 30, 1998 and 1997 of \$3,568,281 and \$3,120,712 respectively and anticipates incurring operating losses through at least the first half of fiscal 1999.

The Company's independent auditors have included an explanatory paragraph in the report on the Company's June 30, 1998 consolidated financial statements discussing issues which raise substantial doubt about the Company's ability to continue as a going concern. The Company believes that the funds available at June 25, 1999 combined with the revenues to be generated during fiscal years 1999 and 2000, the capital raised from private placement activities and the exercise of Common Stock purchase warrants, and the ability to reduce anticipated expenditures, if required, will provide for the Company to continue as a going concern.

Results of Operations

Fiscal year ended June 30, 1998:

For the fiscal year ended June 30, 1998, the Company had a net loss of \$3,568,281. The overall loss applicable to common shares of \$5,322,847 or \$(1.51) loss per common share (basic and diluted) was derived by adding the \$3,568,281 net loss and the \$1,754,566 cumulative preferred dividends and other adjustments and dividends by the weighted average shares outstanding of 3,532,048.

Revenues for the fiscal year ended June 30, 1998 of \$1,825,229, an increase of \$1,217,457 or 200% over the prior year reflecting the continued entrance of the Business Express(TM) and MBE Business Express(TM) into the marketplace.

Operating expenses for the fiscal year ended June 30, 1998 were \$5,501,650, representing a \$1,758,689 or increase over the prior year. The primary contributors to this increase were cost of sales, general and administrative and compensation expenses, as discussed below.

Cost of sales increased by \$736,639 from the prior year, primarily reflecting the increase in MBE Business Express(TM) business during fiscal year 1998. General and administrative expenses of \$2,213,984 increased by \$173,821 or 8.5% which reflects both a general increase in spending to support the expansion of operations and other factors as described below. Specifically, the major contributors to this increase were: reserves of \$87,520 established in fiscal year 1998 to cover estimated future field service warranty expenses for the Company's C3X terminals; marketing promotions and trade show expenses increased \$64,901 or 59.0%; and advertising increased by \$125,204 or 143%, reflecting the need to increase product awareness in the marketplace. Certain other increases were experienced in outside services, telephone, and office supplies. Certain other expenses decreased as compared to the prior year, primarily professional and consultant fees, which decreased by \$109,916 or 20%.

Compensation expense was \$1,909,682, an increase of \$829,224 or 76.7% over the previous year. The increase was primarily due to the non-cash expense of \$554,630 which reflects the compensation charge recorded for the repricing of the common stock options below fair market value during April 1998. The remainder of the increase is due to increased personnel requirements in the operations and sales areas.

Depreciation expense of \$116,255 increased by \$19,005, which is attributable to the increased depreciable asset base.

Fiscal year ended June 30, 1997:

For the fiscal year ended June 30, 1997, the Company had a net loss of \$3,120,712. Overall this loss reflects the continuing development stage activities of the Company. The Company's preferred stock provides for an annual cumulative dividend of \$1.50 per share payable to the shareholders of record on February 1 and August 1 each year as declared by the Company's Board of Directors. The \$4,364,007 loss applicable to common shares or \$2.08 loss per common share was derived by adding the \$3,120,712 net loss and the \$1,243,295 of cumulative preferred dividends earned for the year ending June 30, 1997, and dividing by the weighted average shares outstanding, of 2,098,438.

Revenues for the period were \$607,772, which increased \$554,793 from last year, primarily reflecting the sales of the Business Express(TM) product line.

Operating expenses for the fiscal year ended June 30, 1997 were \$3,742,961, representing a \$1,212,166 or 47.9% increase over the prior year. The primary contributors to this increase were cost of sales, general and administrative expense and compensation, as detailed below.

Cost of sales increased by \$525,090 from the prior year, reflecting the first year of equipment sales. The cost of equipment sales increased \$473,529 and the cost of license fee revenues increased \$51,561. General and administrative expense of \$2,040,163 increased sharply by \$528,882 or 35.0% which reflects both a general increase in spending to support the expansion of operations as well as several non-operational factors. Specifically the major contributors to this increase were: Travel and lodging increased by a total of \$66,393, which reflected significant marketing related travel as well as an increase in travel for the increased numbers of installations. Marketing promotions, mailings and trade show expenses increased \$110,147. Advertising increased by \$26,000, reflecting the need to increase product awareness in the marketplace. Professional and consultant fees increased by \$86,770, reflecting increased legal, public relations and patent activity. Product development expense increased \$119,852 primarily due to developmental costs for new customers. The balance of the increase includes temporary services, telephone, office expense, and postage.

Compensation expense was \$1,080,458, an increase of \$177,060 or 19.6% over the previous year. This increase was primarily due to headcount increases in the sales function and to a lesser extent, operations. The cost of employee benefits also rose by \$34,468.

Depreciation expense of \$97,250 increased by \$25,234, which is attributable to the increased depreciable asset base.

Three And Nine Months Ended March 31, 1999:

The fiscal quarter ended March 31, 1999 resulted in a net operating loss of \$758,643 compared to a net loss of \$643,317 for the comparable fiscal quarter ended March 31, 1998. Losses are projected to continue until sufficient revenue is generated from equipment sales and licensing fees from the Company's proprietary technology.

Revenues were \$997,436 compared to \$548,208 from the previous year's fiscal quarter. This \$449,228 or 82% improvement reflects the success of the Company's sales efforts and the increasing marketplace acceptance of the Company's products. Of the total revenues, equipment sales totaled \$864,343, an increase of \$387,104 or 81% over the same period last year. License fees increased to \$133,093 from \$70,969 for the same period during the prior year, an increase of 87%. Despite these gains, revenue is still well below the level required for the Company to be profitable.

Cost of equipment sales for the period included labor and equipment of \$684,836 which represented an increase of \$304,363 over the same period during the prior year, and is directly attributable to the increase in equipment sales described above.

General and administrative expenses of \$616,069 increased by \$148,025 or 32% from the same quarter last year. The principal reason was a large increase in legal costs of \$226,077 to pay for activities related to the pending litigation with MBE. See "Business - Legal Proceedings." Without this legal cost, overall general and administrative costs would have decreased by \$78,052. Other components of general and administrative costs included increases in professional fees of \$45,805, and increases in trade show expenses of \$14,480; offset by reductions in advertising costs of \$42,154, product development cost reductions of \$23,994, and reductions in travel and entertainment of \$57,660.

Compensation expense of \$336,674 increased by 5% due to increased personnel requirements in all areas of the Company. Depreciation and amortization expense increased from \$25,497 to \$31,710.

Accounts payable has increased substantially from June 30, 1998 due to the increased activity resulting from increased operations and increased expenses. Inventory and accounts payable both increased due to preparation for activity anticipated in the fourth quarter of fiscal year 1999.

As of March 31, 1999, the Company had an installed base of a total of 1,224 control systems, distributed as follows: 1,068 Business Express(TM) or MBE Business Express(TM) control systems, 45 Copy Express(TM) control systems, 33 Debit Express(TM) control systems, 9 Fax/Printer Express(TM) control systems, and 69 Public PC(TM) control systems located at various hotels and libraries throughout the United States and Canada. The total Business Express(TM) or MBE Business Express(TM) locations as of March 31, 1999 is 290, compared to 100 locations as of March 31, 1998. The total license fee revenues received by the Company from these systems has been increasing but is still well below the level required to achieve profitability.

The nine month period ended March 31, 1999 resulted in a net operating loss of \$2,138,780 compared to a net loss of \$2,046,813 for the comparable period ended March 31, 1998. Revenues were \$3,340,282 compared to \$1,280,012, a \$2,060,270 or 161% improvement. Of the total revenues, equipment sales totaled \$3,021,727, an increase of \$1,924,766 or 175%. Cost of sales of \$2,576,394 represented an increase of \$1,646,784, and is directly attributable to the increase in equipment sales. General and administrative expenses of \$1,614,407 increased by \$254,445 or 19%. The principal reason was a large increase in legal fees of \$358,586 to pay for activities related to the pending litigation with MBE. Without this legal cost, overall general and administrative costs would have decreased by \$104,141. Other components of general and administrative costs included increases in outside marketing and operational services of \$72,001, and increased charges for warranty cost coverage of \$26,648; offset by reductions in consultant and professional fees of \$113,341 and reductions in travel and entertainment of \$102,884. Compensation expense of \$1,025,154 increased by 6% due to permanent and increased personnel requirements in all areas of the Company.

Plan of Operations

On May 14, 1999, the Company signed a new agreement with International Business Machines (IBM). This agreement expanded the original agreement whereby IBM will install USA products in 1,000 locations, to 5,000 locations. In addition, the new agreement includes a wider array of Company products which are eligible for such installations.

The Company introduced in June 1999 its next generation of terminal, which has received the approval for the trademark "e-port." This new terminal contains all the functionality of the current TransAct(TM) terminal for card processing, control and data management, and in addition offers capability for public access electronic commerce and advertising using the internet.

Three patents have been filed for e-port(TM), raising the total to fifteen patents filed covering various Company products. Two patents have been issued. Two other patents have received notices of allowance, one for a vending application and one for the dataport. This vending patent, in conjunction with e-port(TM), may allow the Company to explore the vending market. Other markets may also be available with e-port(TM), such as retail point of sale. See "Risk Factors - Dependence on Proprietary Technology's Patent Issues."

The Company has developed a product line extension to its flagship Business Express(TM) product, called the Business Express(TM) Limited Service Series (LSS). The LSS has copier and fax capabilities plus laptop printing, dataport capabilities and credit card activated phone. The LSS is targeted to the hospitality industry, which includes mid-market, limited service and economy properties. On May 14, 1999, as part of the Company's marketing effort for LSS, an Agreement was reached with Choice Hotels (franchisor of approximately 3,000 Comfort, Clarion and Sleep brand hotels) which reflects Choice's commitment to promote the LSS internally to its hotels.

An additional market which the Company is beginning to explore with current TransAct(TM) technology is apartments. Approximately 27,000 operators of apartment buildings in the United States have been identified as potential users of the Company's products. The first installation in an apartment complex has already occurred at a site in Maryland.

The Company is currently marketing its products through its full-time sales staff consisting of three national accounts salespeople, three telephone salespeople and one director of marketing, either directly to customer locations or to management companies servicing these locations.

Liquidity and Capital Resources

During the fiscal year ended June 30, 1998, the Company completed a number of equity transactions. Net proceeds of \$761,510 were realized from private placement offerings of Series A Preferred Stock and \$1,530,639 were realized from Common Stock transactions, principally the exercise of Common Stock Purchase Warrants. As of June 30, 1998, the Company had negative working capital of \$5,312, which included cash and cash equivalents of \$324,824 and inventory of \$436,971.

During the fiscal year ended June 30, 1998, net cash of \$2,578,597 was used by operating activities, primarily due to the net loss of \$3,568,281. The net cash provided by financing activities of \$2,273,878 was principally due to the net proceeds generated from the issuance of securities as described in the prior paragraph.

The Company's independent auditors have included an explanatory paragraph in their report on the Company's June 30, 1998 consolidated financial statements discussing issues which raise substantial doubt about the Company's ability to continue as a going concern. The Company believes that the funds available at June 30, 1998 combined with the revenues and earnings to be generated during fiscal year 1999, the potential capital to be raised from private placement activities and the exercise of the Common Stock Purchase Warrants, and the ability to reduce anticipated expenditures, if required, will provide for the Company to continue as a going concern through at least June 30, 1999. There can be no assurance, however, that adequate revenues and earnings will be generated during the 1999 fiscal year or that sufficient capital can be raised by the Company. In such event, the Company may cease to be a going concern or may have to reduce its operations or operating procedures.

During July and August 1998, the Company engaged in a private placement offering pursuant to Regulation D promulgated under the Act. The offering consisted of units at \$10,000 each, with each unit consisting of 2,000 shares of Preferred Stock and 5,000 1998-B Warrants. The 1998-B Warrants enable the holder to purchase one share of Common Stock for \$1.50 on or before January 1, 1999, and for \$4.00 through September 1, 2003. The offering commenced on or about July 31, 1998, and terminated on August 17, 1998. The Company sold 27.8 units, generating gross proceeds of \$278,000.

For the nine month period ended March 31, 1999, there was a net increase in cash of \$37,688. This was attributable to using \$1,245,213 for operating activities, partially offset by net proceeds of \$883,192 raised pursuant to the private placement offering described in the following paragraph, \$193,775 raised through the exercise of Common Stock purchase warrants and options, and net proceeds of \$234,485 raised through the issuance of Series A Preferred Stock. As of March 31, 1999, total cash on hand was \$362,512, and the working capital deficit was \$764,993 of which \$790,860 was invested in inventory.

From September 1998 through June 23, 1999, the Company engaged in a private placement offering of 500 units at a unit price of \$10,000. Each unit of the Offering consisted of a 12% Senior Note in the principal amount of \$10,000, 2,000 1999-A Warrants, and 1,000 shares of Series B Preferred Stock. Each share of Series B Preferred Stock was converted into 4 shares of Common Stock as a result of the June 7, 1999 reverse stock split of the Common Stock. The Company sold an aggregate of 466.8 units or an aggregate of \$4,668,000 pursuant to the offering.

In connection with the offering described above, in January 1999 the Board of Directors approved a commitment by the President to purchase 10 units for \$100,000. The President will pay for the units by foregoing payroll from April 1, 1999 through June 30, 2000. The President has also directly purchased 10 additional units for \$100,000.

During the quarter ended March 31, 1999, 128,900 Common Stock purchase warrants were exercised at \$1.00 per share, resulting in proceeds to the Company of \$128,900 and 45,000 Common Stock options were exercised at \$1.00 per share, resulting in proceeds of \$45,000.

As of June 30, 1999, the Company had cash on hand of approximately \$1,700,000. The Company believes that these funds, together with funds available from the potential exercise of outstanding warrants and options, plus increased revenues from its business would be sufficient to fund operations until at least through the quarter ended December 31, 1999. There can be no assurance that any such additional sales of securities could be made by the Company or that increased revenues would result from its business activities. In such event, the Company may cease to be a going concern or may have to reduce its operations. Since the cash received in exchange for the Senior Notes does not add to shareholder equity but is reflected as a liability, a shareholder deficit has arisen. The Company anticipates that improved operating results and exercise of warrants or options would turn the current deficit into positive shareholder equity.

Commitment

The Company leases 7,000 square feet in Wayne, Pennsylvania for a monthly rental of \$5,000 plus utilities and operating expenses. The lease expires on October 15, 1999.

During May 1998, the Company, on behalf of the MBE Joint Venture, entered into a commitment to acquire 1,500 control systems for \$779,865. As of June 17, 1999, there is an amount of approximately \$420,000 remaining unpaid thereon. The MBE Joint Venture currently owes IBM approximately \$800,000 (which includes the \$420,000 referred to in the prior sentence) in connection with control systems and equipment ordered by the MBE Joint Venture. The Company is currently attempting to come to an agreement with MBE pursuant to which the amount due to IBM would be paid. As of June 17, 1999, the MBE Joint Venture had an inventory of approximately 700 control systems.

BUSINESS

USA Technologies, Inc., a Pennsylvania corporation (the "Company"), was founded in January 1992. The Company is an owner and licensor of automated, credit card activated control systems for use in connection with copying machines, debit card purchase/revalue stations, facsimile machines, personal computers and computer printers.

The Company generates its revenues from the sale of equipment utilizing its control systems, as well as from retaining a portion of the revenues generated from all credit card transactions conducted through its control systems, and from monthly administrative fees paid by various locations utilizing its control systems. The Company also anticipates generating revenues from electronic commerce and advertising through the expansion of its technology to allow advertisers and merchants to conduct business transactions for goods and services.

The Company has entered into agreements which establish itself as a preferred supplier of business center products to two of the top hospitality companies in the world: Choice Hotels International (Clarion, Quality, Comfort, Sleep Inns), and Promus Hotel Corporation (Embassy Suites, Hampton, Doubletree). The agreement with Choice Hotels International was entered into in April 1997 and has been renewed through April 1999 and the agreement with Promus Hotels, Inc. was entered into in May 1997. The agreement with Choice is for one year and is automatically renewed from year to year unless terminated upon at least 30 days notice prior to the end of any one year period. The agreement with Promus is for a term of three years and may be terminated by either party for any reason upon at least 90 days written notice. The agreements provide that Choice or Promus, as the case may be, would promote the products of the Company to its owned, franchised and licensed properties at the prices set forth in the agreements. The agreements do not obligate Choice, Promus, or any other party to purchase any of the Company's products. Through June 30, 1998, Business Express(TM) have been installed in 18 Choice Hotels and in 19 Doubletree or Embassy Suites. In addition, the Company's Business Express(TM) has been approved and recommended as a solution by Marriott for its hotels to satisfy an identified Business Service Center need. The recommendation was set forth in an interoffice memo from Marriott corporate to its hotels and was distributed during September 1997. Through June 30, 1998, Business Express(TM) Units have been installed in 16 Marriott properties.

On September 24, 1997, the Company entered into a Joint Venture Agreement with Mail Boxes Etc. USA, Inc. ("MBE"), the leading franchisor of postal, business, and communications retail service centers, (the "MBE Joint Venture"). The MBE Joint Venture shall exclusively sell and market unattended, credit card activated business centers under the name MBE Express(TM) to the hospitality industry, travel industry, convention centers, colleges, universities, supermarkets, banks, military, convenience stores, and mass merchandisers located in the United States.

On February 17, 1998, Prime Hospitality Corp. ("Prime") entered into an agreement with the MBE Joint Venture pursuant to which Prime would purchase 100 MBE Business Express(TM) units for installation at Prime's owned and managed hotels. The agreement provided that Prime would purchase the first six units on a trial basis. If the 90-day trial period was successful, then Prime would order the remaining 94 units. The agreement provides for a purchase price of approximately \$2.0 million for all 100 units.

On June 19, 1998, the Company received notification from Prime that the trial period was successful, and Prime would adopt the MBE Business Express(TM) as a brand standard at all of its AmeriSuites properties. Pursuant to the agreement, Prime has purchased 94 additional MBE Business Express(TM) units through March 31, 1999.

On May 14, 1999, the Company notified MBE that the Company was terminating the Joint Venture Agreement. The Joint Venture Agreement provided that it could be terminated at any time by either partner if the other partner breached any material term or condition of the agreement; provided that the terminating partner allowed the other partner at least a sixty day period to cure any alleged breach.

As required under the Joint Venture Agreement, on February 4, 1999 and February 19, 1999, the Company delivered to MBE notice that MBE was in default of the Joint Venture Agreement in connection with five separate items, and demanded that MBE cure the breaches within sixty days. Through the date of the termination of the Joint Venture Agreement, MBE failed to cure any of the breaches and had not otherwise taken any steps to remedy the breaches.

The Company's May 14, 1999 letter to MBE states five reasons for the termination: MBE's refusal to authorize the installation of data port terminals as required under the sales agreement between the joint venture and a customer; MBE's refusal to allow the joint venture to market and sell the data port terminals; MBE's ongoing failure to commit adequate and appropriate resources to joint venture sales and marketing to effectuate a reasonable number of sales of joint venture business center equipment; MBE's failure to acknowledge the Company's ownership of the trademark "Business Express" and its actions inconsistent with the Company's ownership of the mark; and MBE's refusal to timely meet with the Company to discuss and conclude a joint venture sales and marketing budget for the fiscal year commencing April 1, 1999.

As of the date hereof, there are approximately 200 MBE Express(TM) units at commercial locations. The Company will continue to perform all of its obligations under the Joint Venture Agreement in connection with the operation of these units. See "Business-Procurement."

The Company and MBE are currently involved in litigation against each other in the Federal District Court for the Southern District of California. See "Business--Legal Proceedings."

The Company has entered into corporate agreements which establish itself as a preferred supplier of business center products to two of the top hospitality companies in the world: Choice Hotels International (Clarion, Quality, Comfort, Sleep Inns), and Promus Hotel Corporation (Embassy Suites, Hampton, Doubletree). In addition, the Company's Business Express(TM) has been approved and recommended as a solution by Marriott for its hotels.

The Company has been certified by PNC Merchant Services (a subsidiary of First Data Corporation), a leading credit card processor in the United States. PNC Merchant Services has extended to the Company a fixed rate percentage processing charge in connection with the credit card transactions conducted through the Company's control systems. This charge is payable by the Company (not the locations) out of its share of the gross proceeds.

The Control Systems

The Company has developed unattended, credit card activated control systems that are being utilized in connection with photocopying machines, debit card purchase/revalue stations, personal computers, facsimile machines and computer printers.

In order to activate the equipment attached to the Company's control systems, the consumer must swipe a valid credit card through the control system. The control system then transmits this request to the credit card processor. The credit card processor verifies that the credit card is valid and authorizes the transaction. The control system then activates the equipment for use by the consumer. Each control system acts as an off-line terminal that has the ability to communicate with the Company. When the consumer has finished using the equipment, the control system transmits a record of the transaction to the Company's computer center and prints a record of the transaction for the consumer. On a daily basis, the Company transmits the transaction information collected from all of its installed control devices to the credit card processor. The credit card processor electronically transfers the proceeds derived from these transactions, less the credit card processor's charge, to the Company. The Company then forwards a check to the location of the equipment representing the location's share of the proceeds along with a report reflecting the usage of each piece of equipment attached to the control systems.

As of March 31, 1999, the Company had 1,068 Business Express(TM) control systems, 45 Copy Express(TM) control systems, 33 Debit Express(TM) control systems, 9 Fax/Printer Express(TM) control systems, and 69 Public PC(TM) control systems located at various hotels and libraries throughout the United States and Canada. Through March 31, 1999, the total gross revenues received by the Company from these systems has not been sufficient to cover operating expenses.

For the years ended June 30, 1998 and 1997, and the nine month period ended March 31, 1999, the Company has spent approximately \$199,000, \$344,000 and \$109,092, respectively, for the development of its technology. These amounts include the expense of outside consultants and contractors as well as compensation paid to the Company's employees and included in Compensation in the consolidated financial statements.

Industry Trends

With trends over the last twenty years indicating an ever increasing customer reliance on the use of credit cards as a method of payment, the Company believes the future of purchasing retail products and services is in credit cards rather than cash. For example, according to the New York Times on November 20, 1994, in 1970 the average balance on credit cards in the United States was \$649; by 1986 it was \$1,472, and in 1994 it was \$2,800. According to Time Magazine, May 9, 1994, from 1986 to 1994, the number of credit card transactions in the United States increased 200% compared to an increase of 17% for cash and check transactions. According to the Nilson Report (1999), the value of world-wide credit card transactions doubled from approximately \$.8 trillion in 1992 to approximately \$1.6 trillion in 1998. Consumers are constantly searching for ways to purchase quality products and services in the most convenient manner. Examples of this trend include the increasing use of unattended, Automated Teller Machines ("ATM's") in banking transactions and the use of unattended, self-service gasoline pumps with credit and debit card payment capabilities. In addition, consumers are becoming more accustomed to using credit cards as a method of payment in an ever increasing array of retail and service settings. Almost every department store, restaurant and supermarket accepts credit card payments. Consumers are increasingly using mail order, telephone and the Internet to order goods and services and are using credit cards to pay for these goods and services. In response to this increasing consumer demand for convenience and this increasing consumer acceptance of credit cards as a method of payment, the Company has focused its efforts towards developing and marketing its unattended, credit card activated control systems.

The Business Express(TM)

The Company believes that the hotel/motel hospitality industry continues to expand, but has become more competitive as the industry increases its efforts to attract the business traveler. The Company also believes that business travelers and conference attendees account for the majority of hotel occupancy, stay longer and spend more per visit than the leisure traveler. For these reasons, the Company believes that the hospitality industry has become very responsive to the needs of the business traveler. The Business Express(TM) enables a hotel or conference center to offer an unattended business center to its guests. The Business Express(TM) is credit card activated, therefore eliminating the need for an attendant to provide change, process credit cards, or calculate the charges for the use of the equipment.

The Business Express(TM) utilizes the Company's existing control systems for use in connection with computers, photocopying machines, computer printers, and facsimile equipment, and combines them into a branded product. A typical Business Express(TM) unit could include a personal computer and laser printer, a photocopying machine and a facsimile machine, the corresponding control systems, as well as work station furniture. However, a location can custom order its unit to include any combination of equipment and corresponding control system. Furthermore, the location could add additional equipment in the future.

The Company assists the location in the design of the unit, including selecting a layout and furniture for the equipment. To date, the Company has sold business equipment to the locations, has supplied Company owned equipment to certain locations and has supplied control systems to location for use with location owned equipment. In all such cases, the Company licenses the control systems to the locations and receives a fixed percentage (approximately 5.0%) of the proceeds generated from any transactions.

The MBE Business Express(TM)

On September 24, 1997, the Company entered into the MBE Joint Venture Agreement with Mail Boxes Etc. USA, Inc. ("MBE"), the leading franchisor of postal, business, and communications retail service centers (the "MBE Joint Venture"). During the term of the MBE Joint Venture, the MBE Joint Venture shall exclusively sell and market unattended, credit card activated business centers under the name MBE Express(TM) to the hospitality industry, travel industry, convention centers, colleges, universities, supermarkets, banks, military, convenience stores, and mass merchandisers located in the United States. Through March 31, 1999, the MBE Joint Venture has sold and installed approximately 200 MBE Business Express(TM) business centers. The Company and MBE are currently involved in a litigation involving, among other matters, the MBE Joint Venture. See "Business-Legal Proceedings."

The MBE Express(TM) bundles together the same components as the Business Express(TM): Public PC(TM), Copy Express (TM), and Fax Express(TM), but under the MBE brand name. In addition, the MBE Express(TM) includes a dial-through service to a nearby MBE store making available the products and services of the store.

On May 14, 1999, the Company notified MBE that the Company was terminating the Joint Venture Agreement. The Joint Venture Agreement provided that it could be terminated at any time by either partner if the other partner breached any material term or condition of the agreement; provided that the terminating partner allowed the other partner at least a sixty day period to cure any alleged breach.

As required under the Joint Venture Agreement, on February 4, 1999 and February 19, 1999, the Company delivered to MBE notice that MBE was in default of the Joint Venture Agreement in connection with five separate items, and demanded that MBE cure the breaches within sixty days. Through the date of the termination of the Joint Venture Agreement, MBE failed to cure any of the breaches and had not otherwise taken any steps to remedy the breaches.

The Company's May 14, 1999 letter to MBE states five reasons for the termination: MBE's refusal to authorize the installation of data port terminals as required under the sales agreement between the joint venture and a customer; MBE's refusal to allow the joint venture to market and sell the data port terminals; MBE's ongoing failure to commit adequate and appropriate resources to joint venture sales and marketing to effectuate a reasonable number of sales of joint venture business center equipment; MBE's failure to acknowledge the Company's ownership of the trademark "Business Express" and its actions inconsistent with the Company's ownership of the mark; and MBE's refusal to timely meet with the Company to discuss and conclude a joint venture sales and marketing budget for the fiscal year commencing April 1, 1999.

As of the date hereof, there are approximately 200 MBE Business Express(TM) units at commercial locations. The Company will continue to perform all of its obligations under the Joint Venture Agreement in connection with the operation of these units. See "Business-Procurement."

The Copy Express(TM)

Traditionally, customers wishing to use a photocopying machine have either used a prepaid, stored value card or cash. In most circumstances, this places a burden on employees of the facility to provide a number of services unrelated to their primary jobs, such as providing change, coin collecting, coin counting and coin reloading. By utilizing the Copy Express(TM) control system, the location's attendant no longer is required to interact with the customers for these purposes.

The Copy Express(TM) control system provides a cashless method to pay for the use of photocopying machines. The device is attached to the photocopying machine, computer printer, or microfilm/fiche printer in a similar manner as attaching a standard coin acceptor. The device can be attached to either existing or new equipment. The control system enables customers to photocopy documents with the use of a credit card.

To date, the Company has licensed the control systems to university and public libraries to be attached to their photocopying machines. The Company receives a fixed percentage of the proceeds generated from any transactions and the location receives the balance of the proceeds. As of March 31, 1999, there were 45 Copy Express(TM) control systems and 9 Fax Express(TM) control systems installed in various locations. Since almost all of these units were placements rather than sales, nominal equipment sales were realized through March 31, 1999.

The Debit Express(TM)

Many "closed" environments such as universities utilize a private card system to store cash value known as a debit or "stored value" card. Pursuant thereto, customers transfer lump sum cash values onto a magnetic stripe or imbedded chip card that can be used to activate equipment within the closed environment. As the cardholder uses the card to purchase products or services the cash value is deducted from the total value on the card.

The Company's Debit Express(TM) enables customers to purchase or revalue their debit cards with a credit card and eliminates the need for cash or for an attendant to handle cash, provide change or process credit card transactions. The Debit Express(TM) eliminates any reliance on cash by allowing customers to use a credit card to purchase or place additional value on a debit card.

The Public PC(TM)

The Company's Public PC(TM) (formerly known as the Credit Card Computer Express(TM)) is an automated, credit card activated control system which can be used in connection with general use of a personal computer, as well as for the use of on-line services, including the Internet, and for the use of a laser printer. The Company believes that the growing dependence on personal computers and related services that are accessed through personal computers, such as the Internet and e-mail, has created an environment where there is a need for access to personal computers by the general public on an "as needed" basis. The Company's control system enables locations such as public libraries, hotels and convention centers, airports and retail locations to offer the use of personal computers to the public on an "as needed" basis utilizing credit cards as a method of payment. The Public PC(TM) is designed so that an attendant is not required to process credit card transactions, provide change, or calculate charges for the use of the equipment.

The Company licenses its control system to locations to be attached to their personal computers. Alternatively, the Company may supply the location with a computer system owned by the Company and license the control system to the location for use with the Company's equipment. The Company receives a fixed percentage of the proceeds generated from any transactions and the location receives the balance thereof.

During fiscal 1997, the Company commenced selling personal computers and laser printers to the locations in addition to only licensing the control system. See "Business - Marketing." In connection with any such sales, the Company would realize revenues from the sale of the equipment and also receive a percentage of the proceeds generated from any credit card transactions. In addition, in some cases, the Company receives a negotiated monthly administrative fee.

As of March 31, 1999, there were 69 stand alone Public PC(TM) control systems (not including PC's which are part of Business Express(TM)) installed at various public libraries, hotels and retail locations. These units resulted in over \$200,000 in equipment sales through March 31, 1999.

Marketing

As of March 31, 1999, the Company is marketing its products through its full-time sales staff consisting of eight persons, either directly to locations or through facility management companies servicing the locations. The Company believes the agreements with Minolta, Choice Hotels International and Promus Hotel Corporation are an important component of the Company's effort to market the Business Express(TM) to the hospitality industry because they provide instant brand name recognition.

Procurement

The Company's control system devices consist of a card reader, printer, amplifier, circuit board and micro chip in a specially designed housing. The devices are currently manufactured to the Company's design specification by an independent contractor, LMC - Autotech Technologies, LP. In May 1998, the Company on behalf of the MBE Joint Venture contracted for the purchase of 1,500 control devices, for a total purchase price of \$779,865. The Company anticipates obtaining its complete computer systems (other than the Public PC (TM) control system) from IBM. As of June 17, 1999, there is an amount of approximately \$420,000 remaining unpaid on the May 1998 control system order. The MBE Joint Venture currently owes IBM approximately \$800,000 (which includes the \$420,000 referred to in the prior sentence) in connection with control systems and equipment ordered by the MBE Joint Venture. The Company is currently attempting to come to an agreement with MBE pursuant to which the amount due to IBM would be paid. See "Business - Legal Proceedings." As of June 17, 1999, the MBE Joint Venture had an inventory of 691 control systems.

Competition

There are companies presently offering automated, credit card activated control devices in connection with facsimile machines, personal computers, Internet and e-mail access, and debit card purchase/revalue stations which are in direct competition with the Company's products including Business Express(TM) and Public PC(TM). In addition, the businesses which have developed unattended, credit card activated control systems currently in use in connection with gasoline dispensing, public telephones, prepaid telephone cards, ticket dispensing machines, or vending machines, are capable of utilizing their control systems in direct competition with the Company. Many of these businesses are well established, have substantially greater resources than the Company and have established reputations for success in the development, sale and service of high quality products. Such competition may result in lower percentages of gross revenues being retained by the Company in connection with its licensing arrangements, or otherwise may reduce potential profits or result in a loss of some or all of its customer base. To the extent the Company's competitors are able to offer more attractive technology, the Company's ability to compete could be materially and adversely affected. The Company is also aware of several businesses which make available use of the Internet and use of personal computers to hotel guests in their hotel rooms on an "as-needed" basis. Although these services are not credit card activated, such services would compete with the Company's Business Express(TM), and the location may not order the Business Express(TM), or if ordered by the hotel, the hotel guest may not use it. See "Risk Factors - Competition."

Patents, Trademarks and Proprietary Information

The Company has applied for federal registration of its trademarks Business Express(TM), TransAct(TM), Copy Express(TM), C3X(TM), and Printer Express(TM), and Debit Express(TM). There can be no assurance, however, that any of such applications will be granted or that the Company will continue to maintain or prosecute all of such applications.

Much of the technology developed or to be developed by the Company is subject to trade secret protection. To reduce the risk of loss of trade secret protection through disclosure, the Company has entered into confidentiality agreements with its key employees. There can be no assurance that the Company will be successful in maintaining such trade secret protection or that others will not capitalize on certain of the Company's technology.

As of March 31, 1999 the Company has applied for fifteen United States patents related to its cashless technology, and has applied for certain corresponding foreign letters patent in connection therewith. In April 1997, the United States Patent Office granted the Company's patent number 5,619,024 entitled "Credit Card and Bank Issued Debit Card Operated System and Method for Controlling and Monitoring Access of Computer and Copy Equipment." In June 1997, the United States Patent Office granted the Company's patent number 5,637,845 entitled "Credit and Bank Issued Debit Card Operated System and Method For Controlling a Prepaid Card Encoding/Dispensing Machine." As of the date hereof, notices of allowance have been granted for two other patents, and the remaining eleven applications are pending and have not been granted. There can be no assurance that the Company will continue to maintain and prosecute the remaining pending applications. See "Risk Factors - Dependence on Proprietary Technology; Patent Issues" and "Business - Legal Proceedings."

Year 2000 Compliance

The Company has recently commenced a study of its business in order to determine whether its computer systems are in compliance with Year 2000 issues. In this regard, many existing computer programs use only two digits to identify a year in the date field. These programs were designed and developed without considering the impact of the upcoming change in the century. If not corrected, many computer applications could fail or create erroneous results by or at the Year 2000.

In connection with our study, we are concentrating on five areas of our business:

- (1) control system terminals;
- (2) office computers;
- (3) credit card processing systems and related accounting systems;
- (4) back-up, off-site recovery system and
- (5) non information technology systems.

The study should be completed on or before September 30, 1999. Based on the study to date, we estimate that we would incur costs of up to \$25,000 in order to be Year 2000 compliant. In reference to item two (2) above, we have already found all but two office computers to be compliant. These two computers do not process date sensitive data and therefore the Company believes they should not adversely affect operations.

The Company is in the process of obtaining written assurances of compliance from all material third parties whose products may affect the Company's operations.

The worst case scenario for the Company would be if the control systems in the field were all found to contain a Year 2000 problem causing inaccurate data transmissions to the Company's main processing software. Preliminary analysis indicates the probability of this scenario actually happening is very low. The technology in the control units does not have to deal with any digits representing the year. If, however, it did happen, the Company anticipates utilizing the services of IBM Global Services to replace all defective units. The Company anticipates the cost of such services to be approximately \$150,000.

Employees

As of March 31, 1999, the Company has twenty-three full-time employees.

Properties

The Company leases its principal executive offices, consisting of approximately 7,000 square feet, at 200 Plant Avenue, Wayne, Pennsylvania for a monthly rental of \$5,000 plus utilities and operating expenses. The lease expires on October 15, 1999.

Legal Proceedings

In June 1994, a former employee and Director of the Company filed a complaint against the Company in the Court of Common Pleas of Montgomery County, Pennsylvania. The complaint alleges that the Company engaged in age discrimination in violation of the Pennsylvania Human Relations Act in connection with his termination of employment. The trial of this matter was held in July 1998, and on August 28, 1998 the Court entered an Order in favor of the Company and against the former employee. The Court's decision states that the former employee failed to prove any age discrimination. On September 14, 1998, the former employee appealed the Court's decision as well as other prior orders rendered in the matter to the Superior Court of Pennsylvania.

In June 1998, the Company filed a complaint in the District Court of the Eastern District of Pennsylvania against Alphanet Hospitality Systems, Inc. ("Alphanet Hospitality") and Alphanet Telecom, Inc. ("Alphanet Telecom") (collectively "Alphanet"). The complaint alleges that the Defendants engaged in patent infringement, breach of contract, misappropriation of trade secrets, unfair competition and tortious interference with prospective business relations. The Company and Alphanet Hospitality had previously considered entering into a business relationship. In order to protect the Company's confidential information and trade secrets, Alphanet Hospitality signed a Non-Disclosure and Non-Use Agreement as part of the negotiation process. Alphanet terminated the negotiations and the relationship with the Company. Shortly thereafter, Alphanet began marketing an unattended business center similar to the Company's Business Express(TM). The Company believes that Alphanet wrongfully used the confidential information and trade secrets it became privy to during the negotiations, to develop its product. The Company is seeking damages and injunctive relief. On September 14, 1998, Alphanet filed an answer to the Complaint denying any liability to the Company. Alphanet also filed a counterclaim against the Company seeking a declaratory judgment that the Company's patents are invalid or, in the alternative, there is no patent infringement. The counterclaim also seeks damages against the Company for unfair competition and product disparagement.

In September 1998, MBE commenced a legal action against the Company in the Superior Court of the State of California, San Diego County. The complaint alleges that the 195 terminals purchased by MBE from the Company in September 1997 were defective, and seeks a refund of the purchase price in the amount of \$141,260 as well as lost profits claimed to be several hundred thousand dollars. In addition, the complaint seeks a declaratory judgment that MBE is not obligated to purchase the 600 terminals ordered from the Company in April 1998. In October 1998, the Company had the case removed to the United States District Court for the Southern District of California. The Company believes the claim to be without merit and that it will prevail in this action. Accordingly, there has been no provision recorded for this action in the accompanying consolidated financial statements.

In December 1998, the Company filed an answer and Counterclaim to the Complaint of MBE. The answer denies the allegations of MBE's complaint and denies that MBE is entitled to any of the relief requested in the complaint.

The Counterclaim of the Company alleges that MBE breached the Joint Venture Agreement by among other things, utilizing a competitor of the Company in connection with MBE's in-store computer workstation project ("ICW Project"), for which project the Company believes MBE must purchase USA's terminals. The counterclaim also alleges that by attempting to cancel its written purchase order with the Company for 600 terminals, MBE has breached such purchase order. The Counterclaim includes claims by the Company against MBE for breach of contract, breach of fiduciary duty, and trade libel. The Counterclaim seeks recovery from MBE of monetary damages caused by MBE's actions, including lost profits, consequential damages and/or incidental damages, and punitive damages. The total counterclaims are for an amount in excess of \$10 million. The Company has also requested a declaration that MBE is required to use the Company in connection with its ICW Project and prohibiting MBE from continuing to breach the Joint Venture Agreement. As of the date hereof, limited discovery has been conducted by the parties and no trial date has been set. By court order, discovery is to be completed by December 3, 1999.

In September 1998, the Company had commenced arbitration proceedings against MBE in connection with MBE's breach of the Joint Venture Agreement. In December 1998, the parties agreed that the arbitration proceedings would be terminated, and the Company would proceed with all of its claims against MBE in the pending Federal Court action described above.

On May 14, 1999, the Company notified MBE that the Company was terminating the Joint Venture Agreement. The Joint Venture Agreement provided that it could be terminated at any time by either partner if the other partner breached any material term or condition of the agreement; provided that the terminating partner allowed the other partner at least a sixty day period to cure any alleged breach.

As required under the Joint Venture Agreement, on February 4, 1999 and February 19, 1999, the Company delivered to MBE notice that MBE was in default of the Joint Venture Agreement in connection with five separate items, and demanded that MBE cure the breaches within sixty days. Through the date of the termination of the Joint Venture Agreement, MBE failed to cure any of the breaches and had not otherwise taken any steps to remedy the breaches.

The Company's May 14, 1999 letter to MBE states five reasons for the termination: MBE's refusal to authorize the installation of data port terminals as required under the sales agreement between the joint venture and a customer; MBE's refusal to allow the joint venture to market and sell the data port terminals; MBE's ongoing failure to commit adequate and appropriate resources to joint venture sales and marketing to effectuate a reasonable number of sales of joint venture business center equipment; MBE's failure to acknowledge the Company's ownership of the trademark "Business Express" and its actions inconsistent with the Company's ownership of the mark; and MBE's refusal to timely meet with the Company to discuss and conclude a joint venture sales and marketing budget for the fiscal year commencing April 1, 1999. See "Business Procurement."

MANAGEMENT

Directors and Executive Officers

The Directors and executive officers of the Company, together with their ages and business backgrounds are as follows.

| Name ---- | Age --- | Position(s) Held ----- |
|--------------------------|------------|---|
| George R. Jensen, Jr. | 50 | Chief Executive Officer, Chairman of the Board of Directors |
| Stephen P. Herbert | 37 | President, Chief Operating Officer, Director |
| Haven Brock Kolls, Jr. | 33 | Senior Vice President - Research and Development |
| Leland P. Maxwell | 52 | Senior Vice President, Chief Financial Officer, Treasurer |
| Edwin R. Boynton | 45 | Director |
| Steven Katz | 50 | Director |
| Peter G. Kapourellos | 79 | Director |
| Douglas M. Lurio | 42 | Director |
| William W. Sellers | 77 | Director |
| Henry B. duPont Smith | 37 | Director |
| William L. Van Alen, Jr. | 65 | Director |

Each Director holds office until the next Annual Meeting of Shareholders and until his successor has been elected and qualified.

George R. Jensen, Jr., has been the President, Chief Executive Officer, and Director of the Company since January 1992. Mr. Jensen is the founder, and was Chairman, Director, and Chief Executive Officer of American Film Technologies, Inc. ("AFT") from 1985 until 1992. AFT was in the business of creating color imaged versions of black-and-white films. From 1979 to 1985, Mr. Jensen was Chief Executive Officer and President of International Film Productions, Inc. Mr. Jensen was the Executive Producer of the twelve hour miniseries, "A.D.", a \$33 million dollar production filmed in Tunisia. Procter and Gamble, Inc., the primary source of funds, co-produced and sponsored the epic, which aired in March 1985 for five consecutive nights on the NBC network. Mr. Jensen was also the Executive Producer for the 1983 special for public television, "A Tribute to Princess Grace". From 1971 to 1978, Mr. Jensen was a securities broker, primarily for the firm of Smith Barney, Harris Upham. Mr. Jensen was chosen 1989 Entrepreneur of the Year in the high technology category for the Philadelphia, Pennsylvania area by Ernst & Young LLP and Inc. Magazine. Mr. Jensen is a Director of The Noah Fund, a publicly traded mutual fund. Mr. Jensen received his Bachelor of Science Degree from the University

of Tennessee and is a graduate of the Advanced Management Program at the Wharton School of the University of Pennsylvania.

Stephen P. Herbert was elected a Director of the Company in April 1996, and joined the Company on a full-time basis on May 6, 1996. Prior to joining the Company and since 1986, Mr. Herbert had been employed by Pepsi-Cola, the beverage division of PepsiCo., Inc. From 1994 to April 1996, Mr. Herbert was a Manager of Market Strategy. In such position he was responsible for directing development of market strategy for the vending channel and subsequently the supermarket channel for Pepsi-Cola in North America. Prior thereto, Mr. Herbert held various sales and management positions with Pepsi-Cola. Mr. Herbert graduated with a Bachelor of Science degree from Louisiana State University.

Haven Brock Kolls, Jr., joined the Company on a full-time basis in May 1994 and was elected an executive officer in August 1994. In August 1997, Mr. Kolls became a patent agent registered to practice before the United States Patent and Trademark Office. From January 1992 to April 1994, Mr. Kolls was Director of Engineering for International Trade Agency, Inc., an engineering firm specializing in the development of control systems and management software packages for use in the vending machine industry. Mr. Kolls was an electrical engineer for Plateau Inc. from 1988 to December 1992. His responsibilities included mechanical and electrical computer-aided engineering, digital electronic hardware design, circuit board design and layout, fabrication of system prototypes and software development. Mr. Kolls is a graduate of the University of Tennessee with a Bachelor of Science Degree in Engineering.

Leland P. Maxwell joined the Company on a full-time basis on February 24, 1997 as Chief Financial Officer, Senior Vice President and Treasurer. Prior to joining the Company, Mr. Maxwell was the corporate controller for Klearfold, Inc., a privately-held manufacturer of specialty consumer packaging. From 1992 to 1996, Mr. Maxwell was the regional controller for Jefferson Smurfit/Container Corporation of America, a plastic packaging manufacturer, and from 1986 to 1992 was the divisional accounting manager. Prior thereto, he held financial positions with Safeguard Business Systems and Smithkline-Beecham. Mr. Maxwell received a Bachelor of Arts degree in History from Williams College and a Master of Business Administration-Finance from The Wharton School of the University of Pennsylvania. Mr. Maxwell is a Certified Public Accountant.

Edwin R. Boynton joined the Board of Directors in July 1999. He is a partner of Stradley Ronon Stevens & Young LLP, and is a member of and currently the chair of the firm's estates department. Mr. Boynton received his bachelor of arts degree from Harvard University in 1976 and his Juris Doctor degree from Duke University in 1979.

Peter G. Kapourellos joined the Board of Directors of the Company in May 1993. Mr. Kapourellos has been a branch manager of Advantage Capital Corporation, a subsidiary of Primerica Corporation, since 1972. He has been a member of the Millionaire Production Club since 1972. Mr. Kapourellos is currently the Vice President for American Capital High Yield Bond Fund and of the American Capital Equity Income Fund, which are publicly traded mutual funds.

Steven Katz is President of Steven Katz & Associates, Inc., a management consulting firm specializing in strategic planning and corporate development for technology and service-based companies in the health care, environmental, telecommunications and Internet markets. Mr. Katz's prior experience includes: five years with Price Waterhouse & Co. in audit, tax and management advisory services; two years of corporate planning with Revelon, Inc.; five years with National Patent Development Corporation (NPDC) in strategic planning, merger and acquisition, technology in-licensing and out-licensing, and corporate turnaround experience as President of three NPDC subsidiaries; and two years as a Vice President and General Manager of a non-banking division of Citicorp, N.A.

Douglas M. Lurio joined the Board of Directors of the Company in June 1999. Mr. Lurio is President of Lurio & Associates, P.C., attorneys-at-law, which he founded in 1991. Prior thereto, he was a partner with Dilworth, Paxson LLP. Mr. Lurio received a Bachelor of Arts Degree in Government from Franklin & Marshall College, a Juris Doctor Degree from Villanova Law School, and a Masters in Law (Taxation) from Temple Law School.

William W. Sellers joined the Board of Directors of the Company in May 1993. Mr. Sellers founded The Sellers Company in 1949 which has been nationally recognized as the leader in the design and manufacture of state-of-the-art equipment for the paving industry. Mr. Sellers has been awarded five United States patents and several Canadian patents pertaining to this equipment. The Sellers Company was sold to Mechtron International in 1985. Mr. Sellers is Chairman of the Board of Sellers Process Equipment Company which sells products and systems to the food and other industries. Mr. Sellers is actively involved in his community. Mr. Sellers received his undergraduate degree from the University of Pennsylvania.

Henry B. duPont Smith joined the Board of Directors of the Company in May 1994. Since January 1992, Mr. Smith has been a Vice President of The Rittenhouse Trust Company and since September 1991 has been a Vice President of Rittenhouse Financial Services, Inc. From September 1991 to December 1992, he was a registered representative of Rittenhouse Financial Securities, Inc. Mr. Smith was an Assistant Vice President of Mellon Bank, N.A. from March 1988 to July 1991, and an investment officer of Provident National Bank from March 1985 to March 1988. Mr. Smith received a Bachelor of Arts degree in Accounting in 1984 from Franklin & Marshall College.

William L. Van Alen, Jr., joined the Board of Directors of the Company in May 1993. Mr. Van Alen is President of Cornerstone Entertainment, Inc., an organization engaged in the production of feature films of which he was a founder in 1985. Since 1996, Mr. Van Alen has been President and a Director of The Noah Fund, a publicly traded mutual fund. Prior to 1985, Mr. Van Alen practiced law in Pennsylvania for twenty-two years. Mr. Van Alen received his undergraduate degree in Economics from the University of Pennsylvania and his law degree from Villanova Law School.

Executive Compensation

The following table sets forth certain information with respect to compensation paid or accrued by the Company during the fiscal years ended June 30, 1996, June 30, 1997 and June 30, 1998 to the individual acting in the capacity of Chief Executive Officer of the Company. No individual who was serving as an executive officer of the Company at the end of the fiscal years ended June 30, 1996, June 30, 1997 or June 30, 1998 received salary and bonus in excess of \$100,000 in any such fiscal year.

Summary Compensation Table

| Name and Principal Position ----- | Fiscal Year ----- | Annual Compensation ----- | |
|---|-------------------------|------------------------------|----------------|
| | | Salary ----- | Bonus ----- |
| George R. Jensen, Jr., Chief Executive Officer, President | 1998 | \$100,000 | \$0 |
| | 1997 | \$100,000 | \$0 |
| | 1996 | \$ 90,000 | \$0 |

Executive Employment Agreements

During November 1997, the Company entered into an employment agreement with Mr. Jensen which expires June 30, 2000. The Agreement is automatically renewed from year to year thereafter unless canceled by Mr. Jensen or the Company. The agreement provides for an annual base salary of \$100,000 per year. Mr. Jensen is entitled to receive such bonus or bonuses as may be awarded to him by the Board of Directors. In determining whether to pay such a bonus, the Board would use its subjective discretion. The Agreement requires Mr. Jensen to devote his full time and attention to the business and affairs of the Company, and obligates him not to engage in any investments or activities which would compete with the Company during the term of the Agreement and for a period of one year thereafter.

As part of the agreement, Mr. Jensen canceled an aggregate of 436,500 shares of Common Stock of the Company which had been beneficially owned by him and which had been held in escrow pursuant to the Escrow Agreement dated December 29, 1993 by and between the Company, Mr. Jensen and certain other parties ("Escrow Agreement"). In January 1994, and at the request of the Pennsylvania Securities Commission, Mr. Jensen placed all of the shares of Common Stock beneficially owned by him into escrow as a condition of the Company's initial public offering being declared effective in Pennsylvania. The shares of Common Stock canceled by Mr. Jensen had been subject to cancellation if certain performance goals were not met by the Company on or before June 30, 1998.

The agreement also grants to Mr. Jensen in the event a "USA Transaction" (as defined below) occurs after the date thereof that number of shares of Common Stock as shall when issued to him equal eight percent of all the then issued and outstanding shares of Common Stock (the "Rights"). Mr. Jensen is not required to pay any additional consideration for such shares. At the time of any USA Transaction, all of the shares of Common Stock underlying the Rights are automatically deemed to be issued and outstanding immediately prior to any USA Transaction, and are entitled to be treated as any other issued and outstanding shares of Common Stock in connection with such USA Transaction.

The term USA Transaction is defined as (i) the acquisition of fifty-one percent or more of the then outstanding voting securities entitled to vote generally in the election of Directors of the Company by any person, entity or group, or (ii) the approval by the shareholders of the Company of a reorganization, merger, consolidation, liquidation, or dissolution of the Company, or the sale, transfer, lease or other disposition of all or substantially all of the assets of the Company.

The Rights are irrevocable and fully vested and will not be affected by the termination of Mr. Jensen's employment with the Company for any reason whatsoever. If a USA Transaction shall occur at a time when there are not a sufficient number of authorized but unissued shares of Common Stock, then the Company shall as a condition of such USA Transaction promptly take any and all appropriate action to make available a sufficient number of shares of Common Stock. In the alternative, the Company may structure the USA Transaction so that Mr. Jensen would receive the same amount and type of consideration in connection with the USA Transaction as any other holder of Common Stock.

On January 21, 1999, Mr. Jensen purchased ten (10) units of the recently completed private placement offering for \$100,000. In full payment for such Units, Mr. Jensen has agreed to forego any base salary otherwise payable to him under his employment agreement during the period of time commencing on April 1, 1999 and ending on June 30, 2000, or such longer period of time as may be required based upon his monthly net base salary after all applicable withholding taxes and other deductions.

During June 1999, the Board of Directors approved an amendment to Mr. Jensen's employment agreement to increase the number of shares of Common Stock issuable to him upon the occurrence of a "USA Transaction from five percent to eight percent.

The Company has entered into a one-year employment agreement with Mr. Herbert which expires on April 30, 2000. The agreement is automatically renewed from year to year thereafter unless canceled by Mr. Herbert or the Company. The Agreement provides for an annual base salary of \$90,000 per year, provided, that Mr. Herbert's base salary shall never be less than ninety percent of that of the Chief Executive Officer of the Company. Mr. Herbert is entitled to receive such bonus or bonuses as the Board of Directors

may award to him. The Agreement requires Mr. Herbert to devote his full time and attention to the business and affairs of the Company and obligates him not to engage in any investments or activities which would compete with the Company during the term of the agreement and for a period of one year thereafter.

Mr. Kolls has entered into a one-year employment agreement with the Company which expires on April 30, 2000, and is automatically renewed from year to year thereafter unless canceled by Mr. Kolls or the Company. The agreement provides for an annual base salary of \$90,000 per year. Mr. Kolls is also entitled to receive such bonus or bonuses as may be awarded to him by the Board of Directors. The Agreement requires Mr. Kolls to devote his full time and attention to the business and affairs of the Company, and obligates him not to engage in any investments or activities which would compete with the Company during the term of the agreement and for a period of one year thereafter.

Mr. Maxwell has entered into a one-year employment agreement with the Company which expires on February 28, 2000, and is automatically renewed from year to year thereafter unless cancelled by Mr. Maxwell or the Company. The agreement provides for an annual base salary of \$90,000 per year, provided, that Mr. Maxwell's base salary shall never be less than eighty-five percent of that of the Chief Executive Officer of the Company. Mr. Maxwell is also entitled to receive such bonus or bonuses as by the Board of Directors may award to him. The Agreement requires Mr. Maxwell to devote his full time and attention to the business and affairs of the Company, and obligates him not to engage in any investments or activities which would compete with the Company during the term of the agreement and for a period of one year thereafter.

Director Compensation and Stock Options

Members of the Board of Directors do not currently receive any cash compensation for serving on the Board of Directors.

The Company paid to William W. Sellers the amount of \$76,600 for consulting services rendered by Mr. Sellers to the Company during the fiscal year ended June 30, 1996. Mr. Sellers' consulting services consisted of advising and assisting the Company with a variety of business matters including but not limited to, general operations of the business, expansion of its product line, and identification of new business directions.

The Company paid to Peter G. Kapourellos the amount of \$22,000 for consulting services rendered by Mr. Kapourellos to the Company during the fiscal year ended June 30, 1996. Mr. Kapourellos' services consisted of assisting the Company in connection with investor and public relations.

In March 1998, the Company extended the expiration date of the following options to purchase shares of Common Stock from June 30, 1998 to the close of business on June 30, 2000, to the following Directors of the Company: Peter G. Kapourellos - 10,000 options; William W. Sellers - 10,000 options; and William L. Van Alen, Jr. - 10,000 options.

In April 1998, the Company reduced from \$2.50 to \$1.50 the exercise price of the following options to purchase Common Stock issued to the following Directors of the Company: Peter G. Kapourellos - 17,000 options; William W. Sellers - 15,500 options; William L. Van Alen, Jr. - 12,500 options; and Henry B. duPont Smith - 10,000 options.

In April 1998, all of the Common Stock underlying the above options was registered by the Company under the Act, for resale by the holder thereof. Such registration was at the Company's cost and expense.

During June and July 1999, the Company granted 10,000 options to each of the seven Directors who were not executive officers of the Company. Each option is exercisable at \$2.00 per share at any time for five years following the vesting thereof.

The Board of Directors is responsible for awarding stock options. Such awards are made in the subjective discretion of the Board. Other than the repricing of the options by the Company in April 1998, the exercise price of all the above options represents on the date of issuance of such options an amount equal to or in excess of the market value of the Common Stock issuable upon the exercise of the options. In connection with the April 1998 stock option repriced, the exercise price of all these options were below the fair market value on the date of the repricing, therefore, the Company recorded a charge to compensation expense during fiscal year 1998.

All of the foregoing options are non-qualified stock options and not part of a qualified stock option plan and do not constitute incentive stock options as such term is defined under Section 422 of the Internal Revenue Code, as amended, and are not part of an employee stock purchase plan as described in Section 423 thereunder.

Executive Stock Options

In June 1997, the Company issued to Mr. Kolls options to acquire up to 10,000 shares of Common Stock at an exercise price of \$4.50 per share. Subject to Mr. Kolls' continued employment with the Company, the options will become vested over a one year period at the rate of 2,500 options per quarter. The options must be exercised within five years of vesting.

In June 1997, the Company issued to Mr. Sterling, a former officer and Director of the Company, options to acquire up to 10,000 shares of Common Stock at an exercise price of \$4.50 per share. Subject to Mr. Sterling's continued employment with the Company, the options will become vested over a one year period at the rate of 2,500 options per quarter. The options must be exercised within five years of vesting.

In June 1997, the Company issued to Mr. Herbert options to acquire up to 10,000 shares of Common Stock at an exercise price of \$4.50 per share. Subject to Mr. Herbert's continued employment with the Company, the options will become vested over a one year period at the rate of 2,500 options per quarter. The options must be exercised within five years of vesting.

Keith L. Sterling resigned as the Executive Vice President-Systems Chief Information Officer, Secretary and Director of the Company effective April 3, 1998 for personal reasons. The Company agreed to permanently reduce the exercise price of Mr. Sterling's options to purchase 45,000 shares of Common Stock to \$1.00 per share from \$2.50 per share and \$4.50 per share, and accelerated the vesting of 2,500 options to April 1998. Mr. Sterling agreed to act as a consultant through June 30, 1998.

In April 1998, the Company issued to each of Messrs. Herbert, Kolls and Maxwell options to purchase up to 5,000 shares of Common Stock at \$4.50 per share. The options become vested over a one-year period at the rate of 1,250 per quarter. The options must be exercised within five years of vesting.

In April 1998, the Company permanently reduced the exercise price to \$1.50 of the following options to purchase Common Stock: Haven Brock Kolls, Jr. - 10,000 options from \$2.50 to \$1.50; Stephen P. Herbert - 10,000 options from \$4.50 to \$1.50; and Leland P. Maxwell - 10,000 options from \$4.50 to \$1.50.

In June 1999, the Company granted an aggregate of 470,000 options to the executive officers as follows: Mr. Jensen - 180,000 options; Mr. Herbert - 110,000 options; Mr. Kolls - 100,000 options; Mr. Maxwell - 40,000 options; Mr. Lawlor - 20,000 options; Mr. Donahue - 20,000 options. All of Mr. Jensen's options became vested immediately. All of the other executive officers' options would vest as follows: one-third immediately; one-third on June 17, 2000, and one-third on June 17, 2001. Each option is exercisable at \$2.00 per share at any time for five years following vesting thereof.

The Board of Directors is responsible for awarding stock options. Such awards are made in the subjective discretion of the Board. Other than the repricing of the options by the Company in April 1998, the exercise price of all the above options represents on the date of issuance of such options an amount equal to or in excess of the market value of the Common Stock issuable upon the exercise of the options. In connection with the April 1998 stock options repriced, the exercise prices of all those options were below the fair market value on the date of the repricing, therefore, the Company recorded a charge to compensation expense during fiscal year 1998.

All of the foregoing options are non-qualified stock options and not part of a qualified stock option plan and do not constitute incentive stock options as such term is defined under Section 422 of the Internal Revenue Code, as amended, and are not part of an employee stock purchase plan as described in Section 423 thereunder.

PRINCIPAL SHAREHOLDERS

Common Stock

The following table sets forth, as of June 30, 1999, the beneficial ownership of the Common Stock of each of the Company's directors and executive officers, as well as by the Company's directors and executive officers as a group. Except as set forth below, the Company is not aware of any beneficial owner of more than five percent of the Common Stock. Except as otherwise indicated, the Company believes that the beneficial owners of the Common Stock listed below, based on information furnished by such owners, have sole investment and voting power with respect to such shares.

| Name and Address of Beneficial Owner | Number of Shares of Common Stock Beneficially Owned(1) | Percent of Class(2) |
|---|--|------------------------|
| George R. Jensen, Jr. 16 Marlborough Rd. Newtown Square, Pennsylvania 19073 | 460,000 shares(3) | 4.93% |
| Stephen P. Herbert 536 West Beach Tree Lane Strafford, Pennsylvania 19087 | 97,717 shares(4) | 1.05% |
| Haven Brock Kolls, Jr. 52 Norwood House Road Downingtown, Pennsylvania 19335 | 93,183 shares(5) | 1.00% |
| Leland P. Maxwell 129 Windham Drive Langhorne, Pennsylvania 19047 | 38,383 shares(6) | * |
| Edwin R. Boynton 104 Leighton Drive Bryn Mawr, Pennsylvania 19010 | 55,500 shares(7) | * |
| Peter G. Kapourellos 1515 Richard Drive West Chester, Pennsylvania 19380 | 41,300 shares(8) | * |
| Steven Katz 20 Rebel Run Drive East Brunswick, New Jersey 08816 | 5,000 shares(9) | * |
| Douglas M. Lurio 1760 Market Street, Suite 1300 Philadelphia, Pennsylvania 19103 | 34,533 shares(10) | * |
| William W. Sellers 394 East Church Road King of Prussia, Pennsylvania 19406 | 166,075 shares(11) | 1.78% |
| Henry B. duPont Smith 350 Mill Bank Road Bryn Mawr, Pennsylvania 19010 | 50,000 shares(12) | * |
| William L. Van Alen, Jr. Cornerstone Entertainment, Inc. P.O. Box 727 Edgemont, Pennsylvania 19028 | 32,500 shares(13) | * |
| All Directors and Executive Officers As a Group (11 persons) | 1,074,190 shares(14) | 11.50% |

- - - - -
*Less than one percent (1%)

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and derives from either voting or investment power with respect to securities. Shares of Common Stock issuable upon conversion of the Preferred Stock, or shares of Common Stock issuable upon exercise of options currently exercisable, or exercisable within 60 days of June 30, 1999, are deemed to be beneficially owned for purposes hereof.

(2) On June 30, 1999 there were 6,172,697 shares of Common Stock and 640,577 shares of Series A Preferred Stock issued and outstanding. For purposes of computing the percentages under this table, it is assumed that all shares of issued and outstanding Series A Preferred Stock have been converted into 640,577 shares of Common Stock, that all of the purchase rights and options which have been issued and vested as of June 30, 1999 (or within 60-days of June 30, 1999) have been converted into 729,740 shares of Common Stock. It has also been assumed that all of the Selling Shareholder Warrants have been exercised for 250,000 shares. Of the 928,840 options or purchase rights to acquire Common Stock issued as of June 30, 1999, only 729,740 are vested (or become vested within 60-days) and included in this table. For purposes of computing such percentages, it has also been assumed that all of the remaining warrants have been exercised for 278,600 shares of Common Stock, and all of the accrued and unpaid dividends on the Series A Preferred Stock as of June 30, 1999 have been converted into 334,709 shares of Common Stock. It is also assumed that all 933,600 of the 1999-A Warrants have been exercised and converted into 933,600 shares of Common Stock. Therefore, for purposes of computing the percentages under this table, there are 9,339,923 shares of Common Stock issued and outstanding.

(3) Includes 200,000 shares of Common Stock held by Mr. Jensen with his children as joint tenants, 180,000 shares of Common Stock issuable upon the exercise of options, and 40,000 shares of Common Stock issuable upon the exercise of the 1999-A Warrants. Does not include the right granted to Mr. Jensen under his Employment Agreement to receive eight percent (8%) of the issued and outstanding Common Stock upon the occurrence of a USA Transaction (as defined therein). See "Executive Employment Agreements."

(4) Includes 91,666 shares of Common Stock issuable to Mr. Herbert upon the exercise of options, 2,000 shares issuable to his spouse upon the exercise of 1999-A Warrants, and 4,000 shares of Common Stock owned by his spouse.

(5) Includes 73,333 shares of Common Stock issuable to Mr. Kolls upon exercise of options, 6,000 shares issuable to his spouse upon the exercise of 1999-A Warrants, and 12,000 shares of Common Stock owned by his spouse.

(6) Includes 38,333 shares of Common Stock issuable to Mr. Maxwell upon the exercise of options.

(7) Includes 5,500 shares of Common Stock issuable upon the conversion of 5,500 shares of Series A Preferred Stock. Includes 10,000 shares issuable upon exercise of 1999-A Warrants and 5,000 vested shares issuable upon exercise of options. Does not include any shares of Common Stock issuable upon conversion of any accrued and unpaid dividends on the Series A Preferred Stock.

(8) Includes 1,000 shares of Common Stock issuable upon the conversion of 1,000 shares of Preferred Stock beneficially owned by Mr. Kapourellos. Includes 3,000 shares of Common Stock held on the date hereof by Mr. Kapourellos with his spouse as joint tenants with right of survivorship. Includes 27,000 shares of Common Stock issuable upon exercise of options. Does not include any shares of Common Stock issuable upon conversion of any accrued and unpaid dividends on the Series A Preferred Stock.

(9) Includes 5,000 shares of Common Stock issuable upon exercise of options.

(10) Includes 23,533 shares of Common Stock held jointly with Mr. Lurio's spouse, 5,000 shares of Common Stock issuable upon exercise of options and 6,000 shares issuable upon exercise of 1999-A Warrants.

(11) Includes 17,245 shares of Common Stock owned by the Sellers Pension Plan of which Mr. Sellers is a trustee, 4,651 shares of Common Stock owned by Sellers Process Equipment Company of which he is a Director, and 9,922 shares of Common Stock are owned by Mr. Sellers' wife. Includes 25,500 shares of Common Stock issuable upon exercise of options and 14,000 shares issuable upon exercise of 1999-A Warrants.

(12) Includes 12,000 shares of Common Stock issuable upon conversion of the 12,000 shares of Preferred Stock beneficially owned by Mr. Smith. Includes 20,000 shares of Common Stock issuable upon exercise of options. Includes 8,000 shares of Common Stock issuable upon conversion of the 1996 Warrants held by trusts for the benefit of Mr. Smith's children of which he is a trustee. Does not include any shares of Common Stock issuable upon conversion of any accrued and unpaid dividends on the Series A Preferred Stock.

(13) Includes 22,500 shares of Common Stock issuable to Mr. Van Alen upon exercise of options.

(14) Includes all shares of Common Stock described in footnotes (2) through (13) above.

Series A Preferred Stock

The following table sets forth, as of June 30, 1999 the beneficial ownership of the Preferred Stock by the Company's directors and executive officers, as well as by the Company's directors and executive officers as a group. Except as set forth below, the Company is not aware of any beneficial owner of more than five percent of the Preferred Stock. Except as otherwise indicated, the Company believes that the beneficial owners of the Preferred Stock listed below, based on information furnished by such owners, have sole investment and voting power with respect to such shares.

| Name and Address of Beneficial Owner ----- | Number of Shares of Preferred Stock Beneficially Owned ----- | Percent of Class(1) ----- |
|---|---|---------------------------------|
| Edwin R. Boynton 104 Leighton Avenue Bryn Mawr, Pennsylvania 19010 | 5,500 | * |
| Peter G. Kapourellos 1515 Richard Drive West Chester, Pennsylvania 19380 | 1,000 | * |
| Henry B. duPont Smith 350 Mill Bank Road Bryn Mawr, Pennsylvania 19010 | 12,000(2) | 1.9% |
| All Directors and Executive Officers As a Group (10 persons) (2) ----- | 18,500 | 2.9% |

*Less than one percent (1%)

(1) There are 640,577 shares of Preferred Stock issued and outstanding as of June 30, 1999.

(2) Includes 2,000 shares of Preferred Stock held by trusts for the benefit of Mr. Smith's children of which he is a trustee.

CERTAIN TRANSACTIONS

At June 30, 1998 and 1997, and for the nine months ended March 31, 1999 approximately \$26,000, \$27,000, and \$153,000 respectively, of the Company's accounts payable are due to several shareholders for various legal and technical services performed. For the years ended June 30, 1998 and 1997, and for the nine months ended March 31, 1999 the Company incurred approximately \$340,000, \$308,000, and \$121,000, respectively, for these services.

In June 1997, the Company issued to Mr. Kolls options to acquire up to 10,000 shares of Common Stock at \$4.50 per share, to Mr. Sterling options to acquire up to 10,000 shares of Common Stock at \$4.50 per share, to Mr. Feeney options to acquire up to 500 shares of Common Stock at \$4.50 per share, and to Mr. Herbert option to acquire up to 10,000 shares of Common Stock at \$4.50 per share. See "Management - Executive Stock Options."

In November 1997, Mr. Jensen cancelled 436,500 shares of Common Stock owned by him and which had been held in escrow. See "Principal Shareholders Escrow and Cancellation Arrangements."

In December 1997, the Company issued to each of Joseph Donahue and Phillip Harvey, Vice Presidents of the Company, options to acquire up to 5,000 shares of Common Stock at \$4.50 per share. The options vest of the rate of 1,250 per quarter.

In December 1997, Adele Hepburn, a Director of Public Relations of the Company, loaned the Company the sum of \$50,000 for working capital. The loan is to be repaid on March 31, 1998 and bears interest at the rate of six percent (6%) per annum.

In March 1998, the Company extended the expiration date of the following options to purchase shares of Common Stock from June 30, 1998 to the close of business on June 30, 2000: Adele Hepburn - 5,000 options; Peter G. Kapourellos - 10,000 options; William W. Sellers - 10,000 options; Keith L. Sterling - 10,000 options; and William L. Van Alen, Jr. - 10,000 options.

In March 1998, the Company extended the expiration date of all the purchase rights to acquire 15,730 shares of Common Stock at \$10.00 per share from June 30, 1998 to the close of business June 30, 2000.

In April 1998, the Company reduced from \$2.50 to \$1.50 the exercise price of the following options to purchase Common Stock issued to the following Directors and/or executive officers of the Company: Peter G. Kapourellos - 17,000 options; William W. Sellers - 15,500 options; William L. Van Alen, Jr. - 12,500 options; Henry B. duPont Smith - 10,000 options; and Haven Brock Kolls, Jr. - 10,000 options. The reduced exercise price is less than the fair market value of the Common Stock on the effective date of the repricing, and therefore, a charge to compensation expense was recorded during fiscal year 1998.

In April 1998, the Company authorized a permanent reduction in the exercise price of 5,000 of the 10,000 options to purchase shares of Common Stock of the Company owned by Michael Lawlor, an officer of the Company, from \$4.50 per share to \$0.50 per share. The exercise price of the remaining 5,000 options was permanently reduced from \$4.50 to \$1.50 per share. The reduced exercise price is less than the fair market value of the Common Stock on the effective date of the repricing, and therefore, a charge to compensation expense was recorded during fiscal year 1998.

In April 1998, the Company authorized a temporary reduction in the exercise price of all of the options to purchase up to 12,100 shares of Common Stock of the Company owned by Edward J. Sullivan, a former officer and employee of the Company, to \$1.50 per share through October 31, 1998. Thereafter, the exercise price shall revert back to the current exercise prices. The current exercise price is \$2.50 for 10,000 of the options and \$4.50 for 2,100 of the options. The reduced exercise price of the 10,000 options is less than the fair market value of the Common Stock on the effective date of the repricing, and therefore, a charge to compensation expense was recorded during fiscal year 1998.

In April 1998, the Company authorized a reduction in the exercise price of the 10,000 options to purchase shares of Common Stock of the Company owned by Joseph Donahue, an executive of the Company, from \$4.50 per share to \$1.50 per share. The reduced exercise price of the 10,000 options is less than the fair market value of the Common Stock on the effective date of the repricing, and therefore, a charge to compensation expense was recorded during fiscal year 1998.

In April 1998, the Company authorized a reduction in the exercise price of the 7,500 options to purchase shares of Common Stock of the Company owned by Phillip Harvey, a former executive of the Company, from \$4.50 per share to \$2.00 per share. The reduced exercise price of the 7,500 options is less than the fair market value of the Common Stock on the effective date of the repricing, and therefore, a charge to compensation was recorded during fiscal year 1998.

In April 1998, the Company reduced from \$4.50 to \$1.50 the exercise price of the following options to purchase shares of Common Stock issued to the following Directors and/or executive officers of the Company: Leland P. Maxwell - 10,000 options; and Stephen Herbert - 10,000 options. The reduced exercise price of these options is less than the fair market value of the Common Stock on the effective date of the repricing, and therefore, a charge to compensation expense was recorded during fiscal year 1998.

In April 1998, the Company authorized the reduction in the exercise price of the options to purchase 20,000 shares of Common Stock of the Company owned by Adele Hepburn, an employee of the Company, from \$2.50 to \$1.50. The reduced exercise price of the 20,000 options is less than the fair market value of the Common Stock on the effective date of the repricing, and therefore, a charge to compensation expense was recorded during fiscal year 1998.

In June and July 1999, the Company issued options to purchase an aggregate of 470,000 shares of Common Stock to its executive officers and an aggregate of 70,000 shares of Common Stock to its directors who were not executive officers. Each option is exercisable at \$2.00 per share of Common Stock. See "Management -- Director Compensation and Stock Options" and "Executive Stock Options."

In July 1999, the Company extended the expiration dates until June 30, 2001 of the options to acquire Common Stock held by the following directors, officers, and employees: Adele Hepburn - 77,000 options; H. Brock Kolls - 20,000 options; Henry duPont Smith - 10,000 options; William Sellers - 15,500 options; Peter Kapourellos - 17,000 options; and William Van Alen - 12,500 options. All of the foregoing options would have expired in the first two calendar quarters of the year 2000 or the first calendar quarter of year 2001.

During the fiscal year ended June 30, 1998, the Company paid Lurio & Associates, P.C., of which Mr. Lurio is President, professional fees of approximately \$150,000 for legal services rendered to the Company by such law firm.

SELLING SHAREHOLDERS

Each of the Selling Shareholders listed below is, as of the date hereof, the holder of Selling Shareholder Warrants to acquire the number of shares of Common Stock set forth opposite such Selling Stockholder's name or has exercised the corresponding Selling Shareholder Warrants for the number of shares of Common Stock set forth opposite such Selling Shareholder's name. The Selling Shareholder Warrants were issued by the Company to the Selling Shareholders pursuant to a transaction exempt from the registration requirements of the Act and various state securities laws.

The issuance by the Company of the Common Stock to the Selling Shareholders upon exercise of the Selling Shareholder Warrants is pursuant to a transaction exempt from the registration requirements of the Act and various state securities laws. The Company has agreed, at its expense, to register the Common Stock for resale by the Selling Shareholders under the Act. The Company expects to incur expenses of approximately \$7,500 in connection with the registration. The Common Stock may be sold from time to time by the Selling Shareholders pursuant to this Prospectus. See "Plan of Distribution".

The following tables set forth information with respect to each Selling Shareholder and the respective amounts of Common Stock that may be offered pursuant to this Prospectus. None of the Selling Shareholders has, or within the past three years has had, any position, office or other material relationship with the Company, except as noted below. Except as specifically set forth below, following the offering, and assuming all of the Common Stock offered hereby has been sold, none of the Selling Shareholders will beneficially own one percent (1%) or more of the Common Stock.

| Selling Shareholder ----- | Common Stock Offered Hereby ----- | Beneficial Ownership After Offering (1) ----- | |
|------------------------------|---|---|------------------|
| | | Number ----- | Percent ----- |
| I.W. Miller Group, Inc. | 100,000 | 0 | * |
| Harmonic Research, Inc. | 150,000 | 0 | * |
| | ----- | | |
| Total | 250,000 | | |

* Less than one percent (1%).

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and derives from either voting or investment power with respect to the securities, and includes any shares of Common Stock which a person has the right to acquire within 60-days of the date hereof.

(2) Harmonic Research, Inc. has been retained as a consultant to the Company. In addition, Harmonic Research, Inc., a broker dealer, acted as a selected dealer for the Company in connection with a recent private placement offering. See "Description of Securities-General."

MARKET FOR COMMON STOCK

The Common Stock is currently traded on the OTC Electronic Bulletin Board under the symbol USTT. Such trading began on March 8, 1995. As of the date hereof, there is no established trading market for the Common Stock. See "Risk Factors - No Assurance of Active Public Market" and "Risk Factors - Risks of Low-Priced Stocks".

The high and low bid prices on the OTC Electronic Bulletin Board for the Common Stock were as follows:

| Fiscal - - - - - | High - - - - | Low - - - |
|--|-----------------|--------------|
| 1997 | | |
| First Quarter (through September 30, 1996) | \$6.30 | \$3.80 |
| Second Quarter (through December 31, 1996) | \$5.70 | \$2.90 |
| Third Quarter (through March 31, 1997) | \$4.30 | \$2.80 |
| Fourth Quarter (through June 30, 1997) | \$5.00 | \$1.90 |
| 1998 | | |
| First Quarter (through September 30, 1997) | \$8.00 | \$2.70 |
| Second Quarter (through December 31, 1997) | \$6.00 | \$2.20 |
| Third Quarter (through March 31, 1998) | \$4.90 | \$2.50 |
| Fourth Quarter (through June 30, 1998) | \$4.60 | \$2.50 |
| 1999 | | |
| First Quarter (through September 30, 1998) | \$3.10 | \$1.20 |
| Second Quarter (through December 31, 1998) | \$1.40 | \$1.00 |
| Third Quarter (through March 31, 1999) | \$1.80 | \$1.50 |
| Fourth Quarter (through June 30, 1999) | \$3.38 | \$1.68 |

Such quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions. All of the above bid prices have been adjusted to reflect the 1-for-10 reverse split of the Common Stock occurring on June 7, 1999.

On March 31, 1999, there were 384,130 shares of Common Stock issuable upon exercise of outstanding Management Options which when and is issued would be freely tradeable under the Act. Of such Management Options the 15,000 are exercisable at \$5.00 per share, 99,850 are exercisable at \$4.50 per share, 141,500 are exercisable at \$2.50 per share, 2,500 are exercisable at \$2.00 per share, 105,000 are exercisable at \$1.50 per share, and 5,000 are exercisable at \$0.50 per share. In addition, there are 15,280 purchase rights exercisable at \$10.00 per share. See "Description of Securities -- Management Options."

As of March 31, 1999, there were 67,300 shares of Common Stock issuable upon exercise of the outstanding 1995 Warrants, which when and if issued would be freely tradeable under the Act. See "Description of Securities -- 1995 Common Stock Purchase Warrants."

As of March 31, 1999, there were 86,800 shares of Common Stock issuable upon exercise of the outstanding 1996 Warrants, which when and if issued would be freely tradeable under the Act. See "Description of Securities -- 1996 Common Stock Purchase Warrants."

As of March 31, 1999, there were 4,000 shares of Common Stock issuable upon exercise of the outstanding 1996-B Warrants, which when and if issued would be freely tradeable under the Act. See "Description of Securities -- 1996-B Common Stock Purchase Warrants."

As of March 31, 1999, there were 1,500 shares of Common Stock issuable upon exercise of the outstanding 1997 Warrants, which when and if issued would be freely tradeable under the Act. See "Description of Securities -- 1997 Common Stock Purchase Warrants."

As of March 31, 1999, there were 4,000 shares of Common Stock issuable upon exercise of the outstanding 1998-A Warrants, which when and if issued would be freely tradeable under the Act. See "Description of Securities -- 1998-A Common Stock Purchase Warrants."

As of March 31, 1999, there were 110,000 shares of Common Stock issuable upon the exercise of outstanding GEM Warrants. See "Principal Shareholders -- Convertible Securities Escrow Agreement" and "Description of Securities -- Convertible Securities and Related Warrants."

As of March 31, 1999, there were 938 record holders of the Common Stock and 695 record holders of the Series A Preferred Stock.

The holders of the Common Stock are entitled to receive such dividends as the Board of Directors of the Company may from time to time declare out of funds legally available for payment of dividends. Through the date hereof, no cash dividends have been declared on the Company's securities. No dividend may be paid on the Common Stock until all accumulated and unpaid dividends on the Series A Preferred Stock have been paid. As of June 30, 1999, such accumulated and unpaid dividends amounted to \$3,347,090. On August 1, 1999, approximately \$469,000 of additional dividends will accrue on the Series A Preferred Stock.

DESCRIPTION OF SECURITIES

General

The Company is authorized to issue up to 62,000,000 shares of Common Stock, no par value ("Common Stock"), and 1,800,000 shares of undesignated Preferred Stock. As of the date hereof, 900,000 shares have been designated as Series A Convertible Preferred Stock, no par value ("Series A Preferred Stock"), and 350,000 shares have been designated as Series B Equity Participating Preferred Stock ("Series B Preferred Stock"), no par value.

As of June 30, 1999, there were 6,172,097 shares of Common Stock issued and outstanding and 640,577 shares of Series A Preferred Stock issued and outstanding which are convertible into 640,577 shares of Common Stock. Through March 31, 1999, a total of 451,123 shares of Preferred Stock have been converted into 493,832 shares of Common Stock and \$1,725,192 of accrued and unpaid dividends thereon have been converted into 202,697 shares of Common Stock. As of March 31, 1999, there were 938 record owners of the Common Stock and 695 record owners of the Preferred Stock.

In November 1998, the Company issued 5,000 shares of Common Stock to Ronald Trahan, a consultant to the Company, for services rendered. All of such shares were registered under the Act.

In March 1999, the Company issued 180,000 shares of Common Stock to Mason Sexton, a consultant to the Company, for services rendered. All of such shares were registered under the Act.

From September 1998 through June 1999, the Company sold 466.8 units at \$10,000 each, for an aggregate of \$4,668,000 pursuant to a private placement offering. Each unit consisted of a \$10,000 principal amount 12% Senior Note, 2,000 1999-A Warrants, and 1,000 shares of Series B Preferred Stock. The offering was sold to 223 accredited investors, and did not involve any general advertising or solicitation, and was therefore exempt from registration under Rule 506 of Regulation D promulgated under the Act. The Company paid compensation to Harmonic Research, Inc., a broker-dealer, in connection with the 47 units sold by such broker-dealer. In this regard, the Company paid to such broker-dealer cash compensation of \$47,000 as well as 43,800 shares of Common Stock and 9,400 1999-A Warrants. The shares of Common Stock issued to such broker-dealer are restricted securities as such term is defined under Rule 144 promulgated under the Act. Pursuant to the private placement offering, the Company had issued 466,800 shares of Series B Preferred Stock. The Series B Preferred Stock was convertible into 4 shares of Common Stock in the event of a reverse stock split of the Common Stock. As a result of the 1-for-10 reverse stock split which became effective on June 7, 1999, all of the shares of Series B Preferred Stock were exchanged for 1,867,200 shares of Common Stock, and as of the date hereof, there are no issued and outstanding shares of Series B Preferred Stock. The 1,867,200 shares of Common Stock issued to the holders of the Series B Preferred Stock are restricted securities as defined under Rule 144 promulgated under the Act, and can not be sold or transferred without registration under the Act or pursuant to an applicable exemption therefrom.

On June 7, 1999 the Company effectuated a 1-for-10 reverse stock split of all of its issued and outstanding Common Stock. Pursuant thereto, on the effective date of the reverse stock split (i) each 10 shares of outstanding Common Stock were reduced to one share of Common Stock; (ii) the number of shares of Common Stock into which each outstanding warrant, purchase right or option is exercisable was proportionately reduced on a 10-to-1 basis; (iii) the exercise price of each outstanding warrant, purchase right, or option was proportionately increased on a 1-to-10 basis; (iv) the number of share of Common Stock into which each share of Series A Preferred Stock is convertible was reduced from 10 shares to 1 share; (v) the conversion of the accrued and unpaid dividends on the Series A Preferred Stock was increased from \$1.00 to \$10.00 per share of Common Stock; and (vi) each share of Series B Preferred Stock was converted into 4 shares of Common Stock. All of the share numbers, share prices, exercise prices, and all other similar items contained in this Prospectus have been properly adjusted, on a retroactive basis, to reflect the foregoing.

In June and July 1999, the Company issued options to purchase an aggregate of 470,000 shares of Common Stock to its executive officers and an aggregate of 70,000 shares of Common Stock to its directors who were not executive officers. See "Management -- Director Compensation and Stock Options" and "Executive Stock Options."

In June 1999, the Company issued 4,000 shares of Common Stock to Robert Flaherty in connection with public relations services rendered to the Company. The shares constitute restricted securities as such term is defined under Rule 144 promulgated under the Act.

In June 1999, the Company issued 10,000 shares of Common Stock to Rick Joshi, for consulting services rendered to the Company. The shares constitute restricted securities as such term is defined under Rule 144 promulgated under the Act.

In June 1999, the Company issued options to purchase an aggregate of 12,000 shares of Common Stock to six employees. The options are fully vested and may be exercised at any time for five years following vesting at \$2.00 per share of Common Stock.

In July 1999, the Company extended the expiration dates until June 30, 2001, of various options held by certain directors, officers, and employees of the Company. See "Certain Transactions."

Selling Shareholder Warrants

Pursuant to a Financial Public Relations Agreement between the Company and I.W. Miller Group, Inc. ("Miller"), the Company retained Miller as its public relations consultant effective August 1, 1999. As part of the agreement, the Company issued to Miller fully vested warrants to acquire up to 100,000 shares, 50,000 of which are exercisable at \$2.00 per share and 50,000 of which are exercisable at \$3.00 per share. The warrants are exercisable at any time for two years following issuance. The warrants were issued to Miller pursuant to Rule 506 under the Act, and the shares of Common Stock underlying the warrants will be issued to Miller pursuant to such exemption.

The Company entered into a consulting agreement with Harmonic Research, Inc. ("Harmonic") pursuant to which the Company issued to Harmonic fully vested warrants to acquire up to 150,000 shares of Common Stock at \$2.50 per share. The warrants are exercisable at any time for two years following issuance. The warrants were issued to Harmonic pursuant to Rule 506 under the Act, and the shares of Common Stock underlying the warrants will be issued to Harmonic pursuant to such exemption. Pursuant to the consulting agreement, the Company retained Harmonic as a consultant for a three month period ending December 1, 1999, and agreed to pay Harmonic a fee of \$5,000 per month.

The Company has agreed to prepare and file at its expense a registration statement with the Securities and Exchange Commission covering the resale of the Common Stock underlying the Selling Shareholder Warrants. The Company will also seek to have the resale of the Common Stock exempted from registration in those states in which the Selling Shareholders are located.

Options and Purchase Rights

As of March 31, 1999, the Company had issued to its directors, executive officers, consultants, and employees Options to acquire up to 15,000 shares of Common Stock at \$5.00 per share, options to acquire up to 99,850 shares of Common Stock at \$4.50 per share, options to acquire up to 141,500 shares of Common Stock at \$2.50 per share, options to acquire up to 2,500 shares of Common Stock at \$2.00 per share, options to acquire up to 105,000 shares of Common Stock at \$1.50 per share, and options to acquire up to 5,000 shares of Common Stock at \$.50 per share. See "Management--Executive Stock Options", and "Management - Director Compensation and Stock Options." The Company has also issued purchase rights to acquire up to 15,280 shares of Common Stock at \$10.00 per share. In connection with the Management Options, the Company has, at its cost and expense, filed a registration statement under the Act covering the resale of all the Common Stock underlying the options.

Common Stock

The holder of each share of Common Stock is entitled to one vote on all matters submitted to a vote of the shareholders of the Company, including the election of directors. There is no cumulative voting for directors.

The holders of Common Stock are entitled to receive such dividends as the Board of Directors may from time to time declare out of funds legally available for payment of dividends. No dividend may be paid on the Common Stock until all accumulated and unpaid dividends on the Preferred Stock have been paid.

Upon any liquidation, dissolution or winding up of the Company, holders of shares of Common Stock are entitled to receive pro rata all of the assets of the Company available for distribution, subject to the liquidation preference of the Preferred Stock of \$10.00 per share and any unpaid and accumulated dividends on the Preferred Stock. The holders of the Common Stock do not have any preemptive rights to subscribe for or purchase shares, obligations.

Series A Convertible Preferred Stock

The holders of shares of Series A Preferred Stock have the number of votes per share equal to the number of shares of Common Stock into which each such share is convertible (i.e., 1 share of Series A Preferred Stock equals 1 vote). The shares of Preferred Stock are entitled to vote on all matters submitted to the vote of the shareholders of the Company, including the election of directors.

The holders of Series A Preferred Stock are entitled to an annual cumulative cash dividend of \$1.50 per annum, payable when, as and if declared by the Board of Directors. The record dates for payment of dividends on the Series A Preferred Stock are February 1 and August 1 of each year. Any and all accumulated and unpaid cash dividends on the Series A Preferred Stock must be declared and paid prior to the declaration and payment of any dividends on the Common Stock. Any unpaid and accumulated dividends will not bear interest. As of June 30, 1999 the accumulated and unpaid dividends on the Series A Preferred Stock were \$3,347,090. On August 1, 1999, approximately \$481,070 of additional dividends will accrue on the Series A Preferred Stock.

Each share of Series A Preferred Stock is convertible at any time into 1 share of fully issued and non-assessable Common Stock. Accrued and unpaid dividends earned on shares of Series A Preferred Stock being converted into Common Stock are also convertible into Common Stock at the rate \$10.00 per share of Common Stock at the time of conversion and whether or not such dividends have then been declared by the Company. As of March 31, 1999, a total of 451,123 shares of Series A Preferred Stock have been converted into Common Stock and accrued and unpaid dividends thereon have been converted into 202,697 shares of Common Stock. The conversion rate of the Series A Preferred Stock (and any accrued and unpaid dividends thereon) will be equitably adjusted for stock splits, stock combinations, recapitalizations, and in connection with certain other issuances of Common Stock by the Company. Upon any liquidation, dissolution, or winding-up of the Company, the holders of Series A Preferred Stock are entitled to receive a distribution in preference to the Common Stock in the amount of \$10.00 per share plus any accumulated and unpaid dividends.

The Company has the right, at any time, to redeem all or any part of the issued and outstanding Series A Preferred Stock for the sum of \$11.00 per share plus any and all unpaid and accumulated dividends thereon. Upon notice by the Company of such call, the holders of the Series A Preferred Stock so called will have the opportunity to convert their shares of Series A Preferred Stock and any unpaid and accumulated dividends thereon (whether or not such dividends have been declared by the Company as of such date) into shares of Common Stock. The \$11.00 per share figure was the redemption price approved by the Directors and Shareholders of the Company at the time the Series A Preferred Stock was created and first issued. The Company currently has no plans to redeem the Preferred Stock.

The Company paid a special stock dividend consisting of one-third of a share of Common Stock for each share of Series A Preferred Stock issued and outstanding on August 1, 1995. The stock dividend consisted of an aggregate of 190,860 shares of Common Stock.

12% Senior Notes

The principal amount of each 12% Senior Note shall be payable on December 31, 2001, at which time any unpaid and accrued interest shall also become due. Interest shall accrue at the rate of 12% per annum from and after the date of issuance and shall be payable quarterly in arrears on December 31, March 31, June 30, and September 30 of each year until December 31, 2001. The Senior Notes are senior to all existing equity securities of the Company, including the Series A Preferred Stock. See "Risk Factors -- Ability to Service Debt; Subordination."

The indebtedness evidenced in the Senior Note is subordinated to the prior payment when due of the principal of, premium, if any, and interest on all "Senior Indebtedness", as defined herein, of the Company as follows: Upon any distribution of its assets in a liquidation or dissolution of the Company, or in bankruptcy, reorganization, insolvency, receivership or similar proceedings relating to the Company, the Lender shall not be entitled to receive payment until the holders of Senior Indebtedness are paid in full. Until a payment default occurs with respect to any Senior Indebtedness, all payments of principal and interest due to Lender under the Senior Note shall be made in accordance with this Senior Note. Upon the occurrence of any payment default with respect to any Senior Indebtedness then, upon written notice thereof to the Company and Lender by any holder of such Senior Indebtedness or its representative, no payments of principal or interest on the Senior Note shall be made by the Company until such payment default has been cured to the satisfaction of the holder of such Senior Indebtedness or waived by such holder, provided, however, that if during the 180 day period following such default, the holder of Senior Indebtedness has not accelerated its loan, commenced foreclosure proceedings or otherwise undertaken to act on such default then the Company shall be required to continue making payments under the Senior Note, including any which had not been paid during such 180 day period. In the event that any institutional lender to the Company at any time so requires, the Lender shall execute, upon request of the Company, any intercreditor or subordination agreement(s) with any such institutional lender on terms not materially more adverse to the Lender than the subordination terms contained in this Senior Note.

The term "Senior Indebtedness" shall mean (a) all direct or indirect, contingent or certain indebtedness of any type, kind or nature (present or future) created, incurred or assumed by the Company with respect to any future bank or other financial institutional indebtedness of the Company, or (b) any indebtedness created, incurred, or assumed, by the Company secured by a lien on any assets of the Company.

Notwithstanding anything herein to the contrary, Senior Indebtedness does not include (i) unsecured accounts payable to trade creditors of the Company incurred in the ordinary course of business, (ii) any debt owed by the Company, to any officer, director or stockholder of the Company, (iii) any obligation of Borrower issued or contracted for as payment in consideration of the purchase by the Company of the capital stock or substantially all of the assets of another person or in consideration for the merger or consolidation with respect to which the Company was a party, (iv) any operating lease obligations of the Company, (v) any other indebtedness which by its terms is subordinated to the Senior Note, or (vi) any "other indebtedness" which is subordinated to all indebtedness to which the Senior Note is subordinated in substantially like terms as the Senior Note; which such "other indebtedness" shall be treated as equal with the indebtedness evidenced by the Senior Note.

Series B Equity Participating Preferred Stock

Pursuant to the private placement offering conducted by the Company from September 1998 through June 1999, the Company had issued 466,800 shares of Series B Preferred Stock. The Series B Preferred Stock was convertible into 4 shares of Common Stock in the event of a reverse stock split of the Common Stock. As a result of the 1-for-10 reverse stock split which became effective on June 7, 1999, all of the shares of Series B Preferred Stock were exchanged for 1,867,200 shares of Common Stock, and as of the date hereof, there are no issued and outstanding shares of Series B Preferred Stock. The 1,867,200 shares of Common Stock issued to the holders of the Series B Preferred Stock are restricted securities as defined under Rule 144 promulgated under the Act, and can not be sold or transferred without registration under the Act or pursuant to an applicable exemption therefrom.

Convertible Securities and GEM Warrants

During June 1997, the Company issued an aggregate of \$500,000 of Convertible Securities pursuant to an agreement with Gem Advisors Inc. ("GEMA") which provided GEMA with the exclusive right to place the Convertible Securities with qualified purchasers. Through December 31, 1997, the holders of all \$500,000 of Convertible Securities converted their securities into 191,574 shares of Common Stock at an average price of \$2.60 per share. The Convertible Securities were issued by the Company pursuant to Regulation S promulgated under the Act.

Affiliates and/or consultants to GEMA received non-redeemable warrants to purchase up to 200,000 shares of the Company's Common Stock at a price of \$2.00 per share at any time prior to June 23, 2002 ("GEM Warrants"). These warrants have been issued by the Company pursuant to Regulation S. Through March 31, 1999, 90,000 GEM Warrants have been exercised, leaving a balance of 110,000 GEM Warrants.

1999-A Common Stock Purchase Warrants

Each 1999-A Warrant entitles its holder to immediately purchase one share of Common Stock. The exercise price is \$1.00, except that through December 31, 1999, the exercise price has been reduced to \$.50 per share. The 1999-A Warrants are exercisable at any time on or prior to December 31, 2001, or such later date as may be determined by the Company. As of the date hereof all 933,600 1999-A Warrants remain outstanding.

The Company has, at its expense, registered for resale the Common Stock underlying the 1999-A Warrants under the Act, and has exempted from registration such Common Stock for resale by non-affiliates of the Company, in those states in which holders of the 1999-A Warrants are located.

The 1999-A Warrants have been issued pursuant to a warrant agreement (the "1999-A Warrant Agreement") dated as of September 28, 1998 by and between the Company and American Stock Transfer & Trust Company, the warrant agent, and will be evidenced by warrant certificates.

The exercise price of the 1999-A Warrants and the number of shares of Common Stock issuable upon exercise of the 1999-A Warrants are subject to adjustment in certain circumstances, including a stock split of, stock dividend on, or a subdivision, combination or recapitalization of the Common Stock. Upon the merger, consolidation, sale of substantially all of the assets of the Company, or other similar transaction, the Warrant holders shall, at the option of the Company, be required to exercise the Warrants immediately prior to the closing of the transaction, or such Warrants shall automatically expire. Upon such exercise, the Warrant holders shall participate on the same basis as the holders of Common Stock in connection with the transaction.

The 1999-A Warrants do not confer upon the holder any voting or any other rights of a shareholder of the Company. Upon notice to the 1999-A Warrant holders, the Company has the right, at any time and from time to time, to reduce the exercise price or to extend the expiration date of the 1999-A Warrants.

1998-B Common Stock Purchase Warrants

Each 1998-B Warrant entitles its holder to immediately purchase one share of Common Stock. The exercise price is \$1.50 per share through January 1, 1999 and \$4.00 per share thereafter, subject to reduction at any time by the Company. The 1998-B Warrants are exercisable at any time prior to August 17, 2003, or such later date as may be determined by the Company.

The 1998-B Warrants have been issued pursuant to a warrant agreement (the "1998-B Warrant Agreement") dated as of July 1, 1998 by and between the Company and American Stock Transfer & Trust Company, the transfer agent. The Company issued 139,000 1998-B Warrants to the Selling Shareholders pursuant to the 1998-B Warrant Agreement in a transaction exempt from the registration requirements of the Securities Act of 1933, as amended (the "Act"), and applicable state securities laws. As of March 31, 1999, 10,100 1998-B Warrants remain outstanding.

The Company has, at its expense, registered for resale the Common Stock underlying the 1998-B Warrants under the Act, and has exempted from registration such Common Stock for resale by non-affiliates of the Company, in those states in which the holders of the 1998-B Warrants are located.

The exercise price of the 1998-B Warrants and the number of shares of Common Stock issuable upon exercise of the 1998-B Warrants are subject to adjustment in certain circumstances, including a stock split of, stock dividend on, or a subdivision, combination or recapitalization of the Common Stock. Upon the merger, consolidation, sale of substantially all of the assets of the Company, or other similar transaction, the Warrant holders shall, at the option of the Company, be required to exercise the Warrants immediately prior to the closing of the transaction, or such Warrants shall automatically expire. Upon such exercise, the Warrant holders shall participate on the same basis as the holders of Common Stock in connection with the transaction.

The 1998-B Warrants do not confer upon the holder any voting or any other rights of a shareholder of the Company. Upon notice to the 1998-B Warrant holders, the Company has the right, at any time and from time to time, to reduce the exercise price or to extend the expiration date of the 1998-B Warrants.

1998-A Common Stock Purchase Warrants

Each 1998-A Warrant entitles its holder to immediately purchase one share of Common Stock. The exercise price was \$1.50 per share through June 1, 1998 and \$4.00 per share thereafter, subject to reduction at any time by the Company. The 1998-A Warrants are exercisable at any time prior to March 5, 2003 or such later date as may be determined by the Company.

The 1998-A Warrants have been issued pursuant to a warrant agreement (the "1998-A Warrant Agreement") dated as of January 28, 1998 by and between the Company and American Stock Transfer & Trust Company, the warrant agent. The Company issued 375,000 1998-A Warrants to the Selling Shareholders pursuant to the 1998-A Warrant Agreement in a transaction exempt from the registration requirements of the Act and applicable state securities laws. As of March 31, 1999, 4,000 1998-A Warrants remain outstanding.

The Company has, at its expense, registered for resale the Common Stock underlying the 1998-A Warrants under the Act, and to exempt from registration such Common Stock for resale by non-affiliates of the Company in those states in which the holders of the 1998-A Warrants are located.

The exercise price of the 1998-A Warrants and the number of shares of Common Stock issuable upon exercise of the 1998-A Warrants are subject to adjustment in certain circumstances, including a stock split of stock dividend on, or a subdivision, combination or recapitalization of, the Common Stock. Upon the merger, consolidation, sale of substantially all of the assets of the Company, or other similar transaction, the Warrant holders shall, at the option of the Company, be required to exercise the Warrants immediately prior to the closing of the transaction, or such Warrants shall automatically expire. Upon such exercise, the Warrant holders shall participate on the same basis as the holders of Common Stock in connection with the transaction.

The 1998-A Warrants do not confer upon the holder any voting or any other rights of a shareholder of the Company. Upon notice to the 1998-A Warrant holders, the Company has the right, at any time and from time to time, to reduce the exercise price or to extend the expiration date of the 1998-A Warrants.

1997 Common Stock Purchase Warrants

Each 1997 Warrant entitles its holder to immediately purchase one share of Common Stock. The exercise price was \$2.00 per share through October 31, 1997 and \$4.00 per share thereafter, subject to reduction at any time by the Company. The 1997 Warrants are exercisable at any time prior to July 3, 2002, or such later date as may be determined by the Company.

The 1997 Warrants have been issued pursuant to a warrant agreement (the "1997 Warrant Agreement") dated as of April 8, 1997 by and between the Company and American Stock Transfer & Trust Company, the warrant agent. The Company issued 160,000 1997 Warrants to the Selling Shareholders pursuant to the 1997 Warrant Agreement in a transaction exempt from the registration requirements of the Act and applicable state securities laws. As of March 31, 1999, 158,500 1997 Warrants have been exercised and 1,500 remain outstanding.

The Company has, at its expense, registered for resale the Common Stock underlying the 1997 Warrants under the Act, and has exempted from registration such Common Stock for resale by non-affiliates of the Company in those states in which the holders of the 1997 Warrants are located.

The exercise price of the 1997 Warrants and the number of shares of Common Stock issuable upon exercise of the 1997 Warrants are subject to adjustment in certain circumstances, including a stock split of, stock dividend on, or a subdivision, combination or recapitalization of the Common Stock. Upon the merger, consolidation, sale of substantially all of the assets of the Company, or other similar transaction, the Warrant holders shall, at the option of the Company, be required to exercise the Warrants immediately prior to the closing of the transaction, or such Warrants shall automatically expire. Upon such exercise, the Warrant holders shall participate on the same basis as the holders of Common Stock in connection with the transaction.

The 1997 Warrants do not confer upon the holder any voting or any other rights of a shareholder of the Company. Upon notice to the 1997 Warrant holders, the Company has the right, at any time and from time to time, to reduce the exercise price or to extend the expiration date of the 1997 Warrants.

1996-B Common Stock Purchase Warrants

Each 1996-B Warrant entitles its holder to immediately purchase one share of Common Stock. The exercise price was \$2.00 per share through October 31, 1997 and \$3.00 per share thereafter, subject to reduction at any time by the Company. The 1996-B Warrants are exercisable at any time prior to February 28, 2002 or such later date as may be determined by the Company.

The 1996-B Warrants have been issued pursuant to a warrant agreement dated as of February 28, 1997 (the "1996-B Warrant Agreement") dated as of December 27, 1996 by and between the Company and American Stock Transfer & Trust Company, the warrant agent. The Company issued 37,400 1996-B Warrants to the Selling Shareholders pursuant to the 1996-B Warrant Agreement in a transaction exempt from the registration requirements of the Act and applicable securities laws. As of March 31, 1999, 33,400 1996-B Warrants were exercised and 4,000 remain outstanding.

The Company has, at its expense, registered for resale the Common Stock underlying the 1996-B Warrants under the Act, and has exempted from registration such Common Stock for resale by non-affiliates of the Company in those states in which the holders of the 1996-B Warrants are located.

The exercise price of the 1996-B Warrants and the number of shares of Common Stock issuable upon exercise of the 1996-B Warrants are subject to adjustment in certain circumstances, including a stock split of, stock dividend on, or a subdivision, combination or recapitalization of the Common Stock. Upon the merger, consolidation, sale of substantially all of the assets of the Company, or other similar transaction, the Warrant holders shall, at the option of the Company, be required to exercise the Warrants immediately prior to the closing of the transaction, or such Warrants shall automatically expire. Upon such exercise, the Warrant holders shall participate on the same basis as the holders of Common Stock in connection with the transaction.

The 1996-B Warrants do not confer upon the holder any voting or any other rights of a shareholder of the Company. Upon notice to the 1996-B Warrant holders, the Company has the right, at any time and from time to time, to reduce the exercise price or to extend the expiration date of the 1996-B Warrants.

1996 Common Stock Purchase Warrants

Each 1996 Warrant entitles its holder to immediately purchase one share of Common Stock. The exercise price was \$2.50 through October 31, 1997, and \$5.00 thereafter, or such lower price as may be determined by the Company from time to time. The 1996 Warrants are exercisable at any time through May 31, 2001, or such later date as may be determined by the Company. In July 1998, the Company authorized a temporary reduction in the exercise price of each outstanding 1996 Warrant to \$2.00 through the close of business on September 30, 1998.

The 1996 Warrants have been issued pursuant to a 1996 Warrant Agreement dated as of May 1, 1996, by and between the Company and American Stock Transfer & Trust Company, the warrant agent. The Company issued 520,000 1996 Warrants to the Selling Shareholders pursuant to the 1996 Warrant Agreement in a transaction exempt from the registration requirements of the Act and applicable state securities laws. As of March 31, 1999, 433,200 1996 Warrants were exercised and 86,800 remain outstanding.

The Company has, at its expense, registered for resale the Common Stock underlying the 1996 Warrants under the Act, and has exempted from registration such Common Stock for resale by non-affiliates of the Company in those states in which the holders of the 1996 Warrants are located.

The exercise price of the 1996 Warrants and the number of shares of Common Stock issuable upon exercise of the 1996 Warrants are subject to adjustment in certain circumstances, including a stock split of, stock dividend on, or a subdivision, combination or recapitalization of the Common Stock. Upon the merger, consolidation, sale of substantially all the assets of the Company, or other similar transaction, the 1996 Warrant holders shall, at the option of the Company, be required to exercise the 1996 Warrants immediately prior to the closing of the transaction, or such 1996 Warrants shall automatically expire. Upon such exercise, the 1996 Warrant holders shall participate on the same basis as the holders of Common Stock in connection with the transaction.

The 1996 Warrants do not confer upon the holder any voting or any other rights of a shareholder of the Company. Upon notice to the 1996 Warrant holders, the Company has the right, at any time and from time to time, to reduce the exercise price or to extend the 1996 Warrant Termination Date.

1995 Common Stock Purchase Warrants

Each 1995 Warrant entitles its holder to immediately purchase one share of Common Stock. The exercise price was \$2.50 through October 31, 1997, and \$5.00 thereafter, or such lower exercise price as may be determined by the Company from time to time. The 1995 Warrants are exercisable at any time through January 31, 2001, or such later date as may be determined by the Company. In July 1998, the Company authorized a temporary reduction in the exercise price of each outstanding 1995 Warrant to \$2.00 through the close of business on September 30, 1998.

The 1995 Warrants have been issued pursuant to a 1995 Warrant Agreement dated as of June 21, 1995, by and between the Company and American Stock Transfer & Trust Company, the warrant agent. The Company issued 510,000 1995 Warrants to the Selling Shareholders pursuant to the 1995 Warrant Agreement in a transaction exempt from the registration requirements of the Act and applicable state securities laws. As of March 31, 1999, 442,700 1995 Warrants were exercised and 67,300 remain outstanding.

The Company has registered for resale the Common Stock underlying the 1995 Warrants under the Act, and has registered or exempted from registration such Common Stock for resale by non-affiliates of the Company in those states in which the holders of the 1995 Warrants are located.

The exercise price of the 1995 Warrants and the number of shares of Common Stock issuable upon exercise of the 1995 Warrants are subject to adjustment in certain circumstances, including a stock split of, stock dividend on, or a subdivision, combination or recapitalization of the Common Stock. Upon the merger, consolidation, sale of substantially all the assets of the Company, or other similar transaction, the 1995 Warrant holders shall, at the option of the Company, be required to exercise the 1995 Warrants immediately prior to the closing of the transaction, or such Warrants shall automatically expire. Upon such exercise, the 1995 Warrant holders shall participate on the same basis as the holders of Common Stock in connection with the transaction.

The 1995 Warrants do not confer upon the holder any voting or any other rights of a shareholder of the Company. Upon notice to the 1995 Warrant holders, the Company has the right, at any time and from time to time, to reduce the exercise price or to extend the 1995 Warrant Termination Date.

Shares Eligible for Future Sale

Of the 4,617,198 shares of Common Stock issued and outstanding on March 31, 1999, 4,233,398 are freely transferable without restriction or further registration under the Act (other than shares held by "affiliates" of the Company), and the remaining 383,800 are "restricted securities". As of March 31, 1999, there were 660,027 shares of Preferred Stock issued and outstanding, 510,027 of which are freely transferable without further registration or restriction under the Act (other than shares held by "affiliates" of the Company), and the remaining 150,000 are "restricted securities". The 660,027 shares of Preferred Stock issued and outstanding as of March 31, 1999 are convertible into 660,027 shares of Common Stock. Of such shares of Common Stock, 510,027 would be fully transferrable without registration or regulation under the Act or eligible for sale under the Rule and 150,000 would not be eligible for sale.

As set forth in the prior paragraph, there were 383,800 shares of Common Stock and 150,000 shares of Preferred Stock which are "restricted securities" and cannot be resold without registration. The preferred shares would become eligible for sale under Rule 144 during calendar year 1999, and the Common Stock in calendar year 2000.

In general, under Rule 144 as currently in effect, a person (or persons whose shares are required to be aggregated), including any affiliate of the Company, who beneficially owns "restricted securities" for a period of at least one year is entitled to sell within any three-month period, shares equal in number to the greater of (i) 1% of the then outstanding shares of the same class of shares, or (ii) the average weekly trading volume of the same class of shares during the four calendar weeks preceding the filing of the required notice of sale with the Securities and Exchange Commission. The seller must also comply with the notice and manner of sale requirements of Rule 144, and there must be current public information available about the Company. In addition, any person (or persons whose shares must be aggregated) who is not, at the time of sale, nor during the preceding three months, an affiliate of the Company, and who has beneficially owned restricted shares for at least two years, can sell such shares under Rule 144 without regard to the notice, manner of sale, public information or the volume limitations described above.

Limitation of Liability; Indemnification

As permitted by the Pennsylvania Business Corporation Law of 1988 ("BCL"), the Company's By-laws provide that Directors of the Company will not be personally liable, as such, for monetary damages for any action taken unless the Director has breached or failed to perform the duties of a Director under the BCL and the breach or failure to perform constitutes self-dealing, willful

misconduct or recklessness. This limitation of personal liability does not apply to any responsibility or liability pursuant to any criminal statute, or any liability for the payment of taxes pursuant to Federal, State or local law. The By-laws also include provisions for indemnification of the Company's Directors and officers to the fullest extent permitted by the BCL. Insofar as indemnification for liabilities arising under the Act may be permitted to Directors, officers and controlling persons of the Company pursuant to the foregoing provisions, or otherwise, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable.

Transfer Agent and Registrar

The Transfer Agent and Registrar for the Common Stock, Series A Preferred Stock, 1999-A Warrants, 1998-B Warrants, 1998-A Warrants, 1997 Warrants, 1996-B Warrants, 1996 Warrants and 1995 Warrants is American Stock Transfer & Trust Company, 40 Wall Street, New York, New York 10005.

PLAN OF DISTRIBUTION

The Common Stock is being registered to permit public secondary trading of the Common Stock by the Selling Shareholders from time to time after the date of this Prospectus. The Company has agreed to bear all the expenses (other than selling commissions) in connection with the registration and sale of the Common Stock covered by this Prospectus.

The Common Stock offered by the Selling Shareholders pursuant to this Prospectus may be sold from time to time by the Selling Shareholders. The sale of the Common Stock offered hereby by the Selling Shareholders may be effected in one or more transactions that may take place on the over-the-counter market, including ordinary brokers' transactions, privately negotiated transactions or through sales to one or more dealers for resale of such securities as principals. Usual and customary or specifically negotiated brokerage fees or commissions may be paid by the Selling Shareholders.

The Company will not receive any of the proceeds from the sale of the Common Stock by the Selling Shareholders. The Selling Shareholders will receive all of the net proceeds from the sale of the Common Stock and will pay all selling commissions, if any, applicable to the sale of the Common Stock. The Company is responsible for all other expenses incident to the offer and sale of the Common Stock.

In order to comply with the securities laws of certain states, if applicable, the Common Stock will be sold in such jurisdictions only through registered or licensed brokers or dealers. In

addition, in certain states, the Common Stock may not be sold unless it has been registered or qualified for resale by the Selling Shareholder in the applicable state or an exemption from the registration or qualification requirement is available and complied with.

LEGAL MATTERS

The validity of the Common Stock has been passed upon for the Company by Lurio & Associates P.C., Philadelphia, Pennsylvania 19103.

EXPERTS

The consolidated financial statements of USA Technologies, Inc. at June 30, 1998 and 1997, and for each of the two years in the period ended June 30, 1998, appearing in this Prospectus and Registration Statement have been audited by Ernst & Young LLP, independent auditors, as set forth in their report thereon (which contains an explanatory paragraph describing conditions that raise substantial doubt about the Company's ability to continue as a going concern as described in Note 2 to the consolidated financial statements) appearing elsewhere herein, and are included in reliance upon such report given upon the authority of such firm as experts in accounting and auditing.

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USA TECHNOLOGIES, INC.

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Report of Independent Auditors

To the Board of Directors and Shareholders
USA Technologies, Inc.

We have audited the accompanying consolidated balance sheets of USA Technologies, Inc. as of June 30, 1998 and 1997, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the two years in the period ended June 30, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of USA Technologies, Inc. at June 30, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the two years in the period ended June 30, 1998, in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming USA Technologies, Inc. will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company's recurring losses from operations from its inception and its accumulated deficit through June 30, 1998, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that might result from the outcome of this uncertainty.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
August 17, 1998
except Note 15, as to which the date is
June 7, 1999

USA Technologies, Inc.
Consolidated Balance Sheets

| | 1998 | June 30 1997 | March 31, 1999 (unaudited) |
|---|---------------------|---------------------|----------------------------------|
| | | | |
| Assets | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$ 324,824 | \$ 630,266 | \$ 362,512 |
| Accounts receivable less allowance for uncollectible accounts of \$23,764 and \$19,345 at June 30, 1998 and 1997, and \$23,783 at March 31, 1999 (unaudited) | 222,743 | 127,318 | 749,064 |
| Inventory | 436,971 | 378,318 | 790,860 |
| Stock subscriptions receivable | 19,875 | 60,000 | -- |
| Prepaid expenses and deposits | 20,515 | 15,670 | 32,461 |
| Total current assets | 1,024,928 | 1,211,572 | 1,934,897 |
| Property and equipment, net | 151,906 | 178,457 | 127,505 |
| Other assets | 10,250 | 20,250 | 10,250 |
| Total assets | \$ 1,187,084 | \$ 1,410,279 | \$ 2,072,652 |
| Liabilities and shareholders' equity | | | |
| Current liabilities: | | | |
| Accounts payable | \$ 576,787 | \$ 474,646 | \$ 2,277,926 |
| Accrued expenses | 430,643 | 46,742 | 409,934 |
| Current obligations under capital leases | 22,810 | 18,270 | 12,030 |
| Total current liabilities | 1,030,240 | 539,658 | 2,699,890 |
| Senior Notes | -- | -- | 888,758 |
| Obligations under capital leases, less current portion | 1,669 | 24,480 | 22,124 |
| Total liabilities | 1,031,909 | 564,138 | 3,610,772 |
| Shareholders' equity (deficit): | | | |
| Preferred Stock, no par value: | | | |
| Authorized shares - 1,800,000 | | | |
| Series A Convertible Preferred: Authorized shares 900,000 issued and outstanding shares - 618,236, 861,205 at June 30, 1998 and 1997, respectively and 660,027 at March 31, 1999 (unaudited) (liquidation preference of \$8,625,010 at June 30, 1998 and \$9,982,823 at March 31, 1999) | | | |
| | 4,538,114 | 7,024,811 | 4,673,592 |
| Series B Equity Participating Preferred: | | | |
| Authorized shares - 250,000; issued and outstanding shares - none at June 30, 1998 and 1997, and 95,950 at March 31, 1999 (unaudited) | | | |
| | -- | -- | -- |
| Common Stock, no par value: | | | |
| Authorized shares - 62,000,000 and 55,000,000 at June 30, 1998 and 1997, and 62,000,000 at March 31, 1999 (unaudited) | | | |
| Issued and outstanding shares - 4,016,384 and 2,996,993 at June 30, 1998 and 1997, respectively and 4,233,398 at March 31, 1999 (unaudited) | | | |
| | 11,223,213 | 4,355,334 | 11,595,769 |
| Accumulated deficit | (15,606,152) | (10,534,004) | (17,807,481) |
| Total shareholders' equity (deficit) | 155,175 | 846,141 | (1,538,120) |
| Total liabilities and shareholders' equity | \$ 1,187,084 | \$ 1,410,279 | \$ 2,072,652 |

See accompanying notes.

USA Technologies, Inc.

Consolidated Statements of Operations

| | Year ended June 30 1998 | June 30 1997 | Three months ended March 31, 1999 | | March 31, 1998 | Nine months ended March 31, 1999 | | March 31, 1998 |
|---|----------------------------|-----------------------|--------------------------------------|-----------------------|-----------------------|-------------------------------------|--|-------------------|
| | | | (Unaudited) | | | (Unaudited) | | |
| Revenues: | | | | | | | | |
| Equipment sales | \$ 1,588,487 | \$ 490,614 | \$ 864,343 | \$ 477,239 | \$ 3,021,727 | \$1,096,961 | | |
| License and transaction fees | 236,742 | 117,158 | 133,093 | 70,969 | 318,555 | 173,709 | | |
| Other | | | | | -- | 9,342 | | |
| Total revenues | 1,825,229 | 607,772 | 997,436 | 548,208 | 3,340,282 | 1,280,012 | | |
| Operating expenses: | | | | | | | | |
| General and administrative | 2,213,984 | 2,040,163 | 616,069 | 468,044 | 1,614,407 | 1,359,962 | | |
| Compensation | 1,909,682 | 1,080,458 | 336,674 | 320,723 | 1,025,154 | 968,798 | | |
| Cost of equipment sales | 1,261,729 | 525,090 | 684,836 | 380,473 | 2,576,394 | 929,610 | | |
| Depreciation and amortization | 116,255 | 97,250 | 31,710 | 25,497 | 82,012 | 76,491 | | |
| Total operating expenses | 5,501,650 | 3,742,961 | 1,669,289 | 1,194,737 | 5,297,967 | 3,334,861 | | |
| | (3,676,421) | (3,135,189) | (671,853) | (646,529) | (1,957,685) | (2,054,849) | | |
| Other income (expense): | | | | | | | | |
| Interest income | 18,225 | 26,676 | 1,534 | 5,696 | 5,229 | 15,169 | | |
| Interest expense | (8,443) | (12,199) | (20,353) | (2,484) | (28,260) | (7,133) | | |
| Joint Venture activities | 98,358 | -- | (67,971) | -- | (158,064) | -- | | |
| Total other income (expense) | 108,140 | 14,477 | (86,790) | 3,212 | (181,095) | 8,036 | | |
| Net loss | (3,568,281) | (3,120,712) | (758,643) | (643,317) | (2,138,780) | (2,046,813) | | |
| Cumulative preferred dividends and other adjustments | | | | | | | | |
| | (1,754,566) | (1,243,295) | (499,033) | (522,992) | (1,002,453) | (1,754,566) | | |
| Loss applicable to common shares | \$ (5,322,847) | \$ (4,364,007) | \$ (1,257,676) | \$ (1,166,309) | \$ (3,141,233) | \$ (3,801,379) | | |
| Loss per common share (basic and diluted) | \$ (1.51) | \$ (2.08) | \$ (0.30) | \$ (0.32) | \$ (0.77) | \$ (1.11) | | |
| Weighted average number of common shares outstanding (basic and diluted) | | | | | | | | |
| | 3,532,048 | 2,098,438 | 4,132,107 | 3,609,474 | 4,059,540 | 3,416,076 | | |

See accompanying notes.

USA Technologies, Inc.

Consolidated Statements of Shareholders' Equity

| | Series A Convertible Preferred Stock | Common Stock | Accumulated Deficit | Total |
|---|---|-----------------|------------------------|--------------|
| | ----- | | | |
| Balance, June 30, 1996 | \$ 6,776,132 | \$ 2,720,201 | \$ (7,296,143) | \$ 2,200,190 |
| Issuance of 68,700 shares of Common Stock in exchange for consulting services | - | 277,198 | - | 277,198 |
| Conversion of 24,170 shares of Convertible Preferred Stock to 27,380 shares of Common Stock | (206,009) | 206,009 | - | - |
| Conversion of \$39,001 of cumulative preferred dividends into 3,900 shares of Common Stock at \$10.00 per share | - | 39,001 | (39,001) | - |
| Conversion of \$78,148 of cumulative preferred dividends into 9,416 shares of Common Stock at \$8.30 per share | - | 78,148 | (78,148) | - |
| Common Stock warrants exercised - 320,200 at \$2.00 per warrant, net of offering costs | - | 576,108 | - | 576,108 |
| Issuance of 9,350 shares (9.35 units) of Convertible Preferred Stock at \$10.00 per share in connection with the 1996B Private Placement | 93,500 | - | - | 93,500 |
| Issuance of 80,000 shares (40 units) of Convertible Preferred Stock at \$5.00 per share in connection with the 1997 Private Placement, net of offering costs | 361,188 | - | - | 361,188 |
| Exercise of 15,000 Common Stock options at \$.50 per share | - | 7,500 | - | 7,500 |
| Issuance of Common Stock in connection with convertible security placement (Note 9), net of offering costs | - | 451,169 | - | 451,169 |
| Net loss | - | - | (3,120,712) | (3,120,712) |
| | ----- | | | |
| Balance, June 30, 1997 | 7,024,811 | 4,355,334 | (10,534,004) | 846,141 |

USA Technologies, Inc.

Consolidated Statements of Shareholders' Equity (continued)

| | Series A Convertible Preferred Stock | Common Stock | Accumulated Deficit | Total |
|---|---|-----------------|------------------------|----------------|
| Issuance of 20,500 shares of Common Stock in exchange for consulting services | \$ - | \$ 68,096 | \$ - | \$ 68,096 |
| Issuance of 950 shares of Common Stock to employees as compensation | - | 2,565 | - | 2,565 |
| Conversion of 392,969 shares of Convertible Preferred Stock to 466,452 shares of Common Stock | (3,188,207) | 3,188,207 | - | - |
| Conversion of \$1,388,772 of cumulative preferred dividends into 167,455 shares of Common Stock at \$8.30 per share | - | 1,388,772 | (1,388,772) | - |
| Conversion of \$115,095 of cumulative preferred dividends into 11,509 shares of Common Stock at \$10.00 per share | - | 115,095 | (115,095) | - |
| Common Stock warrants exercised - 371,000 at \$1.50 per warrant | - | 556,500 | - | 556,500 |
| Common Stock warrants exercised - 281,900 at \$2.00 per warrant, net of offering costs | - | 521,639 | - | 521,639 |
| Common Stock warrants exercised - 187,100 at \$2.50 per warrant | - | 467,750 | - | 467,750 |
| Exercise of 7,000 Common Stock options - at \$.50 per share | - | 3,500 | - | 3,500 |
| Exercise of 450 Common Stock purchase rights - at \$2.50 per share | - | 1,125 | - | 1,125 |
| Cancellation of 436,500 shares of Common Stock by the President of the Company | - | - | - | - |
| Issuance of 150,000 shares (75 units) of Convertible Preferred Stock at \$5.00 per share, in connection with 1997B Private Placement, net of offering costs | 701,510 | - | - | 701,510 |
| Reduction in exercise price below the fair market value for 189,600 Common Stock options | - | 554,630 | - | 554,630 |
| Net loss | - | - | (3,568,281) | (3,568,281) |
| Balance, June 30, 1998 | \$ 4,538,114 | \$ 11,223,213 | \$ (15,606,152) | \$ 155,175 |
| Issuance of 50 shares of Common Stock to an employee as compensation (unaudited) | - | 100 | - | 100 |
| Conversion of 13,809 shares of Convertible Preferred Stock to 13,809 shares of Common Stock (unaudited) | (99,007) | 99,007 | - | - |
| Conversion of \$62,549 of cumulative preferred dividends into 6,255 shares of Common Stock at \$10.00 per share (unaudited) | - | 62,549 | (62,549) | - |
| Issuance of 55,600 shares (27.8 units) of Convertible Preferred Stock at \$5.00 per share for 1998-B Private Placement, net of offering costs of \$43,155 (unaudited) | 234,485 | - | - | 234,485 |
| Issuance of 23,000 shares of Common Stock in exchange for consulting services (unaudited) | - | 37,000 | - | 37,000 |
| Exercise of 128,900 Common Stock warrants at \$1.00 per share (unaudited) | - | 128,900 | - | 128,900 |
| Exercise of 45,000 Common Stock options at \$1.00 per share (unaudited) | - | 45,000 | - | 45,000 |
| Issuance of 95,950 shares (95.95 units) of Series B Equity Participating Preferred Stock (unaudited) | - | - | - | - |
| Net loss (unaudited) | - | - | (2,138,780) | (2,138,780) |
| Balance, March 31, 1999 | \$ 4,673,592 | \$ 11,595,769 | \$ (17,807,481) | \$ (1,538,120) |

See accompanying notes.

USA Technologies, Inc.

Consolidated Statements of Cash Flows

| | Year ended June 30 | | Nine months ended March 31 | |
|---|--------------------|----------------|----------------------------|---------------|
| | 1998 | 1997 | 1999 | 1998 |
| | | | (Unaudited) | |
| | ----- | | ----- | |
| Operating activities | | | | |
| Net loss | \$(3,568,281) | \$ (3,120,712) | \$(2,138,780) | \$(2,046,813) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | | |
| Compensation charges incurred in connection with the issuance of Common Stock and repricing of Common Stock options | 625,291 | 277,198 | 37,100 | 70,661 |
| Depreciation and amortization | 116,255 | 97,250 | 82,012 | 76,491 |
| Provision for allowance for uncollectible accounts | 10,441 | 19,345 | 19 | 3,264 |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | (105,866) | (146,663) | (526,340) | (280,934) |
| Inventory | (147,634) | 48,073 | (367,708) | (218,012) |
| Prepaid expenses, deposits, and other assets | 5,155 | 9,702 | (11,946) | (8,449) |
| Accounts payable | 102,141 | 172,797 | 1,701,139 | 271,273 |
| Accrued expenses | 383,901 | (8,332) | (20,709) | 167,627 |
| | ----- | | ----- | |
| Net cash used in operating activities | (2,578,597) | (2,651,342) | (1,245,213) | (1,964,892) |
| Investing activities | | | | |
| Purchase of property and equipment | (723) | (17,855) | (8,984) | (723) |
| | ----- | | ----- | |
| Net cash used in investing activities | (723) | (17,855) | (8,984) | (723) |
| Financing activities | | | | |
| Net proceeds from issuance of Senior Notes | - | - | 883,192 | - |
| Net proceeds from issuance of Common Stock and exercise of Common Stock warrants | 1,530,639 | 1,141,126 | 193,775 | 1,055,439 |
| Net proceeds from issuance of Convertible Preferred Stock | 761,510 | 394,688 | 234,485 | 715,125 |
| Repayment of principal on capital lease obligations | (18,271) | (9,707) | (19,567) | (13,316) |
| | ----- | | ----- | |
| Net cash provided by financing activities | 2,273,878 | 1,526,107 | 1,291,885 | 1,757,248 |
| | ----- | | ----- | |
| Net increase (decrease) in cash and cash equivalents | (305,442) | (1,143,090) | 37,688 | (208,367) |
| Cash and cash equivalents at beginning of period | 630,266 | 1,773,356 | 324,824 | 630,266 |
| | ----- | | ----- | |
| Cash and cash equivalents at end of period | \$ 324,824 | \$ 630,266 | \$ 362,512 | 421,899 |
| | ===== | | ===== | |
| Supplemental disclosures of cash flow information: | | | | |
| Conversion of Convertible Preferred Stock to Common Stock | \$ 3,188,207 | \$ 206,009 | \$ 99,007 | \$ 3,016,253 |
| | ===== | | ===== | |
| Conversion of Cumulative Preferred Dividends to Common Stock | \$ 1,503,867 | \$ 117,149 | \$ 62,549 | \$ 1,398,979 |
| | ===== | | ===== | |
| Transfer of inventory to property and equipment | \$ 88,981 | \$ - | \$ 13,819 | \$ - |
| | ===== | | ===== | |
| Stock subscription receivable | \$ 19,875 | \$ 60,000 | \$ - | \$ - |
| | ===== | | ===== | |
| Capital lease obligations incurred | \$ - | \$ 22,200 | \$ 29,242 | \$ - |
| | ===== | | ===== | |
| Cash paid during the period for interest | \$ 18,777 | \$ 10,549 | \$ 28,260 | \$ 7,133 |
| | ===== | | ===== | |

See accompanying notes.

June 30, 1998

1. Business

USA Technologies, Inc., a Pennsylvania corporation (the "Company"), was incorporated on January 16, 1992. The Company is a provider and licensor of unattended, credit card activated control systems for the copying, debit card and personal computer industries. The Company's customers are principally located in the United States and are comprised of hotels, retail locations, university libraries, and public libraries. The Company generates its revenues from the direct sale of equipment utilizing its control systems, from retaining a percentage of the gross licensing fees generated by the control systems, and from a monthly administrative service fee.

During September 1996, the Company commenced offering the Business Express(TM) principally to the hospitality industry, which combined the Company's business applications for computers, copiers and facsimile machines into a kiosk type unit. During September 1997, the Company entered into a joint venture agreement (Joint Venture) with Mail Boxes Etc. ("MBE") and commenced selling the MBE Business Express(TM) ("MBEX") primarily to hotels located in the United States (Note 3).

2. Accounting Policies

Basis of Financial Statement Presentation

The consolidated statements of the Company have been prepared assuming the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Accordingly, the consolidated financial statements do not include any adjustments that might be necessary should the Company be unable to continue in existence. The Company has incurred substantial losses of approximately \$3.6 million and approximately \$3.1 million during the fiscal years ending June 30, 1998 and 1997, respectively, and cumulative losses from its inception through June 30, 1998 amounting to approximately \$12.9 million. Losses have continued through August 1998. The Company's ability to meet its future obligations is dependent upon the success of its products in the marketplace and its ability to raise capital until the Company's products can generate sufficient operating revenues. These factors raise doubt about the Company's ability to continue as a going concern. Management believes that actions presently being taken will allow for the Company to continue as a going concern. Such actions include the generation of revenues from operations, raising capital from private placements (Notes 14 and 15), the exercise of Common Stock purchase warrants and options, and continued efforts to reduce costs.

Interim Financial Information

The consolidated financial statements and disclosures included herein for the three and nine months ended March 31, 1999 and 1998 are unaudited. These financial statements and disclosures have been prepared by the Company in accordance with generally accepted accounting principles and reflect all adjustments consisting of adjustments of a normal and recurring nature which, in the opinion of management, are necessary for a fair presentation of the Company's consolidated financial position and the results of its operations and cash flows.

2. Accounting Policies (continued)

Development Stage Corporation

During the quarter ended June 30, 1998, the Company determined that it is no longer designated as a development stage enterprise as defined in Statement of Financial Accounting Standards No. 7 Development Stage Enterprises. During its development stage, the Company devoted a substantial portion of its efforts toward raising capital, research and development, establishing new business and developing new products and markets. The strategic alliances entered into during the year ended June 30, 1998 (Note 3) have provided the Company with the ability to complete its transition from a development stage enterprise to an enterprise focusing on marketing its products and its commercial operations.

Consolidation

The consolidated financial statements include the accounts of the Joint Venture (Note 3). All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

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

Cash Equivalents

Cash equivalents represent all highly liquid investments with original maturities of three months or less. At June 30, 1998, cash equivalents were comprised of a money market fund and certificates of deposit.

Inventory

Inventory is stated at the lower of cost (first-in, first-out method) or market.

Notes to Consolidated Financial Statements

2. Accounting Practices (continued)

Property and Equipment

Property and equipment are recorded at cost. Property and equipment consists of control systems, which generate monthly transaction fees from usage and are depreciated using the straight-line method over three years, and furniture and vehicles, which are depreciated using the straight-line method over seven and five years, respectively, for financial statement purposes and accelerated methods for income tax reporting purposes.

Revenue Recognition

Revenue from the sale of equipment is recognized upon installation and customer acceptance of the related equipment. License and transaction fee revenue is recognized upon the usage of the Company's credit card activated control systems.

Research and Development

Research and development costs are charged to operations as incurred. Such research and development costs amounted to approximately \$199,000 and \$344,000 for the years ended June 30, 1998 and 1997, respectively. These costs are reflected in general and administrative and compensation expenses in the accompanying consolidated financial statements.

Income Taxes

The Company provides for income taxes using the asset and liability approach whereby deferred tax assets and liabilities are recorded based on the difference between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Such differences result from differences in the timing of recognition by the Company of certain expenses, and the periods of amortization and depreciation of certain assets.

Accounting for Stock Options

During 1995, the Financial Accounting Standards Board issued Statement No. 123 ("SFAS 123"), Accounting for Stock-Based Compensation. SFAS 123 provides companies with a choice to follow the provisions of SFAS 123 in determination

Notes to Consolidated Financial Statements

2. Accounting Practices (continued)

Accounting for Stock Options (continued)

of stock-based compensation expense or to continue with the provisions of Accounting Principles Board Opinion No. 25 ("APB 25"). The Company has elected to follow the provisions of APB 25. Under APB 25, because the exercise price of the Company's stock options equals or exceeds the market price of the underlying Common Stock on the date of grant, no compensation expense is recognized. The effect of applying SFAS 123 to the Company's stock-based awards results in net loss and net loss per common share that are disclosed on a proforma basis in Note 11.

Loss Per Common Share

During February 1997, the Financial Accounting Standards Board issued Statement No. 128 ("SFAS 128"), Earnings per Share, which was adopted by the Company during the quarter ending December 31, 1997. SFAS 128 replaced the calculation of primary and fully diluted earnings per share. Basic earnings per share is calculated by dividing net income (loss) by the weighted average common shares outstanding for the period. Diluted earnings per share is calculated by dividing net income (loss) by the weighted average common shares outstanding for the period plus the dilutive effect of stock options. SFAS 128 had no impact on the calculation of the Company's previously reported primary and fully diluted loss per common share. No exercise of stock options, purchase rights, stock purchase warrants, or the conversion of preferred stock and cumulative preferred dividends was assumed because the assumed exercise of these securities would be antidilutive.

Impact of Recent Accounting Pronouncements

During June 1997, the Financial Accounting Standards Board issued Statement No. 130, Reporting Comprehensive Income ("SFAS 130") and Statement No. 131, Disclosures about Segments of an Enterprise and Related Information ("SFAS 131"). SFAS 130 requires financial statement reporting of all non-owner related changes in equity for the periods presented. SFAS 131 requires disclosure about revenue, earnings and other financial information pertaining to business segments by which a company is managed, as well as factors used by management to determine segments. Both SFAS 130 and

2. Accounting Practices (continued)

Impact of Recent Accounting Pronouncements (continued)

SFAS 131 are effective for fiscal years beginning after December 15, 1997. The Company is in the process of evaluating the disclosure requirements of these standards and believes the adoption of SFAS 130 and SFAS 131 will have no material effect on the Company's results of operations or its financial condition.

3. Joint Venture

During September 1997, the Company entered into a five year 50/50 (unless otherwise specified) Joint Venture Agreement with Mail Boxes Etc. ("MBE"). The Joint Venture operates under the name "MBE Express Joint Venture" (hereinafter referred to as "Joint Venture") and will exclusively sell and market the Company's Business Express(TM) product under the name MBE Business Express(TM). Gross profits earned by the Joint Venture from sales on a National Account level and sales referred to the Joint Venture by MBE franchisees are split equally by the partners. Any sales generated by either of the partners responsible for obligating the customer for the sale would receive 75% of the gross profit and the other partner would receive 25% of the gross profit. The agreement also allows the Company to have the option to directly sell its Business Express products. Sharing of the transaction fees earned varies based on the initiator of the sale of the MBE Business Express(TM). All other revenues and expenses of the Joint Venture are shared equally by the partners. Reimbursements due from the Joint Venture partner of \$98,358 are recorded against other amounts payable to MBE at June 30, 1998.

The Joint Venture Agreement specifies that if certain sales goals are not met by the Joint Venture, the Company may terminate the exclusivity provisions of the agreement after the second year. In this regard, if 2,000 business centers are not sold by September 24, 1999, the exclusivity provisions may be terminated. The Joint Venture may be terminated at any time by either partner if the other partner has breached any material term or condition of the agreement; provided that the terminating partner has allowed the other partner at least a sixty-day period to cure any alleged breach (Note 15).

During the year ended June 30, 1998, the Company delivered to MBE 195 control boxes to be used by its MBE franchisees. Through June 30, 1998, 7 control systems were installed in MBE franchise operations. During April 1998, MBE agreed to accept an additional 600 control boxes which are scheduled to be shipped at the rate of 100 units per month commencing in September 1998 (See Note 15).

Notes to Consolidated Financial Statements

3. Joint Venture (continued)

At June 30, 1998, the Joint Venture recorded accounts payable to MBE of approximately \$248,000 which principally represents amounts payable for inventory and other expenditures paid by MBE on behalf of the Joint Venture.

During February 1998, Prime Hospitality Corp. ("Prime") entered into an agreement with the Joint Venture whereby Prime would purchase a minimum of 100 MBE Business Express(TM) units for installation at its owned and managed hotels for a purchase price of approximately \$2 million. The agreement provided for a 90-day trial period on 6 units and if such trial was successful, Prime would order the remaining 94 units. During June 1998, the Joint Venture was notified by Prime that the trial period was successful and accordingly, the remaining 94 units will be purchased by Prime prior to June 1999.

During March 1998, the Joint Venture entered into an agreement with International Business Machines Corporation ("IBM") whereby IBM agreed to be the executional partner for certain aspects of the Joint Venture's business, including project management services, asset procurement and inventory financing, configuration and testing of equipment, site preparation, installation, maintenance services, and asset management. Under this agreement, IBM will also assist the Joint Venture with marketing and technology exchange. This agreement is expected to commence in the first quarter of fiscal 1999.

4. Property and Equipment

Property and equipment consist of the following:

| | June 30 | | March 31 |
|-------------------------------|------------|------------|-------------|
| | 1998 | 1997 | 1999 |
| | | | (Unaudited) |
| Control systems | \$ 357,021 | \$ 269,590 | \$370,840 |
| Furniture and equipment | 75,710 | 73,437 | 113,936 |
| Vehicles | 10,259 | 10,259 | 10,259 |
| | ----- | ----- | ----- |
| | 442,990 | 353,286 | 495,035 |
| Less accumulated depreciation | 291,084 | 174,829 | 367,530 |
| | ----- | ----- | ----- |
| | \$ 151,906 | \$ 178,457 | \$127,505 |
| | ===== | ===== | ===== |

Notes to Consolidated Financial Statements

5. Accrued Expenses

Accrued expenses consist of the following:

| | 1998 | June 30 | 1997 | March 31 1999 (unaudited) |
|--|------------|---------|-----------|---------------------------------|
| | ----- | | | |
| Accrued product warranty costs | \$ 102,520 | | \$ - | \$115,000 |
| Accrued software license and support costs | 84,297 | | - | 18,948 |
| Accrued compensation and related sales commissions | 79,147 | | 3,698 | 92,577 |
| Accrued professional fees | 76,000 | | - | 72,000 |
| Accrued sales tax | 44,630 | | 25,559 | 46,830 |
| Accrued other | 30,524 | | 7,144 | 47,491 |
| Advanced customer billings | 13,525 | | - | 17,088 |
| Accrued rent | - | | 10,341 | - |
| | ===== | | | |
| | \$ 430,643 | | \$ 46,742 | \$409,934 |
| | ===== | | | |

6. Related Party Transactions

At June 30, 1998 and 1997, and March 31, 1999 approximately \$26,000, \$27,000 and \$153,000 (unaudited) respectively, of the Company's accounts payable were due to several shareholders for various legal and technical services performed. During the years ended June 30, 1998 and 1997 and for the nine months ended March 31, 1999, the Company incurred approximately \$340,000, \$308,000, and \$121,000 (unaudited) respectively, for these services.

7. Commitments

During November 1997, the Company entered into a new Employment and Non-Competition Agreement through June 30, 2000 (the Employment Agreement) with the Company's President, providing for a base annual salary of \$100,000. The Employment Agreement is automatically renewed annually thereafter unless canceled by either the President or the Company. In connection with the Employment Agreement, the President canceled an aggregate of 436,500 shares of Common Stock held in escrow in accordance with the terms as described in Note 12. The Employment Agreement also granted the President in the event of a "USA Transaction," as defined, irrevocable and fully vested rights equal to that number of shares of Common Stock that when issued to him equals five percent of all the then issued and outstanding shares of the Company's Common Stock. The President is not required to pay any additional consideration for such shares. The stock rights have no expiration and are not affected by the President's termination of employment.

Notes to Consolidated Financial Statements

7. Commitments (continued)

The Company conducts its operations from various facilities under operating leases. Rental expense under such arrangements was approximately \$70,000, \$94,000 and \$49,000 during the years ended June 30, 1998 and 1997 and for the nine months ended March 31, 1999 (unaudited), respectively.

During the year ended June 30, 1997, the Company entered into agreements to lease \$22,200 of computer equipment which was accounted for as a capital lease. This computer equipment is included in control systems in the accompanying consolidated financial statements. Lease amortization of \$18,862 and \$17,600 is included in depreciation expense for the years ended June 30, 1998 and 1997.

Future minimum lease payments subsequent to June 30, 1998 under capital and noncancelable operating leases are as follows:

| | Capital Leases | Operating Leases |
|---|-------------------|---------------------|
| | ----- | |
| 1999 | \$ 26,055 | \$ 79,900 |
| 2000 | 1,717 | 34,200 |
| 2001 | - | 9,000 |
| | ----- | |
| Total minimum lease payments | 27,772 | \$ 123,100 |
| | | ===== |
| Less amount representing interest (25% per annum) | 3,293 | |
| | ----- | |
| Present value of net minimum lease payments | 24,479 | |
| Less current obligation under capital leases | 22,810 | |
| | ----- | |
| Obligation under capital leases, less current portion | \$ 1,669 | |
| | | ===== |

During May 1998, the Company entered into an agreement with a vendor (on behalf of the Joint Venture) whereby the Company committed to acquire 1,500 control systems for approximately \$780,000. The control systems are anticipated for delivery by the Company through the quarter ending March 31, 1999. As more fully discussed in Note 15, certain of these control systems have recently become the subject of litigation.

Notes to Consolidated Financial Statements

8. Income Taxes

At June 30, 1998 and 1997, the Company had federal net operating loss carryforwards of approximately \$11,231,000 and \$8,181,000, respectively, to offset future federal taxable income expiring through 2013. Additionally, at June 30, 1998 and 1997, the Company had state net operating loss carryforwards of approximately \$8,655,000 and \$5,753,000, respectively, to offset future state taxable income expiring through 2008. At June 30, 1998 and 1997, the Company recorded a deferred tax asset of \$4,905,000 and \$3,402,000, respectively, which were reduced by a valuation allowance of the same amount as the realization of these deferred tax assets are not certain.

The deferred tax assets arose primarily from the use of different accounting methods for financial statement and income tax reporting purposes as follows:

| | June 30 | |
|---|--------------|--------------|
| | 1998 | 1997 |
| Deferred tax asset: | | |
| Net operating loss carryforwards | \$ 4,384,000 | \$ 3,081,000 |
| Compensation expense on stock option re-pricing | 222,000 | - |
| Deferred research and development costs | 207,000 | 226,000 |
| Deferred pre-operating costs | 18,000 | 84,000 |
| Other temporary differences | 81,000 | 20,000 |
| | ----- | ----- |
| | 4,912,000 | 3,411,000 |
| Deferred tax liabilities: | | |
| Depreciation | (7,000) | (9,000) |
| | ----- | ----- |
| Deferred tax asset, net | 4,905,000 | 3,402,000 |
| Valuation allowance | (4,905,000) | (3,402,000) |
| | ===== | ===== |
| | \$ - | \$ - |
| | ===== | ===== |

The timing and manner in which the Company can utilize operating loss carryforwards and future tax deductions for capitalized items in any year was limited by provisions of the Internal Revenue Code regarding changes in ownership of corporations. The Company believes that such limitation may have an impact on the ultimate realization of its carryforwards and future tax deductions.

Notes to Consolidated Financial Statements

9. Preferred Stock

The Preferred Stock authorized may be issued from time to time in one or more series, each series with such rights, preferences or restrictions as determined by the Board of Directors. Each share of Series A Preferred Stock shall have the right to ten votes and is convertible at any time into ten shares of Common Stock. Each share of Common Stock entitles the holder to one voting right. During the period from March 24, 1997 to December 31, 1997, each share of Series A Preferred Stock was convertible into twelve shares of Common Stock. Series A Convertible Preferred Stock provides for an annual cumulative dividend of \$1.50 per share payable to the shareholders of record on February 1 and August 1 of each year. Cumulative unpaid dividends at June 30, 1998 and 1997 and March 31, 1999 (unaudited) amounted to \$2,442,650, \$2,837,086 and \$3,382,553, respectively. Cumulative unpaid dividends are convertible into common shares at \$10.00 per common share at the option of the shareholder. During the period from March 24, 1997 to December 31, 1997, the cumulative unpaid dividends were convertible into common shares at \$8.30 per common share. During the years ended June 30, 1998 and 1997 and for the nine months ended March 31, 1999 (unaudited) certain holders of the Preferred Stock converted 392,969, 24,170 and 13,809 shares, respectively, into 466,452, 27,380 and 13,809 shares of Common Stock, respectively. Certain of these shareholders also converted cumulative preferred dividends of \$1,503,867, \$117,149 and \$62,549, respectively, into 178,964, 13,316 and 6,255 shares of Common Stock at June 30, 1998 and 1997 and March 31, 1999 (unaudited), respectively. The Series A Preferred Stock may be called for redemption at the option of the Board of Directors at any time on and after January 1, 1998 for a price of \$11.00 per share plus payment of all accrued and unpaid dividends. No such redemption has occurred as of June 30, 1998 or March 31, 1999 (unaudited). In the event of any liquidation, the holders of shares of Series A Preferred Stock issued shall be entitled to receive \$10.00 for each outstanding share plus all cumulative unpaid dividends. If funds are insufficient for this distribution, the assets available will be distributed ratably among the preferred shareholders.

10. Common Stock Transactions

During June 1998, the Company's shareholders approved an increase in the number of the Company's authorized common stock shares from 55,000,000 to 62,000,000.

During January 1998, the Company's Board of Directors authorized a \$750,000 private placement offering of 75 units at a unit price of \$10,000. Each unit included 2,000 shares of Convertible Preferred Stock and 5,000 1998-A Common Stock purchase warrants at an exercise price of \$1.50 through June 30, 1998 and \$4.00 thereafter through March 5, 2003. The Company terminated this offering during February 1998 selling all 75 units and

Notes to Consolidated Financial Statements

10. Common Stock Transactions (continued)

generating net proceeds of \$701,510 (\$750,000 less offering costs of \$48,490). Through June 30, 1998, 371,000 1998-A warrants were exercised at \$1.50 per warrant generating gross proceeds of \$556,500. At June 30, 1998 and March 31, 1999, there were 4,000 1998-A Common Stock purchase warrants outstanding.

On June 23, 1997, the Company closed on a private placement offering of Convertible Debentures (the Placement) resulting in net proceeds to the Company of \$451,169 (\$500,000 less offering costs of \$48,831). The Placement was issued pursuant to Regulation S of the Securities Act of 1933 to five qualified purchasers, as defined, (Purchasers). The Placement was convertible by the Purchasers into Common Stock at any time after 45 days from issuance (August 7, 1997) and through the Placement's maturity of June 1, 2002 at the option of the Purchaser. The Company had the right to redeem the unconverted portion of the Placement at any time after June 23, 1998 through June 1, 2002. The conversion or redemption rate (hereinafter referred to as conversion rate) was equal to the lesser of 100% of the average closing bid price of the Common Stock for the five trading days immediately preceding June 23, 1997, or 65% of the average closing bid price of the Common Stock for the five trading days immediately preceding the date prior to the conversion or redemption date. Upon maturity (unless converted or redeemed prior thereto), the Placement would be automatically converted into shares of Common Stock at the conversion rate. As the terms and intent of the Placement were to raise equity for the Company through the issuance of Common Stock, and the terms of the Placement do not provide for the repayment of principal in cash, the substance of the Placement is that of an equity transaction and, accordingly, the net proceeds have been reflected as Common Stock in the accompanying consolidated financial statements.

As a requirement to the closure of the Placement, the Company placed an aggregate of 250,000 shares of Common Stock in escrow to ensure such shares would be available upon conversion of the Placement by the Purchasers. As the 250,000 shares held in escrow were legally issued and outstanding at June 30, 1997, such shares were included in the common shares issued and outstanding in the June 30, 1997 balance sheet. During fiscal year 1998, the entire Placement was converted (at varying prices) into 191,574 of common shares. Accordingly, the Placement and escrow shares were canceled and the appropriate number of shares of Common Stock were issued to the Purchasers.

10. Common Stock Transactions (continued)

Certain affiliates of the placement agent were issued non-detachable Common Stock purchase warrants, exercisable immediately, to purchase up to 200,000 shares of the Company's Common Stock at \$2.00 per warrant at any time through June 22, 2002. As of June 30, 1998, 90,000 of these warrants were exercised generating gross proceeds of \$180,000. During the nine months ended March 31, 1999, no additional warrants were exercised.

During March 1997, the Company's Board of Directors authorized a \$1,100,000 private placement offering of 110 units at a unit price of \$10,000. Each unit included 2,000 shares of Convertible Preferred Stock and 4,000 1997 Common Stock purchase warrants at an exercise price of \$2.00 through October 31, 1997 (extended from the original date of August 31, 1997) and \$4.00 thereafter through February 28, 2002. During June 1997, the Company's Board of Directors authorized the reduction of this offering to a maximum of 40 units at an aggregate sales price of \$400,000. As of June 30, 1997, 40 units were sold, generating net proceeds of \$361,189 (\$400,000 less offering costs of \$38,811). The stock subscriptions receivable of \$60,000 as of June 30, 1997, recorded in connection with this offering were collected in August 1997. The Company terminated this offering on July 3, 1997. During the year ended June 30, 1998, 158,500 warrants were exercised at \$2.00 per warrant generating gross proceeds of \$317,000. At June 30, 1998 and 1997, 1,500 and 160,000, respectively, of 1997 Common Stock purchase warrants were outstanding. No additional warrants have been exercised subsequent to June 30, 1998.

During November 1996, the Company's Board of Directors authorized a \$200,000 private placement offering of 20 units at a unit price of \$10,000. Each unit included 1,000 shares of Series A Convertible Preferred Stock and 4,000 1996-B Common Stock purchase warrants at an exercise price of \$2.00 per share through October 31, 1997 (extended from original date of August 31, 1997) and \$3.00 per share through February 28, 2002. The offering closed during February 1997 resulting in the sale of 93.5 units generating gross proceeds of \$93,500. During the year ended June 30, 1998, 33,400 warrants were exercised at \$2.00 per warrant generating gross proceeds of \$66,800. At June 30, 1998 and 1997, 4,000 and 37,400, respectively, of 1996-B Common Stock purchase warrants were outstanding. No additional warrants have been exercised subsequent to June 30, 1998.

During 1996, the Company issued Common Stock purchase warrants (the 1996 warrants) which are exercisable at any time on or before May 31, 2001, unless such date is extended by the Company. Each 1996 warrant entitles the holder to purchase one share of Common Stock for \$4.00 through December 31, 1996 and for \$5.00 at any time thereafter. The exercise price of the 1996 warrants may be reduced by the Company at any time.

Notes to Consolidated Financial Statements

10. Common Stock Transactions (continued)

During November 1996, the Company's Board of Directors reduced the exercise price of the 1996 warrants from \$4.00 to \$2.00 during the period November 1, 1996 through February 28, 1997, after which the exercise price returned to \$5.00. During September 1997, the Company's Board of Directors reduced the exercise price of the 1996 Common Stock purchase warrants from \$5.00 to \$2.50 through October 31, 1997. Thereafter the exercise price returned to \$5.00. During the years ended June 30, 1998 and 1997, 113,000 and 320,200 warrants were exercised generating gross proceeds of \$282,500 and \$640,400, respectively. At June 30, 1998 and 1997, respectively, there were 86,800 and 199,800 1996 Common Stock purchase warrants outstanding. No additional warrants have been exercised subsequent to June 30, 1998.

During 1995, the Company issued Common Stock purchase warrants (the 1995 warrants) which are exercisable at any time on or before January 31, 2001, unless such date is extended by the Company. Each 1995 warrant entitles the holder to purchase one share of Common Stock for \$5.00. The exercise price of the 1995 warrants may be reduced by the Company at any time. During September 1997, the Company's Board of Directors reduced the 1995 Common Stock purchase warrants from \$5.00 to \$2.50 through October 31, 1997. During the year ended June 30, 1998, 74,100 warrants were exercised at \$2.50 generating gross proceeds of \$185,250. At June 30, 1998 and 1997, respectively, the Company had 67,300 and 141,400, 1995 Common Stock purchase warrants outstanding. No additional warrants have been exercised subsequent to June 30, 1998.

At June 30, 1998 and 1997, the Company had outstanding 15,280 and 15,730 Common Stock purchase rights, respectively. These Common Stock purchase rights, issued in 1993, allow the holder to purchase shares of the Company's Common Stock at \$10.00 per share and are exercisable through June 30, 2000. During April 1998, the Company's Board of Directors authorized a reduction in the exercise price of the purchase rights to \$2.50 per share through June 30, 1998.

At June 30, 1998, stock subscriptions receivable of \$19,875 were collected during July 1998.

Notes to Consolidated Financial Statements

11. Stock Options

The Company's Board of Directors has granted options to employees and consultants to purchase shares of Common Stock at or above fair market value. All options granted have 5 year terms and vest and become fully exercisable on the schedule established by the contract which granted the option. During fiscal year 1997, the Company's Board of Directors authorized the reduction in the exercise price of 65,000 options from \$6.50 to \$4.50 per share. These options were previously issued during the periods March 1996 through November 1996 and represented all options previously granted at \$6.50. The new exercise price of these options was equal to or greater than the fair market value of the Common Stock on the date of such reduction. During April 1998, the Company's Board of Directors authorized the reduction in the exercise price of 189,600 options from \$2.50-\$4.50 per share to \$.50-\$2.00 per share. As the new exercise prices were below the fair market value of the Company's Common Stock on the date of repricing, the Company recorded a non-cash charge to compensation expense of approximately \$555,000 during fiscal year 1998.

The following table summarizes all stock option activity:

| | Common Shares Under Options Granted | Exercise Price Per Share |
|---------------------------------------|--|--------------------------------|
| | ----- | |
| Balance at June 30, 1996 | 333,500 | \$.50-\$5.00 |
| Granted | 81,500 | \$ 2.50-\$5.00 |
| Exercised | (15,000) | \$.50 |
| Canceled | (2,900) | \$ 4.50 |
| | ----- | |
| Balance at June 30, 1997 | 397,100 | \$.50-\$5.00 |
| Granted | 30,000 | \$ 4.50-\$5.00 |
| Exercised | (7,000) | \$.50 |
| | ----- | |
| Balance at June 30, 1998 | 420,100 | \$.50-\$5.00 |
| Exercised (unaudited) | (45,000) | \$ 1.00 |
| | ----- | |
| Balance at March 31, 1999 (unaudited) | 375,100 | \$.50-\$5.00 |
| | ===== | |

Notes to Consolidated Financial Statements

11. Stock Options (continued)

The price range of the outstanding and exercisable common stock options at June 30, 1998 is as follows:

| Option Exercise Prices | Options Outstanding | Weighted Average Remaining Contract Life (Yrs.) | Weighted Exercise Price | Options Exercisable | Weighted Average Exercise Price |
|------------------------|---------------------|---|-------------------------|---------------------|---------------------------------|
| \$.50 | 5,000 | 3.03 | \$.50 | 5,000 | \$.50 |
| \$1.00 | 45,000 | 2.23 | \$1.00 | 45,000 | \$1.00 |
| \$1.50 | 132,100 | 2.36 | \$1.50 | 128,350 | \$1.50 |
| \$2.00 | 7,500 | 0.33 | \$2.00 | 7,500 | \$2.00 |
| \$2.50 | 131,500 | 1.46 | \$2.50 | 131,500 | \$2.50 |
| \$4.50 | 84,000 | 3.58 | \$4.50 | 49,000 | \$4.50 |
| \$5.00 | 15,000 | 3.56 | \$5.00 | 15,000 | \$5.00 |
| | ----- | | ----- | ----- | |
| | 420,100 | | \$2.50 | 381,350 | |
| | ===== | | ===== | ===== | |

The price range of the outstanding and exercisable common stock options at March 31, 1999 (unaudited) is as follows:

| Option Exercise Prices | Options Outstanding | Weighted Average Remaining Contract Life (Yrs.) | Weighted Exercise Price | Options Exercisable | Weighted Average Exercise Price |
|------------------------|---------------------|---|-------------------------|---------------------|---------------------------------|
| \$.50 | 5,000 | 2.27 | \$.50 | 5,000 | \$.50 |
| \$1.50 | 105,000 | 1.21 | \$1.50 | 105,000 | \$1.50 |
| \$2.00 | 2,500 | 3.70 | \$2.00 | 2,500 | \$2.00 |
| \$2.50 | 141,500 | 0.64 | \$2.50 | 141,500 | \$2.50 |
| \$4.50 | 106,100 | 3.00 | \$4.50 | 99,850 | \$4.50 |
| \$5.00 | 15,000 | 2.80 | \$5.00 | 15,000 | \$5.00 |
| | ----- | | ----- | ----- | |
| | 375,100 | | \$2.54 | 368,850 | |
| | ===== | | ===== | ===== | |

Pro forma information regarding net loss and net loss per common share determined as if the Company is accounting for stock options granted under the fair value method of SFAS 123 is as follows:

| | 1998 | June 30 1997 | March 31 1999 (unaudited) |
|--|---------------|-----------------|---------------------------------|
| Net loss applicable to common shares as reported under APB 25: | \$(5,322,847) | \$(4,364,007) | \$(3,141,233) |
| Stock option expense per SFAS 123 | (391,704) | (137,013) | (150,047) |
| Pro forma net loss | \$(5,714,551) | \$(4,501,020) | \$(3,291,280) |
| Pro forma net loss per common share | \$ (1.62) | \$ (2.14) | \$ (0.81) |
| Loss per common share as reported | \$ (1.51) | \$ (2.08) | \$ (0.77) |

The fair value for the Company's stock options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for fiscal years 1998 and 1997; risk-free interest rate of 5.5%; an expected life of 2 years; no expected cash dividend payments on common stock and volatility factors of the expected market price of the Company's common stock, based on historical volatility of 0.793 and 0.765, respectively.

11. Stock Options (continued)

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. As noted above, the Company's stock options are vested over an extended period. In addition, option models require the input of highly subjective assumptions including future stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective assumptions can materially affect the fair value estimates, in management's opinion, the Black-Scholes model does not necessarily provide a reliable measure of the fair value of the Company's stock options. The Company's pro forma information reflects the impact of the reduction in price of certain stock options.

12. Escrow and Cancellation Arrangements

At the request of the Pennsylvania Securities Commission, all of the executive officers and directors of the Company serving at the commencement of the initial public offering of the Company agreed to place in escrow 839,500 shares, as adjusted, beneficially owned by them until December 29, 1996. Under certain circumstances as outlined by the Pennsylvania Securities Commission, the President's shares were to be held in escrow for an additional period of time, but not later than June 30, 1998. Additionally, the President of the Company agreed that his 436,500 escrowed common shares would be canceled by the Company and would no longer be issued and outstanding unless certain performance measures as specified by the Commission were achieved by June 30, 1998. During November 1997, in connection with a new Employment and Non-competition Agreement entered into by the Company with the President, the President canceled his 436,500 escrowed common shares.

13. Retirement Plan

During July 1997, the Company adopted a Savings and Retirement Plan (the Plan) which allows employees who have attained the age of 21 and have completed one year of service to make voluntary contributions up to a maximum of 15% of their annual compensation, as defined in the Plan. The Plan does not provide for any matching contribution by the Company, however, the Board of Directors may authorize, at its sole discretion, Company contributions to the Plan. During fiscal year 1998 and during the nine months ended March 31, 1999 there were no contributions made to the Plan by the Company.

Notes to Consolidated Financial Statements

14. Subsequent Events

During July 1998, the Company's Board of Directors authorized a \$700,000 private placement offering of 70 units at a unit price of \$10,000. Each unit includes 2,000 shares of Convertible Preferred Stock and 5,000 1998-B Common Stock purchase warrants at an exercise price of \$1.50 through January 1, 1999 and \$4.00 thereafter for five years after the termination of the offering. The Company terminated the offering on August 17, 1998. As of August 17, 1998, 27.8 units were sold generating gross proceeds of \$278,000.

During July 1998, the Company's Board of Directors reduced the exercise price of the 1995 Common Stock purchase warrants and the 1996 Common Stock purchase warrants from \$5.00 to \$2.50 through September 30, 1998. Thereafter, the exercise price will return to \$5.00.

15. Reverse Stock Split

On May 27, 1999, the Company's shareholders approved a Plan of Recapitalization and amendment to the Company's Articles of Incorporation to effect a 1-for-10 reverse split of Common Stock. All Common Stock per share amounts, and related Common Stock equivalents have been restated to reflect the reverse stock split in the accompanying consolidated financial statements.

16. Events (Unaudited) Subsequent to the Date of the Auditors' Report

During August 1998, the Company notified MBE that MBE breached the Joint Venture Agreement (Note 3). Specifically, the Company indicated that MBE entered into an arrangement with another vendor which was a violation of the Joint Venture Agreement which obligates MBE to solely use the Company's control boxes. On September 3, 1998, MBE commenced a legal action against the Company in the Superior Court of the State of California alleging that the 195 control boxes purchased by MBE were defective and seeks a refund of the purchase price in the amount of \$141,260, plus lost profits claimed to be several hundred thousand dollars. Additionally, the complaint seeks a declaratory judgment that MBE is not obligated to purchase the control boxes ordered in April 1998. In October 1998, the Company had the case removed to the United States District Court for the Southern District of California. The Company believes the claim to be without merit and that it will prevail in this action. Accordingly, there has been no provision for this action in the accompanying consolidated financial statements.

In December 1998, the Company filed an answer and Counterclaim to the Complaint of MBE. The answer denies the allegations of MBE's complaint and denies that MBE is entitled to any of the relief requested in the complaint.

The Counterclaim of the Company alleges that MBE breached the Joint Venture Agreement by among other things, utilizing a competitor of the Company in connection with MBE's in-store computer workstation project ("ICW Project"), for which project the Company believes MBE must purchase USA's terminals. The counterclaim also alleges that by attempting to cancel its written purchase order with the Company for 600 terminals, MBE has breached such purchase order. The Counterclaim includes claims by the Company against MBE for breach of contract, breach of fiduciary duty, and trade libel. The Counterclaim seeks recovery from MBE of monetary damages caused by MBE's actions, including lost profits, consequential damages and/or incidental damages, and punitive damages. The Company has also requested a declaration that MBE is required to use the Company in connection with its ICW Project and prohibiting MBE from continuing to breach the Joint Venture Agreement. As of the date hereof, limited discovery has been conducted by the parties and no trial date has been set.

In September 1998, the Company had commenced arbitration proceedings against MBE in connection with MBE's breach of the Joint Venture Agreement. In December 1998, the parties agreed that the arbitration proceedings would be terminated, and the Company would proceed with all of its claims against MBE in the pending Federal Court action described above.

On May 14, 1999, the Company notified MBE that the Company was terminating the Joint Venture Agreement. The Joint Venture Agreement provided that it could be terminated at any time by either partner if the other partner breached any material term or condition of the agreement; provided that the terminating partner allowed the other partner at least a sixty day period to cure any alleged breach.

As required under the Joint Venture Agreement, on February 4, 1999 and February 19, 1999, the Company delivered to MBE notice that MBE was in default of the Joint Venture Agreement in connection with five separate items, and demanded that MBE cure the breaches within sixty days. Through the date of the termination of the Joint Venture Agreement, MBE failed to cure any of the breaches and had not otherwise taken any steps to remedy the breaches.

The Company's May 14, 1999 letter to MBE states five reasons for the termination: MBE's refusal to authorize the installation of data port terminals as required under the sales agreement between the joint venture and a customer; MBE's refusal to allow the joint venture to market and sell the data port terminals; MBE's ongoing failure to commit adequate and appropriate resources to joint venture sales and marketing to effectuate a reasonable number of sales of joint venture business center equipment; MBE's failure to acknowledge the Company's ownership of the trademark "Business Express" and its actions inconsistent with the Company's ownership of the mark; and MBE's refusal to timely meet with the Company to discuss and conclude a joint venture sales and marketing budget for the fiscal year commencing April 1, 1999.

During September 1998, the Company's Board of Directors authorized a \$2,000,000 private placement offering (the "Senior Note Offering") of 200 units at a unit price of \$10,000. Each unit consists of a 12% Senior Note in the principal amount of \$10,000, 1,500 1998-C Common Stock purchase warrants (later redesignated as 1999-A Common Stock purchase warrants) and 1,000 shares of Series B Equity Participating Preferred Stock. Each 1999-A Common Stock purchase warrant entitles the holder to purchase 1 share of Common Stock for \$1.00 at any time through

Notes to Consolidated Financial Statements

16. Events (Unaudited) Subsequent to the Date of the Auditors' Report
(continued)

December 31, 2001. Each share of Series B Preferred Stock is automatically convertible into 4 shares of Common Stock at the time of a "USA Transaction," as defined. In connection with this Offering, the Board of Directors also authorized the creation of 200,000 shares of a new Series B Equity Participating Preferred Stock. The offering commenced on September 28, 1998.

In January 1999, the Board of Directors approved the reduction of the exercise price of the 1999-A Warrants from \$1.00 to \$.50, effective until December 31, 1999 at which time the price shall revert to \$1.00, an increase in the number of 1999-A Warrants in each unit from 1,500 per unit to 2,000 per unit, an extension of the reduced exercise price of \$1.00 for the 139,000 1998-B warrants through March 31, 1999 instead of only through February 1, 1999, and a reduction in the exercise price of 15,280 purchase rights issued in July 1993 from \$10.00 per share to \$1.00 per share through March 31, 1999, at which time the price will revert to \$10.00.

In connection with the Senior Note Offering, on January 21, 1999 the Board of Directors approved a commitment by the President to purchase 10 units for \$100,000. The President will pay for the units by foregoing payroll from April 1, 1999 through June 30, 2000. The President also directly purchased 10 units, resulting in proceeds to the Company of \$100,000. The Board of Directors on January 21, 1999 also expanded the rights of holders of the Series B Equity Participating Preferred Stock to allow them to convert each share into 4 shares of Common Stock in the event of a reverse stock split.

On March 4, 1999, the Board of Directors extended the Senior Note Offering to April 30, 1999 and increased the number of shares of Series B Equity Participating Preferred Stock from 200,000 to 250,000.

As of March 31, 1999, the Senior Note Offering sold 95.95 units. In connection with this sale, 143,925 1999-A Warrants were issued with a fair value of \$145,364.

On May 6, 1999, the Board of Directors authorized an increase in the aggregate Senior Note Offering from \$2,000,000 to \$3,500,000; increased the aggregate of 1999-A Warrants from 400,000 to 700,000 and the aggregate of Series B Equity Participating Preferred Stock from 250,000 shares to 350,000 shares; and extended the offering deadline from April 30, 1999 to May 31, 1999, with right of extension for another 30 days, or until June 30, 1999.

On May 27, 1999, the shareholders approved an increase in the number of authorized shares of undesignated Series Preferred Stock from 1,200,000 to 1,800,000, and an increase in the number of authorized shares of Series A Preferred Stock from 787,591 to 900,000.

On June 17, 1999, the Board of Directors authorized an increase in the aggregate Senior Note Offering from \$3,500,000 to \$5,000,000 which would also allow issuance of up to 1,000,000 1999-A Warrants and 500,000 shares of Series B Equity Participating Preferred Stock; and extended the termination date of the offering to June 30, 1999.

The Senior Note Offering closed on June 23, 1999. The Company sold to 223 accredited investors an aggregate of 466.8 units at \$10,000 each, for an aggregate of \$4,668,000.

In June 1999, pursuant to the terms of the Series B Equity Participating Preferred Stock, each share of Series B Equity Participating Preferred Stock was exchanged for 4 shares of Common Stock, or an aggregate of 1,867,200 shares of Common Stock. The 1,867,200 shares of Common Stock are restricted securities as defined under Rule 144 of the Act.

In June 1999, the Company issued 25,000 shares of Common Stock to a broker-dealer, as part of its compensation in connection with its assisting the Company to raise monies in the Senior Note Offering.

In June 1999, the Company issued to an individual 4,000 shares of Common Stock in connection with public relations services rendered to the Company.

In June 1999, the Company issued 10,000 shares of Common Stock to an individual in consideration of consulting services performed on behalf of the Company.

In June 1999, the Company issued options to purchase an aggregate of 470,000 shares of Common Stock at \$2.00 per share to its executive officers. The Chairman's 180,000 options all vest immediately. All of the other executive officers' options vest as follows: one-third immediately; one-third on the first annual anniversary of the date of grant; and the final one-third on the second annual anniversary of the date of grant. The options are exercisable at any time within five years following the vesting thereof.

In June 1999, the Company issued options to purchase an aggregate of 60,000 shares of Common Stock at \$2.00 per share to its outside directors. Certain of these options vest immediately and others vest as follows: one-half immediately; and one-half on the six month anniversary of the date of grant. The options are exercisable at any time within five years following the vesting thereof.

In June 1999, the Company issued options to purchase an aggregate of 12,000 shares of Common Stock at \$2.00 per share to six employees. These options vest immediately and are exercisable at any time within five years of vesting.

During the period April 1999 to June 1999 the Company sold 371.3 units of the Senior Note Offering generating gross proceeds of \$3,713,000.

In July 1999 the Company's Board of Directors authorized the issuance of 100,000 fully vested warrants to purchase common stock to a financial and public relations consultant in exchange for future consulting services. The warrants are exercisable as follows: 50,000 at \$2 per share and 50,000 at \$3 share and expire in July 2001.

In July 1999 the Company's Board of Directors authorized the issuance of 150,000 fully vested warrants to purchase common stock to a financial and public relations consultant in exchange for future consulting services. The warrants are exercisable at \$2.50 per share and expire in July 2001.

In July 1999 the Company issued options to purchase an aggregate of 10,000 shares of common stock at \$2.00 per share to a new director of the Company. These options vest 5,000 immediately and 5,000 six months from the date of grant.

In July 1999 the Company extended the expiration date for 5,000 options with an exercise price of \$2.50 from June 30, 1999 to August 31, 1999 and for 175,000 options with an exercise price of \$2.50 with various expiration dates to June 30, 2001.

PART II

INFORMATION NOT REQUIRED IN THE PROSPECTUS

Item 24. Indemnification of Officers and Directors.

Section 1746 of the Pennsylvania Business Corporation Law of 1988, as amended ("BCL"), authorizes a Pennsylvania corporation to indemnify its officers, directors, employees and agents under certain circumstances against expenses and liabilities incurred in legal proceedings involving such persons because of their holding or having held such positions with the corporation and to purchase and maintain insurance of such indemnification. The Company's Bylaws substantively provide that the Company will indemnify its officers, directors, employees and agents to the fullest extent provided by Section 1746 of the BCL.

Section 1713 of the BCL permits a Pennsylvania corporation, by so providing in its By-laws, to eliminate the personal liability of a director for monetary damages for any action taken unless the director has breached or failed to perform the duties of his office and the breach or failure constitutes self-dealing, willful misconduct or recklessness. In addition, no such limitation of liability is available with respect to the responsibility or liability of a director pursuant to any criminal statute or for the payment of taxes pursuant to Federal, state or local law. The Company's By-laws eliminate the personal liability of the directors to the fullest extent permitted by Section 1713 of the BCL.

Item 25. Other Expenses of Issuance and Distribution.

The following is an itemized statement of the estimated amounts of all expenses payable by the Registrant in connection with the registration of the Common Stock, other than underwriting discounts and commissions.

| | |
|---|-------------|
| Securities and Exchange Commission - Registration Fee | \$ 173.75 |
| Blue Sky fees and expenses | \$ 526.25 |
| Printing and Engraving Expenses | \$ 1,800.00 |
| Accounting Fees and Expenses | \$ 2,500.00 |
| Legal Fees and Expenses | \$ 2,500.00 |
| | ----- |
| Total | \$ 7,500.00 |
| | ----- |

Item 26. Recent Sales of Unregistered Securities.

During the three years immediately preceding the date of the filing of this Registration Statement, the following securities were issued by the Company without registration under the Securities Act of 1933, as amended ("Act"):

I. Private Placements.

During January and February 1997, the Company sold 9.35 units at \$10,000. Each unit consisted of 1,000 shares of Preferred Stock and 4,000 1996-B Common Stock Purchase Warrants. An aggregate of 9,350 shares of Preferred Stock and 37,400 1996-B Common Stock Purchase Warrants were sold to 16 accredited investors. The offering was offered and sold only to accredited investors, involved no general solicitation or advertising, and was therefore exempt from registration under Rule 506 of Regulation D promulgated under the Act.

During April, May, June and July 1997, the Company sold 40 units at \$10,000. Each unit consisted of 2,000 shares of Preferred Stock and 4,000 1997 Common Stock Purchase Warrants. An aggregate of 80,000 shares of Preferred Stock and 160,000 1997 Common Stock Purchase Warrants were sold to 44 accredited investors and 10 non-accredited investors. In connection therewith, Adele and Austin Hepburn purchased a total of 1 1/4 units for \$12,500. Ms. Hepburn is the Director of Public Relations of the Company. The offering was sold to accredited investors and less than 35 non-accredited investors, involved no general solicitation or advertising, and was therefore exempt from registration under Rule 506 of Regulation D promulgated under the Act.

During June 1997, the Company issued an aggregate of \$500,000 of Convertible Securities pursuant to an agreement with Gem Advisors Inc. ("GEMA") which provided GEMA with the exclusive right to place the Convertible Securities with qualified purchasers. Upon completion of the sale of the Convertible Securities, GEMA received 8% of the gross proceeds (i.e. \$40,000) as a management/documentation fee. In addition, affiliates and/or consultants to GEMA received non-redeemable warrants to purchase up to 200,000 shares of the Company's Common Stock at a price of \$2.00 per share at any time prior to June 23, 2002. The securities were offered and sold in an offshore transaction to a non-U.S. person and was therefore exempt from registration under Regulation S promulgated under the Act.

During the quarter ended March 1997, the Company sold 75 units at \$10,000. Each unit consisted of 2,000 shares of Preferred Stock and 5,000 1998-A Common Stock Purchase Warrants. An aggregate of 150,000 shares of Preferred Stock and 375,000 1998-A Common Stock Purchase Warrants were sold to 44 accredited investors and 15 non-accredited investors. The offering was sold to accredited investors and less than 35 non-accredited investors, involved no general solicitation or advertising, and was therefore exempt from registration under Rule 506 of Regulation D promulgated under the Act.

During July and August 1998, the Company sold 27.8 units at \$10,000. Each unit consisted of 2,000 shares of Preferred Stock and 5,000 1998-B Common Stock Purchase Warrants. An aggregate of 55,600 shares of Preferred Stock and 139,000 1998-B Common Stock Purchase Warrants were sold to 20 accredited investors. The offering was sold only to accredited investors, involved no general solicitation or advertising, and was therefore exempt from registration under Rule 506 of Regulation D promulgated under the Act.

Other than the securities issued pursuant to Regulation S, the above securities were issued pursuant to the exemption set forth in Section 4(2) of the Act.

From September 1998 through June 23, 1999, the Company sold 466.8 units at \$10,000 each, for an aggregate of \$4,668,000. Each unit consisted of a \$10,000 principal amount 12% Senior Note, 2,000 1999-A Common Stock Purchase Warrants, and 1,000 shares of Series B Equity Participating Preferred Stock. The offering was sold to 223 accredited investors, and did not involve any general advertising or solicitation, and was therefore exempt from registration under Rule 506 of Regulation D promulgated under the Act.

In June 1999, pursuant to the terms of the Series B Preferred Stock, each share of Series B Preferred Stock was exchanged for 4 shares of Common Stock, or an aggregate of 1,867,200 shares of Common Stock. Such exchange was exempt from registration under the Act pursuant to Section 3(a)(9) of the Act. The 1,867,200 shares of Common Stock are restricted securities as defined under Rule 144 promulgated under the Act.

In June 1999, the Company issued 43,800 shares of Common Stock to Harmonic Research, Inc., a broker-dealer, as part of its compensation in connection with its assisting the Company to raise monies in a private placement offering. The Company also issued to Harmonic Research, Inc. 9,400 1999-A Common Stock Purchase Warrants. The shares and warrants are restricted securities as such term is defined in Rule 144 promulgated under the Act and were issued pursuant to Section 4(2) thereof.

In June 1999, the Company issued to Robert Flaherty 4,000 shares of Common Stock in connection with public relations services rendered to the Company. Such shares were exempt from registration under Rule 701 promulgated under the Act.

In June 1999, the Company issued 10,000 shares of Common Stock to Rick Joshi in consideration of consulting services performed on behalf of the Company. The shares were exempt from registration pursuant to Rule 701 promulgated under the Act.

In July 1999, the Company issued to I. W. Miller Group, Inc. fully vested warrants to acquire up to 100,000 shares, 50,000 of which are exercisable at \$2.00 per share and 50,000 of which are exercisable at \$3.00 per share. The warrants are exercisable at any time for two years following issuance. The warrants were issued to Miller pursuant to Rule 506 under the Act, and the shares of Common Stock underlying the Warrants will be issued pursuant to such exemption.

In July 1999, the Company issued to Harmonic Research, Inc. fully vested warrants to acquire up to 150,000 shares of Common Stock at \$2.50 per share. The warrants are exercisable at any time for two years following issuance. The warrants were issued pursuant to Rule 506 under the Act, and the shares of Common Stock underlying the Warrants will be issued pursuant to such exemption.

II. Stock Options

In August 1996, the Company issued to a RAM Group, consultant, options to purchase up to 5,000 shares of Common Stock at \$5.00 per share.

In September 1996, the Company issued to Joseph Donahue options to purchase up to 5,000 shares of Common Stock at \$4.50 per share.

In November 1996, the Company issued to a RAM Group, consultant, options to purchase up to 5,000 shares of Common Stock at \$5.00 per share.

In November 1996, the Company issued to Phillip A. Harvey options to purchase up to 5,000 shares of Common Stock at \$6.50 per share.

In November 1996, the Company issued to Michael Feeney options to purchase up to 1,000 shares of Common Stock at \$5.00 per share.

In February 1997, the Company issued to Leland P. Maxwell options to purchase up to 20,000 shares of Common Stock at \$4.50 per share.

In June 1997, the Company issued to Haven Brock Kolls options to purchase up to 10,000 shares of Common Stock at \$4.50 per share.

In June 1997, the Company issued to Keith Sterling options to purchase up to 10,000 shares of Common Stock at \$4.50 per share.

In June 1997, the Company issued to Stephen Herbert options to purchase up to 10,000 shares of Common Stock at \$4.50 per share.

In June 1997, the Company issued to Michael Feeney options to purchase up to 500 shares of Common Stock at \$4.50 per share.

In September 1997, the Company issued to RAM Group, a consultant, options to purchase up to 5,000 shares of Common Stock at \$5.00 per share.

In December 1997, the Company issued to Joseph Donahue options to purchase up to 5,000 shares of Common Stock at \$4.50 per share.

In December 1997, the Company issued Phillip A. Harvey options to purchase up to 5,000 shares of Common Stock at \$4.50 per share.

In April 1998, the Company issued to Stephen Herbert options to purchase up to 5,000 shares of Common Stock at \$4.50 per share.

In April 1998, the Company issued to Haven Brock Kolls options to purchase up to 5,000 shares of Common Stock at \$4.50 per share.

In April 1998, the Company issued to Leland P. Maxwell options to purchase up to 5,000 shares of Common Stock at \$4.50 per share.

In June 1999, the Company issued options to purchase an aggregate of 470,000 shares of Common Stock at \$2.00 per share to its executive officers, as follows: George R. Jensen, Jr. - 180,000 options; Stephen P. Herbert - 110,000 options; Haven Brock Kolls - 100,000 options; Leland Maxwell - 40,000 options; Michael Lawlor - 20,000 options; and Joseph Donahue - 20,000 options.

In June and July 1999, the Company issued options to purchase an aggregate of 70,000 shares of Common Stock at \$2.00 per share to its outside directors, as follows: Steven Katz - 10,000 options; Edwin R. Boynton - 10,000 options; Peter Kapourellos - 10,000 options; William Sellers - 10,000 options; Henry Smith - 10,000 options; William Van Alen, Jr. - 10,000 options; and Douglas M. Lurio - 10,000 options.

In June 1999, the Company issued options to purchase an aggregate of 12,000 shares of Common Stock at \$2.00 per share to six employees as follows: Margaret Broadwell - 5,000 options; Cecil Ladesma - 2,000 options; Amy Thigpen - 2,000 options; Vivian Stroud - 1,000 options; Jim Tierney - 1,000 options; and Dave DeMedio - 1,000 options.

The issuance of all of the foregoing options was made in reliance upon the exemption provided by Section 4(2) of the Act as all of the options were issued to officers, directors, employees or consultants to the Company, each of such issuances were separate transactions not part of any plan, and none of the issuances involved any general solicitation or advertising.

III. Common Stock-For Cash.

In October 1995, options to purchase 10,000 shares of Common Stock at \$.50 per share were exercised by the holders thereof.

In June 1997, options to purchase 15,000 shares of Common Stock at \$.50 per share were exercised by the holders thereof.

In September 1997, options to purchase 7,000 shares of Common Stock at \$.50 per share were exercised by the holders thereof.

In March 1998, options to purchase 45,000 shares of Common Stock at \$1.00 per share were exercised by the holder thereof.

All of the foregoing issuances were made in reliance upon the exemption provided by Section 4(2) of the Act as all of the issuances were to existing security holders of the Company, the securities issued contained restrictive legends, and the issuance did not involve any general solicitation or advertising.

Item 27. Exhibits

| Exhibit Number | Description |
|-------------------|---|
| 3.1 | Articles of Incorporation of Company filed on January 16, 1992 (Incorporated by reference to Exhibit 3.1 to Form SB-2 Registration Statement No. 33-70992). |
| 3.1.1 | First Amendment to Articles of Incorporation of the Company filed on July 17, 1992 (Incorporated by reference to Exhibit 3.1.1 to Form SB-2 Registration Statement No. 33-70992). |
| 3.1.2 | Second Amendment to Articles of Incorporation of the Company filed on July 27, 1992 (Incorporated by reference to Exhibit 3.1.2 to Form SB-2 Registration Statement No. 33-70992). |
| 3.1.3 | Third Amendment to Articles of Incorporation of the Company filed on October 5, 1992 (Incorporated by reference to Exhibit 3.1.3 to Form SB-2 Registration Statement No. 33-70992). |
| 3.1.4 | Fourth Amendment to Articles of Incorporation of the Company filed on October 18, 1993 (Incorporated by reference to Exhibit 3.1.4 to Form SB-2 Registration Statement No. 33-70992). |
| 3.1.5 | Fifth Amendment to Articles of Incorporation of the Company filed on June 7, 1995 (Incorporated by reference to Exhibit 3.1 to Form SB-2 Registration Statement No. 33-98808). |
| 3.1.6 | Sixth Amendment to Articles of Incorporation of the Company filed on May 1, 1996 (Incorporated by reference to Exhibit 3.1.6 to Form SB-2 Registration Statement No. 333-09465). |
| 3.1.7 | Seventh Amendment to Articles of Incorporation of the Company filed on March 24, 1997 (Incorporated by reference to Exhibit 3.1.7 to Form SB-2 Registration Statement No. 333-30853). |
| 3.1.8 | Eighth Amendment to Articles of Incorporation of the Company filed on July 5, 1998. |
| 3.1.9 | Ninth Amendment to Articles of Incorporation of the Company filed on October 1, 1998. |
| 3.1.10 | Tenth Amendment to Articles of Incorporation of the Company filed on April 12, 1999. |
| 3.1.11 | Eleventh Amendment to Articles of Incorporation of the Company filed on June 7, 1999. |
| 3.2 | By-Laws of the Company (Incorporated by reference to Exhibit 3.2 to Form SB-2 Registration Statement No. 33-70992). |
| 4.1 | Warrant Agreement dated as of June 21, 1995 between the company and American Stock Transfer and Trust Company (Incorporated by reference to Exhibit 4.1 to Form SB-2 Registration Statement N. 33-98808, filed October 31, 1995). |
| 4.2 | Form of Warrant Certificate (Incorporated by reference to Exhibit 4.2 to Form SB-2 Registration Statement, No. 33-98808, filed October 31, 1995). |
| 4.3 | 1996 Warrant Agreement dated as of May 1, 1996 between the Company and American Stock Transfer and Trust Company. |
| 4.4 | Form of 1996 Warrant Certificate. |
| 4.5 | Form of 1997 Warrant (Incorporated by reference to Exhibit 4.1 to Form SB-2 Registration Statement No. 333-38593, filed February 4, 1998). |
| 4.6 | Form of 12% Senior Note |
| **4.7 | Warrant Certificate of I.W. Miller Group, Inc. |
| **4.8 | Warrant Certificate of Harmonic Research, Inc. |
| **5.1 | Opinion of Lurio & Associates, P.C. |

- 10.1 Employment and Non-Competition Agreement between the Company and Adele Hepburn dated as of January 1, 1993 (Incorporated by reference to Exhibit 10.7 to Form SB-2 Registration Statement No. 33-70992).
- 10.2 Robert L. Bartlett common Stock Options dated as of July 1, 1993 (incorporated by reference to Exhibit 10.9 to Form SB-2 Registration Statement No. 33-70992).
- 10.3 Edward J. Sullivan Common Stock Options dated as of July 1, 1993 (Incorporated by reference to Exhibit 10.10 to Form SB-2 Registration Statement No. 33-70992).
- 10.4 Keith L. Sterling Common Stock Options dated July 1, 1993 (Incorporated by reference to Exhibit 10.11 to Form SB-2 Registration Statement No. 33-70992).
- 10.5 Adele Hepburn Common Stock Options dated as of July 1, 1993 (Incorporated by reference to Exhibit 10.12 to Form SB-2 Registration Statement No. 33-70992).
- 10.6 Gregory C. Rollins Common Stock Options dates as of August 23, 1993 (Incorporated by reference to Exhibit 10.13 to Form SB-2 Registration Statement No. 33-70992).
- 10.7 Certificate of Appointment of American Stock Transfer & Trust Company as Transfer Agent and Registrar dated October 8, 1993 (Incorporated by reference to Exhibit 10.23 to Form SB-2 Registration Statement No. 33-70992).
- 10.8 Employment and Non-Competition Agreement between the Company and H. Brock Kolls dated as of May 1, 1994 (Incorporated by reference to Exhibit 10.32 to Form SB-2 Registration Statement No. 33-70992).
- 10.8.1 First Amendment to Employment and Non-Competition Agreement between the Company and H. Brock Kolls dated as of May 1, 1994 (Incorporated by reference to Exhibit 10.13.1 to Form SB-2 Registration Statement No. 333-09465).
- 10.9 Agreement of Lease dated March 16,1994, by and between the Company and G.F. Florida Operating Alpha, Inc. (Incorporated by reference to Exhibit 10.33 to Form SB-2 Registration Statement No. 33-70992).
- 10.10 Megan N. Cherney Common Stock Options dated as of April 1, 1994 (Incorporated by reference to Exhibit 10.41 to Form SB-2 Registration Statement No. 33-70992).
- 10.11 H. Brock Kolls Common Stock Options dated as of May 1, 1994 (Incorporated by reference to Exhibit 10.42 to Form SB-2 Registration Statement No. 33-70992).
- 10.11.1 H. Brock Kolls Common Stock Options dated as of March 20, 1996 (Incorporated by reference to Exhibit 10.19 to Form SB-2 Registration Statement No. 33-70992)
- 10.12 Barry Slawter Common Stock Options dated as of August 25, 1994 (Incorporated by reference to Exhibit 10.43 to Form SB-2 Registration Statement No. 33-70992).
- 10.13 Employment and Non-Competition Agreement between the Company and Michael Lawlor dated June 7, 1996 (Incorporated by reference to Exhibit 10.28 to Form SB-2 Registration Statement No. 333-09465).

- 10.14 Michael Lawlor Common Stock Option Certificate dated as of June 7, 1996 (Incorporated by reference to Exhibit 10.29 to Form SB-2 Registration Statement No.333-09465).
- 10.15 Employment and Non-Competition Agreement between the Company and Stephen P. Herbert dated April 4, 1996 (Incorporated by reference to Exhibit 10.30 to Form SB-2 Registration Statement No. 333-09465).
- 10.16 Stephen P. Herbert Common Stock Option Certificate dated April 4, 1996 (Incorporated by reference to Exhibit 10.31 to Form SB-2 Registration Statement No. 333-09465).
- 10.17 RAM Group Common Stock Option Certificate dated as of August 22, 1996 (Incorporated by reference to Exhibit 10.34 to Form SB-2 Registration No. 33-98808).
- 10.18 RAM Group Common Stock Option Certificate dated as of November 1, 1996 (Incorporated by reference to Exhibit 10.35 to Form SB-2 Registration No. 33-98808).
- 10.19 Philip A. Harvey Common Stock Option Certificate dated as of November 1, 1996 (Incorporated by reference to Exhibit 10.36 to Form SB-2 Registration No. 33-98808).
- 10.20 Joseph Donahue Common Stock Option Certificate dated as of September 2, 1996 (Incorporated by reference to Exhibit 10.37 to Form SB-2 Registration No. 33-98808).
- 10.21 Employment and Non-Competition Agreement between the Company and Leland P. Maxwell dated February 24, 1997 (Incorporated by reference to Exhibit 10.39 to Form SB-2 Registration No. 33-98808)
- 10.21.1 First Amendment to Employment and Non-competition Agreement between the Company and Leland P. Maxwell dated February 24, 1998.
- 10.22 Leland P. Maxwell Common Stock Option Certificate dated February 24, 1997 (Incorporated by reference to Exhibit 10.40 to Form SB-2 Registration No. 33-98808).
- 10.23 Letter between the Company and GEM Advisers, Inc. signed May 15, 1997 (Incorporated by reference to Exhibit 10.1 to Form 8-K filed on May 22, 1997).
- 10.24 Business Express Agreement between the Company and 1217909 Ontario Inc. dated May 20, 1997 (Incorporated by reference to Exhibit 10.42 to Form 8-K filed on May 22, 1997).
- 10.25 H. Brock Kolls Common Stock Option Certificate dated as of June 9, 1997 (Incorporated by reference to Exhibit 10.43 to Form SB-2 Registration Statement No. 333-30853).

- 10.26 Stephen Herbert Common Stock Option Certificate dated as of June 9, 1997 (Incorporated by reference to Exhibit 10.44 to Form SB-2 Registration Statement No. 333-30853).
- 10.27 Keith Sterling Common Stock Option Certificate dated as of June 9, 1997 (Incorporated by reference to Exhibit 10.45 to Form SB-2 Registration Statement No. 333-30853).
- 10.28 Michael Feeney Common Stock Option Certificate dated as of June 9, 1997 (Incorporated by reference to Exhibit 10.46 to Form SB-2 Registration Statement No. 333-30853).
- 10.29 Joint Venture Agreement dated September 24, 1997 between the Company and Mail Boxes Etc. (Incorporated by reference to Exhibit 10.47 to Form 10-KSB filed on September 26, 1997).
- 10.30 Employment and Non-competition Agreement between the Company and George R. Jensen, Jr. dated November 20, 1997 (Incorporated by reference to Exhibit 10.1 to Form 8-K filed on November 26, 1997).
- 10.31 Agreement between the Company and Promus Hotels, Inc. dated May 8, 1997 (incorporated by reference to Exhibit 10.49 to Form SB-2 Registration Statement No. 333-38593, filed on February 4, 1998).
- 10.32 Agreement between the Company and Choice Hotels International, Inc. dated April 24, 1997 (Incorporated by reference to Exhibit 10.50 to Form SB-2 Registration Statement No. 333-38593, filed on February 4, 1998).
- 10.33 Agreement between the Company and PNC Merchant Services dated July 18, 1997 (Incorporated by reference to Exhibit 10.51 to Form SB-2 Registration Statement No. 333-38593, filed on February 4, 1998).
- 10.34 Separation Agreement between the Company and Keith L. Sterling dated April 8, 1998 (Incorporated by reference to Exhibit to Exhibit 10.1 to Form 10-QSB filed May 12, 1998).
- 10.35 Phillip A. Harvey Common Stock Option Certificate dated as of April 22, 1999.
- 10.36 Consulting Agreement between Ronald Trahan and the Company dated November 16, 1998 (incorporated by reference to Exhibit 28 to Registration Statement No. 333-67503 on Form S-8 filed on November 18, 1998).
- 10.37 Consulting Agreement between Mason Sexton and the Company dated March 10, 1999 (incorporated by reference to Exhibit 28 to Registration Statement No. 333-74807 on Form S-8 filed on March 22, 1999).
- **10.38 Financial Public Relations Agreement between the Company and I.W. Miller Group, Inc. dated August 1, 1999.
- **10.39 Consulting Agreement between Harmonic Research, Inc. and the Company dated August 3, 1999.
- **23.1 Consent of Ernst & Young LLP.
- **27.1 Power of Attorney

 ** -- Filed herewith.

Item 28. Undertakings.

The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20 percent change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement.

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.

Provided, however, that paragraphs (1)(i) and (1)(ii) do not apply if the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed by the registrant pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in

the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

For purposes of determining any liability under the Securities Act of 1933, each filing of the registrant's annual report pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 that is incorporated by reference in this registration statement shall be deemed to be a new registration statement relating to the securities offered herein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, as amended, the Registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing this Form SB-2 and has duly caused this Registration Statement on Form SB-2 to be signed on its behalf by the undersigned, thereunto duly authorized, in Wayne, Pennsylvania, on August 4, 1999.

USA TECHNOLOGIES, INC.

By: /s/ George R. Jensen, Jr.

George R. Jensen, Jr.,
Chairman and Chief Executive Officer

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints George R. Jensen, Jr. and Leland P. Maxwell, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Registration Statement, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto such attorneys-in-fact and agents, full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or either of them or their or his substitutes, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Act of 1933, as amended, this Registration Statement has been duly signed below by the following persons in the capacities and dates indicated.

| Signatures ----- | Title ----- | Date ---- |
|---|---|----------------|
| /s/ George R. Jensen, Jr. ----- George R. Jensen, Jr. | Chairman of the Board, and Chief Executive Officer (Principal and Chief Executive Officer) Director | August 4, 1999 |
| /s/ Leland P. Maxwell ----- Leland P. Maxwell | Vice President, Chief Financial Officer Treasurer (Principal Accounting Officer) | August 4, 1999 |
| /s/ Stephen P. Herbert ----- Stephen P. Herbert | President, Chief Operating Officer, Director | August 4, 1999 |
| /s/ William W. Sellers ----- William W. Sellers | Director | August 4, 1999 |
| /s/ Peter G. Kapourellos ----- Peter G. Kapourellos | Director | August 4, 1999 |
| ----- Henry B. duPont Smith | Director | August , 1999 |
| ----- William L. Van Alen, Jr. | Director | August , 1999 |
| ----- Steven Katz | Director | August , 1999 |

/s/ Douglas M. Lurio

Douglas M. Lurio

Director

August 4, 1999

Edwin R. Boynton

Director

August __, 1999

EXHIBIT INDEX

| Exhibit Number ----- | Description ----- |
|----------------------------|--|
| 4.7 | Warrant Certificate of I.W. Miller Group, Inc. |
| 4.8 | Warrant Certificate of Harmonic Research, Inc. |
| 5.1 | Opinion of Lurio & Associates |
| 10.38 | Financial Public Relations Agreement between the Company and I.W. Miller Group, Inc. dated August 1, 1999. |
| 10.39 | Consulting Agreement between Mason Sexton and the Company dated August 3, 1999. |
| 23.1 | Consent of Independent Auditors |
| 24.1 | Power of Attorney (appears as part of signature page) |

THESE WARRANTS AND THE COMMON STOCK ISSUABLE UPON THE EXERCISE HEREOF HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAW. THESE WARRANTS AND THE COMMON STOCK ISSUABLE UPON THE EXERCISE HEREOF MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF A REGISTRATION STATEMENT IN EFFECT UNDER SUCH ACT AND SUCH LAWS WITH RESPECT TO THESE WARRANTS AND THE COMMON STOCK ISSUABLE UPON THE EXERCISE HEREOF, OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.

WARRANT CERTIFICATE
NO. 162

100,000 COMMON STOCK WARRANTS

USA TECHNOLOGIES, INC.

COMMON STOCK WARRANTS

(These Warrants will be void if not exercised
by the Termination Date specified below.)

1. Warrants. Subject to the terms and conditions hereof, this certifies that I.W. MILLER GROUP, INC. is the owner of 100,000 Warrants (the "Warrants") of USA Technologies, Inc., a Pennsylvania corporation (the "Company"). Each Warrant entitles the holder hereof to purchase from the Company at any time prior to 5:00 p.m. on August 1, 2001 (the "Termination Date"), one fully paid and non-assessable share of the Company's Common Stock, without par value (the "Common Stock"), subject to adjustment as provided in Section 7 hereof.

2. Warrant Price. The Warrants shall be exercised by delivery to the Company (prior to the Termination Date) of the Warrant price for each share of Common Stock being purchased hereunder (the "Warrant Price"), this Certificate, and the completed Election To Purchase Form which is attached hereto. The Warrant Price shall be \$2.00 per share of Common Stock for 50,000 of the Warrants, and \$3.00 per share for 50,000 of the Warrants. The Warrant Price shall be subject to adjustment as provided in Section 7 hereof. The Warrant Price is payable either in cash or by certified check or bank draft payable to the order of the Company.

3. Exercise. Upon the surrender of this Certificate and payment of the Warrant Price as aforesaid, the Company shall issue and cause to be delivered with all reasonable dispatch to or upon

the written order of the registered holder of this Warrant and in such name or names as the registered holder may designate, a certificate or certificates for the number of full shares of Common Stock so purchased upon the exercise of any Warrant. Such certificate or certificates shall be deemed to have been issued and any person so designated to be named therein shall be deemed to have become a holder of record of such Common Stock on and as of the date of the delivery to the Company of this Certificate and payment of the Warrant Price as aforesaid. If, however, at the date of surrender of this Certificate and payment of such Warrant Price, the transfer books for the Common Stock purchasable upon the exercise of any Warrant shall be closed, the certificates for the Common Stock in respect to which any such Warrant are then exercised shall be issued and the owner of such Common Stock shall become a record owner of such Common Stock on and as of the next date on which such books shall be opened, and until such date the Company shall be under no duty to deliver any certificate for such Common Stock.

4. Partial Exercise. The rights of purchase represented by the Warrants shall be exercisable, at the election of the registered holder hereof, either as an entirety, or from time to time for any part of the Common Stock specified herein and, in the event that the Warrants are exercised with respect to less than all of the Common Stock specified herein at any time prior to the Termination Date, a new Certificate will be issued to such registered holder for the remaining number of Warrants not so exercised.

5. Termination Date. All of the Warrants must be exercised in accordance with the terms hereof prior to the Termination Date. At and after the Termination Date any and all unexercised rights hereunder shall become null and void and all such unexercised Warrants shall without any action on behalf of the Company become null and void.

6. Lost, Mutilated Certificate. In case this Common Stock Warrant Certificate shall become mutilated, lost, stolen or destroyed, the Company shall issue in exchange and substitution for and upon cancellation of the mutilated certificate, or in lieu of and in substitution for the Certificate lost, stolen, or destroyed, a new Certificate of like tenor and representing an equivalent right or interest, but only upon receipt of evidence satisfactory to the Company of such loss, theft or destruction of such certificate and indemnity, if requested, also satisfactory to the Company.

7. Adjustments. Subject and pursuant to the provisions of this Section 7, the Warrant Price and number of shares of Common Stock subject to the Warrants shall be subject to adjustment from time to time only as set forth hereinafter:

a. In case the Company shall declare a Common Stock dividend on the Common Stock, then the Warrant Price shall be proportionately decreased as of the close of business on the date of record of said Common Stock dividend in proportion to such increase of outstanding shares of Common Stock.

b. If the Company shall at any time subdivide its outstanding Common Stock by recapitalization, reclassification or split-up thereof, the Warrant Price immediately prior to such subdivision shall be proportionately decreased, and, if the Company shall at any time combine the outstanding shares of Common Stock by recapitalization, reclassification, or combination thereof, the Warrant Price immediately prior to such combination shall be proportionately increased. Any such adjustment to the Warrant Price shall become effective at the close of business on the record date for such subdivision or combination. The Warrant Price shall be proportionately increased or decreased, as the case may be, in proportion to such increase or decrease, as the case may be, of outstanding shares of Common Stock.

c. Upon any adjustment of the Warrant Price as hereinabove provided, the number of shares of Common Stock issuable upon exercise of the Warrants remaining unexercised immediately prior to any such adjustment, shall be changed to the number of shares determined by dividing (i) the appropriate Warrant Price payable for the purchase of all shares of Common Stock issuable upon exercise of all of the Warrants remaining unexercised immediately prior to such adjustment by (ii) the Warrant Price per share of Common Stock in effect immediately after such adjustment. Pursuant to this formula, the total sum payable to the Company upon the exercise of the Warrants remaining unexercised immediately prior to such adjustment shall remain constant.

d. (i) If any capital reorganization or reclassification of the capital stock of the Company, or consolidation or merger of the Company with another corporation, person, or entity, or the sale of all or substantially all of its assets to another corporation, person, or entity, shall be effected

in such a way that holders of Common Stock shall be entitled to receive stock, securities, cash, property, or assets with respect to or in exchange for Common Stock, and provided no election is made by the Company pursuant to subsection (ii) hereof, then, as a condition of such reorganization, reclassification, consolidation, merger or sale, the Company or such successor or purchasing corporation, person, or entity, as the case may be, shall agree that the registered holder of the Warrants shall have the right thereafter and until the Termination Date to exercise such Warrants for the kind and amount of stock, securities, cash, property, or assets receivable upon such reorganization, reclassification, consolidation, merger, or sale by a holder of the number of shares of Common Stock for the purchase of which such Warrants might have been exercised immediately prior to such reorganization, reclassification, consolidation, merger or sale, subject to such subsequent adjustments which shall be equivalent or nearly equivalent as may be practicable to the adjustments provided for in this Section 7.

(ii) Notwithstanding subsection (i) hereof and in lieu thereof, the Company may elect by written notice to the registered holder hereof, to require such registered holder to exercise all of the Warrants remaining unexercised prior to any such reorganization, reclassification, consolidation, merger or sale. If the holder of this Warrant shall not exercise all or any part of the Warrants remaining unexercised prior to such event, such unexercised Warrants shall automatically become null and void upon the occurrence of any such event, and of no further force and effect. The Common Stock issued pursuant to any such exercise shall be deemed to be issued and outstanding immediately prior to any such event, and shall be entitled to be treated as any other issued and outstanding share of Common Stock in connection with such event. If an election is not made by the Company pursuant to this subsection (ii) in connection with any such event, then the provisions of subsection (i) hereof shall apply to such event.

e. Whenever the Warrant Price and number of shares of Common Stock subject to this Warrant is adjusted as herein provided, the Company shall promptly mail to the registered holder of this Warrant a statement signed by an officer of the Company setting forth the adjusted Warrant Price and the number of shares of Common Stock subject to this Warrant, determined as so provided.

f. This form of Certificate need not be changed because of any adjustment which is required pursuant to this

Section 7. However, the Company may at any time in its sole discretion (which shall be conclusive) make any change in the form of this Certificate that the Company may deem appropriate and that does not affect the substance hereof; and any Certificate thereafter issued, whether in exchange or substitution for this Certificate or otherwise, may be in the form as so changed.

8. Reservation. There has been reserved, and the Company shall at all times keep reserved out of the authorized and unissued shares of Common Stock, a number of shares of Common Stock sufficient to provide for the exercise of the right of purchase represented by the Warrants. The Company agrees that all shares of Common Stock issued upon exercise of the Warrants shall be, at the time of delivery of the Certificates for such Common Stock, validly issued and outstanding, fully paid and non-assessable.

9. Fractional Shares. The Company shall not issue any fractional shares of Common Stock pursuant to any exercise of any Warrant and shall pay cash to the holder of any Warrant in lieu of any such fractional shares.

10. No Right. The holder of any Warrants shall not be entitled to any of the rights of a shareholder of the Company prior to the date of issuance of the Common Stock by the Company pursuant to an exercise of any Warrant.

11. Securities Laws. As a condition to the issuance of any Common Stock pursuant to the Warrants, the holder of such Common Stock shall execute and deliver such representations, warranties, and covenants, that may be required by applicable federal and state securities law, or that the Company determines is reasonably necessary in connection with the issuance of such Common Stock. In addition, the certificates representing the Common Stock shall contain such legends, or restrictive legends, or stop transfer instructions, as shall be required by applicable Federal or state securities laws, or as shall be reasonably required by the Company or its transfer agent.

12. Applicable Law. The Warrants and this Certificate shall be deemed to be a contract made under the laws of the Commonwealth of Pennsylvania and for all purposes shall be construed in accordance with the laws thereof regardless of its choice of law rules.

IN WITNESS WHEREOF, USA TECHNOLOGIES, INC., has executed and delivered this Warrant Certificate as of the date written below.

USA TECHNOLOGIES, INC.

By: /s/ George R. Jensen, Jr.

George R. Jensen, Jr.,
Chief Executive Officer

Attest: /s/ Leland P. Maxwell

Leland P. Maxwell, Secretary

Dated: August 1, 1999

USA TECHNOLOGIES, INC.
200 Plant Avenue
Wayne, Pennsylvania 19087
Attn: George R. Jensen, Jr.,
Chief Executive Officer

ELECTION TO PURCHASE

The undersigned hereby irrevocably elects to exercise the right of purchase represented by the attached Warrant Certificate No. of the Company. The undersigned desires to purchase _____ shares of Common Stock provided for therein and tenders herewith full payment of the Warrant Price for the shares of Common Stock being purchased, all in accordance with the Certificate. The undersigned requests that a Certificate representing such shares of Common Stock shall be issued to and registered in the name of, and delivered to, the undersigned at the following address: _____

_____. If said number of shares of Common Stock shall not be all the shares purchasable under the Certificate, then a new Common Stock Warrant Certificate for the balance remaining of the shares of Common Stock purchasable shall be issued to and registered in the name of, and delivered to, the undersigned at the address set forth above.

Dated: _____, 19__

Signature: _____

THESE WARRANTS AND THE COMMON STOCK ISSUABLE UPON THE EXERCISE HEREOF HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAW. THESE WARRANTS AND THE COMMON STOCK ISSUABLE UPON THE EXERCISE HEREOF MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF A REGISTRATION STATEMENT IN EFFECT UNDER SUCH ACT AND SUCH LAWS WITH RESPECT TO THESE WARRANTS AND THE COMMON STOCK ISSUABLE UPON THE EXERCISE HEREOF, OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.

WARRANT CERTIFICATE
NO. 163

150,000 COMMON STOCK WARRANTS

USA TECHNOLOGIES, INC.

COMMON STOCK WARRANTS

(These Warrants will be void if not exercised
by the Termination Date specified below.)

1. Warrants. Subject to the terms and conditions hereof, this certifies that HARMONIC RESEARCH, INC. is the owner of 150,000 Warrants (the "Warrants") of USA Technologies, Inc., a Pennsylvania corporation (the "Company"). Each Warrant entitles the holder hereof to purchase from the Company at any time prior to 5:00 p.m. on August 3, 2001 (the "Termination Date"), one fully paid and non-assessable share of the Company's Common Stock, without par value (the "Common Stock"), subject to adjustment as provided in Section 7 hereof.

2. Warrant Price. The Warrants shall be exercised by delivery to the Company (prior to the Termination Date) of the Warrant price for each share of Common Stock being purchased hereunder (the "Warrant Price"), this Certificate, and the completed Election To Purchase Form which is attached hereto. The Warrant Price shall be \$2.50 per share of Common Stock. The Warrant Price shall be subject to adjustment as provided in Section 7 hereof. The Warrant Price is payable either in cash or by certified check or bank draft payable to the order of the Company.

3. Exercise. Upon the surrender of this Certificate and payment of the Warrant Price as aforesaid, the Company shall issue and cause to be delivered with all reasonable dispatch to or upon the written order of the registered holder of this Warrant and in such name or names as the registered holder may designate, a

certificate or certificates for the number of full shares of Common Stock so purchased upon the exercise of any Warrant. Such certificate or certificates shall be deemed to have been issued and any person so designated to be named therein shall be deemed to have become a holder of record of such Common Stock on and as of the date of the delivery to the Company of this Certificate and payment of the Warrant Price as aforesaid. If, however, at the date of surrender of this Certificate and payment of such Warrant Price, the transfer books for the Common Stock purchasable upon the exercise of any Warrant shall be closed, the certificates for the Common Stock in respect to which any such Warrant are then exercised shall be issued and the owner of such Common Stock shall become a record owner of such Common Stock on and as of the next date on which such books shall be opened, and until such date the Company shall be under no duty to deliver any certificate for such Common Stock.

4. Partial Exercise. The rights of purchase represented by the Warrants shall be exercisable, at the election of the registered holder hereof, either as an entirety, or from time to time for any part of the Common Stock specified herein and, in the event that the Warrants are exercised with respect to less than all of the Common Stock specified herein at any time prior to the Termination Date, a new Certificate will be issued to such registered holder for the remaining number of Warrants not so exercised.

5. Termination Date. All of the Warrants must be exercised in accordance with the terms hereof prior to the Termination Date. At and after the Termination Date any and all unexercised rights hereunder shall become null and void and all such unexercised Warrants shall without any action on behalf of the Company become null and void.

6. Lost, Mutilated Certificate. In case this Common Stock Warrant Certificate shall become mutilated, lost, stolen or destroyed, the Company shall issue in exchange and substitution for and upon cancellation of the mutilated certificate, or in lieu of and in substitution for the Certificate lost, stolen, or destroyed, a new Certificate of like tenor and representing an equivalent right or interest, but only upon receipt of evidence satisfactory to the Company of such loss, theft or destruction of such certificate and indemnity, if requested, also satisfactory to the Company.

7. Adjustments. Subject and pursuant to the provisions of this Section 7, the Warrant Price and number of shares of Common Stock subject to the Warrants shall be subject to adjustment from time to time only as set forth hereinafter:

a. In case the Company shall declare a Common Stock dividend on the Common Stock, then the Warrant Price shall be proportionately decreased as of the close of business on the date of record of said Common Stock dividend in proportion to such increase of outstanding shares of Common Stock.

b. If the Company shall at any time subdivide its outstanding Common Stock by recapitalization, reclassification or split-up thereof, the Warrant Price immediately prior to such subdivision shall be proportionately decreased, and, if the Company shall at any time combine the outstanding shares of Common Stock by recapitalization, reclassification, or combination thereof, the Warrant Price immediately prior to such combination shall be proportionately increased. Any such adjustment to the Warrant Price shall become effective at the close of business on the record date for such subdivision or combination. The Warrant Price shall be proportionately increased or decreased, as the case may be, in proportion to such increase or decrease, as the case may be, of outstanding shares of Common Stock.

c. Upon any adjustment of the Warrant Price as hereinabove provided, the number of shares of Common Stock issuable upon exercise of the Warrants remaining unexercised immediately prior to any such adjustment, shall be changed to the number of shares determined by dividing (i) the appropriate Warrant Price payable for the purchase of all shares of Common Stock issuable upon exercise of all of the Warrants remaining unexercised immediately prior to such adjustment by (ii) the Warrant Price per share of Common Stock in effect immediately after such adjustment. Pursuant to this formula, the total sum payable to the Company upon the exercise of the Warrants remaining unexercised immediately prior to such adjustment shall remain constant.

d. (i) If any capital reorganization or reclassification of the capital stock of the Company, or consolidation or merger of the Company with another corporation, person, or entity, or the sale of all or substantially all of its assets to another corporation, person, or entity, shall be effected in such a way that holders of Common Stock shall be entitled to receive stock, securities, cash, property, or assets with respect

to or in exchange for Common Stock, and provided no election is made by the Company pursuant to subsection (ii) hereof, then, as a condition of such reorganization, reclassification, consolidation, merger or sale, the Company or such successor or purchasing corporation, person, or entity, as the case may be, shall agree that the registered holder of the Warrants shall have the right thereafter and until the Termination Date to exercise such Warrants for the kind and amount of stock, securities, cash, property, or assets receivable upon such reorganization, reclassification, consolidation, merger, or sale by a holder of the number of shares of Common Stock for the purchase of which such Warrants might have been exercised immediately prior to such reorganization, reclassification, consolidation, merger or sale, subject to such subsequent adjustments which shall be equivalent or nearly equivalent as may be practicable to the adjustments provided for in this Section 7.

(ii) Notwithstanding subsection (i) hereof and in lieu thereof, the Company may elect by written notice to the registered holder hereof, to require such registered holder to exercise all of the Warrants remaining unexercised prior to any such reorganization, reclassification, consolidation, merger or sale. If the holder of this warrant shall not exercise all or any part of the Warrants remaining unexercised prior to such event, such unexercised Warrants shall automatically become null and void upon the occurrence of any such event, and of no further force and effect. The Common Stock issued pursuant to any such exercise shall be deemed to be issued and outstanding immediately prior to any such event, and shall be entitled to be treated as any other issued and outstanding share of Common Stock in connection with such event. If an election is not made by the Company pursuant to this subsection (ii) in connection with any such event, then the provisions of subsection (i) hereof shall apply to such event.

e. Whenever the Warrant Price and number of shares of Common Stock subject to this Warrant is adjusted as herein provided, the Company shall promptly mail to the registered holder of this Warrant a statement signed by an officer of the Company setting forth the adjusted Warrant Price and the number of shares of Common Stock subject to this Warrant, determined as so provided.

f. This form of Certificate need not be changed because of any adjustment which is required pursuant to this Section 7. However, the Company may at any time in its sole discretion (which shall be conclusive) make any change in the form

of this Certificate that the Company may deem appropriate and that does not affect the substance hereof; and any Certificate thereafter issued, whether in exchange or substitution for this Certificate or otherwise, may be in the form as so changed.

8. Reservation. There has been reserved, and the Company shall at all times keep reserved out of the authorized and unissued shares of Common Stock, a number of shares of Common Stock sufficient to provide for the exercise of the right of purchase represented by the Warrants. The Company agrees that all shares of Common Stock issued upon exercise of the Warrants shall be, at the time of delivery of the Certificates for such Common Stock, validly issued and outstanding, fully paid and non-assessable.

9. Fractional Shares. The Company shall not issue any fractional shares of Common Stock pursuant to any exercise of any Warrant and shall pay cash to the holder of any Warrant in lieu of any such fractional shares.

10. No Right. The holder of any Warrants shall not be entitled to any of the rights of a shareholder of the Company prior to the date of issuance of the Common Stock by the Company pursuant to an exercise of any Warrant.

11. Securities Laws. As a condition to the issuance of any Common Stock pursuant to the Warrants, the holder of such Common Stock shall execute and deliver such representations, warranties, and covenants, that may be required by applicable federal and state securities law, or that the Company determines is reasonably necessary in connection with the issuance of such Common Stock. In addition, the certificates representing the Common Stock shall contain such legends, or restrictive legends, or stop transfer instructions, as shall be required by applicable Federal or state securities laws, or as shall be reasonably required by the Company or its transfer agent.

12. Applicable Law. The Warrants and this Certificate shall be deemed to be a contract made under the laws of the Commonwealth of Pennsylvania and for all purposes shall be construed in accordance with the laws thereof regardless of its choice of law rules.

IN WITNESS WHEREOF, USA TECHNOLOGIES, INC., has executed and delivered this Warrant Certificate as of the date written below.

USA TECHNOLOGIES, INC.

By: /s/ George R. Jensen, Jr.

George R. Jensen, Jr.,
Chief Executive Officer

Attest: /s/ Leland P. Maxwell

Leland P. Maxwell, Secretary

Dated: August 3, 1999

USA TECHNOLOGIES, INC.
200 Plant Avenue
Wayne, Pennsylvania 19087
Attn: George R. Jensen, Jr.,
Chief Executive Officer

ELECTION TO PURCHASE

The undersigned hereby irrevocably elects to exercise the right of purchase represented by the attached Warrant Certificate No. ____ of the Company. The undersigned desires to purchase _____ shares of Common Stock provided for therein and tenders herewith full payment of the Warrant Price for the shares of Common Stock being purchased, all in accordance with the Certificate. The undersigned requests that a Certificate representing such shares of Common Stock shall be issued to and registered in the name of, and delivered to, the undersigned at the following address:_____

_____. If said number of shares of Common Stock shall not be all the shares purchasable under the Certificate, then a new Common Stock Warrant Certificate for the balance remaining of the shares of Common Stock purchasable shall be issued to and registered in the name of, and delivered to, the undersigned at the address set forth above.

Dated: _____, 19__

Signature: _____

LURIO & ASSOCIATES, P.C.

ATTORNEYS AT LAW
SUITE 1300
1760 MARKET STREET
PHILADELPHIA, PA 19103-4132

DOUGLAS M. LURIO**
MARGARET SHERRY LURIO*
ALLA PASTERNAK
KEVIN M. RULIS

NEW JERSEY OFFICE

215 / 665-9300
FAX 215 / 665-8582

411 COOPER STREET
CAMDEN, NEW JERSEY 08102
TEL. NO.: 609/225-9434

**MEMBER PENNSYLVANIA & FLORIDA BARS
*MEMBER PENNSYLVANIA & NEW JERSEY BARS

August 4, 1999

USA Technologies, Inc.
200 Plant Avenue
Wayne, PA 19087

Attn: Mr. George R. Jensen, Jr., President

Re: USA Technologies, Inc. -
Registration Statement on Form SB-2

Dear Mr. Jensen:

We have acted as counsel to USA Technologies, Inc., a Pennsylvania corporation (the "Company"), in connection with a Registration Statement on Form SB-2, filed with the Securities and Exchange Commission on the date hereof (the "Registration Statement"). The Registration Statement covers 250,000 shares of Common Stock ("Common Stock") issuable upon exercise of Warrants to purchase shares of Common Stock of the Company.

In rendering this opinion, we have examined (i) the Articles of Incorporation, as amended, and By-Laws of the Company; (ii) the resolutions of the Board of Directors evidencing the corporate proceedings taken by the Company to authorize the issuance of the Common Stock pursuant to the Registration Statement; (iii) the Registration Statement (including all exhibits thereto); and (iv) such other documents as we have deemed appropriate or necessary as a basis for the opinion hereinafter expressed.

In rendering the opinion expressed below, we assumed the authenticity of all documents and records examined, the conformity with the original documents of all documents submitted to us as copies and the genuineness of all signatures.

Based upon and subject to the foregoing, and such legal considerations as we deem relevant, we are of the opinion that, when resold as contemplated by the Registration Statement, and subject to effectiveness of the Registration Statement and compliance with applicable state securities laws, the Common Stock when issued will be legally issued, fully paid and nonassessable.

We hereby consent to the filing of this opinion as an Exhibit to the Registration Statement and to references made to this firm under the heading "Legal Matters" in the Prospectus contained in the Registration Statement and all amendments thereto.

Sincerely,

/s/ LURIO & ASSOCIATES, P.C.

LURIO & ASSOCIATES, P.C.

FINANCIAL PUBLIC RELATIONS AGREEMENT

This Financial Public Relations Agreement (this "Agreement") is made and entered into effective the 1st of August, 1999 between USA TECHNOLOGIES, a Pennsylvania corporation, (the "Company"), having offices at 200 Plant Avenue, Wayne, Pennsylvania and I.W. Miller Group, Inc., a California Corporation (the "Consultant"), having offices at 2361 Campus Drive, Suite 101, Irvine, CA 92612, based on the following:

Premise

- A. The Company is a publicly held corporation whose securities are listed on the OTC Bulletin Board market. The Company is seeking to expand its investor base and the number of market professionals who are aware of the Company's activities.
- B. Consultant is established in the securities industry and has experience in providing advice and support for publicly held companies.
- C. The Company desires to retain the services of Consultant, and Consultant desires to offer such services on the terms and conditions set forth in this Agreement.

NOW, THEREFORE, based on the foregoing premises, and in consideration of the mutual covenants of the parties and the benefits to be derived therefrom, it is hereby agreed as follows:

Agreement

1. Engagement of Consultant. The Company hereby engages Consultant to provide services to the Company under the terms of this Agreement, including, but not limited to, the analysis of business and proposed business of the Company by the Consultant as it pertains to the desirability and suitability of an investment in the Company by equity participants; the presentation of the Company to market professionals, including broker-dealers, mutual funds, and other institutional investors; providing the Company advice concerning shareholder relations and the preparation of information for the Company's shareholders; assisting in long-term financial planning, including borrowings, equity financing and other opportunities; providing advice concerning the existing and future capital structure of the Company. Notwithstanding the foregoing, Consultant shall not act as an agent of the Company and shall not contact the holders of the securities of the Company in connection with the exercise or conversion of currently issued and outstanding warrants, options, or convertible securities.
2. Marketing. Company shall furnish to Consultant disclosure and filing materials, financial statements, business plans, promotional materials, annual reports and press releases. In addition, Company agrees to distribute due diligence packages in ample quantities to potential investors as well as to the brokerage community. Consultant may rely on, and assume the accuracy of the due diligence package and/or research reports. Consultant may disseminate through the use of the media and advertisement the contents of the due diligence package and any research reports in order to attract potential investors as well as the brokerage community. Company acknowledges that Consultant is engaged in other business activities during the term of this Agreement.
3. Advertising. Advertising is defined as the cost associated with lead generation programs arranged by the Consultant for the Company. These programs are designed to create investor awareness for the Company. All advertising/lead generation programs are to be presented by the Consultant to the Company and approved by the Company in advance.
4. Compensation to Consultant. Consultant is to receive an initial \$10,000.00 retainer, payable upon execution of this Agreement. Each subsequent payment of \$10,000.00 is to be paid on the 1st of each month.

- a. Consultant is to receive a Warrant to purchase 50,000 common shares of USTT, @ \$2.00 per share. Said Warrant shall be issued within 6 months of this contract and shall have a 2-year term from the date of issuance and shall be fully vested upon issuance.
- b. Consultant is to receive a Warrant to purchase 50,000 common shares of USTT, @ \$3.00 per share. Said Warrant shall be issued within 6 months of this contract and shall have a 2-year term from the date of issuance and shall be fully vested upon issuance.
- c. Consultant represents and warrants to the Company that it is an Accredited Investor as such term is defined in Rule 501 promulgated under the Securities Act of 1933, as amended ("Act"). As a result thereof, the Warrants and the Common Stock underlying the Warrants will be issued to the Consultant pursuant to Rule 506 promulgated under the Act.
- d. The Warrants and the Common Stock underlying the Warrants issuable to the Consultant shall not be registered under the Act or any state securities laws, and shall constitute restricted securities as defined under Rule 144 promulgated under the Act. Following the issuance of the Warrants, the Company shall, at its expense, file and use its best efforts to have declared effective, a registration statement under the Act covering the resale by the Consultant of the Common Stock underlying the Warrants. The Company shall use its best efforts to have the resale of the Common Stock exempted from the registration requirements under applicable state securities laws.

5. Reimbursement of Costs. Consultant shall be responsible for all advertising costs for its lead generation campaigns. All travel costs are to be presented to the company in advance and are to be split on a 50/50 basis between the consultant and the company.

6. Term. This Agreement shall commence on the date hereof and will terminate on earliest of the following:

- a. The term of this Agreement is one-year from date of execution.
- b. Company can terminate consultant for cause upon 30 days written notice. Cause shall be determined solely as the following: violation of any rule or regulation of any regulatory agency; any other neglect, act or omission detrimental to the conduct of Company business; material breach of the Agreement or any unauthorized disclosure of any of the secrets or confidential information of the Company; dishonesty related to independent contractor status; a change in personnel, management control of the Consultant which materially affects the Consultant's work on behalf of the Company.
- c. Notwithstanding anything else set forth herein, Company can terminate consultant for any reason given 30 days written notice to consultants legal address of 2361 Campus Dr. Irvine, CA 92612
- d. The Consultant is to furnish to the Company activity reports on a monthly basis.

7. Confidentiality. Consultant acknowledges that it may receive confidential and proprietary information of the Company in connection with the services provided under the terms of the Agreement. The Consultant agrees to keep all such information confidential and to take prudent steps to assure that its officers, directors, and employees, and to not use such confidential information, except for the direct benefit of the Company. Consultant shall not disclose such confidential information and shall take reasonable steps to prevent the disclosure by its officers, directors, and employees, without the prior written consent of the Company.

8. Independent Consultant. The Company and Consultant hereby acknowledge that Consultant is an independent contractor. Consultant shall not hold itself out as, nor shall it take any action from which others might infer that it is a partner or agent of or a joint venture with the Company. Consultant shall have no authority to act on behalf of or bind the Company and shall take no action, which purports to bind the Company. The Company shall have no authority to act on behalf of or bind the Consultant and shall take no action, which purports to bind the Consultant.

9. Entire Agreement. This Agreement is and shall be considered to be the only Agreement or understanding between the parties hereto with respect to the engagement of Consultant by the Company. All negotiations, commitments, and understandings acceptable to both parties have been incorporated herein. No letter, telegram, or communication passing between the parties hereto covering any matter during this contract period, or any plans or periods thereafter, shall be deemed as part of this Agreement and shall not have the effect of modifying or adding to this Agreement unless it is distinctly stated in such letter, telegram, or communication to this Agreement and is signed by the parties to this Agreement.

10. Governing Law. This Agreement shall be governed by and interpreted in accordance with the laws of the state of Pennsylvania.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

USA TECHNOLOGIES, INC.

/s/ George R. Jensen, Jr.
By:-----
George R. Jensen, Jr.
Chairman & CEO

/s/ Ira W. Miller

Ira W. Miller
President
H.W. Miller Group, Inc.

August 3, 1999

Mr. George R. Jensen, Jr.
Chairman & CEO
USA Technologies, Inc.
200 Plant Avenue
Wayne, PA 19087-3520

Dear George:

Harmonic Research extends our warmest congratulations to you and your staff on the closing of the recent \$4,600,000 financing. We believe that USA Technologies, Inc. possesses the kind of "transformational" technology which we have made the strategic focus of our investment banking effort. We are also confident that your management team has the skills and drive necessary to fully exploit its commercial potential.

It is in that light that we agree to extend the contractual relationship as defined by the consulting agreement dated February 26, 1999 as amended March 10, 1999 between Harmonic Research, Inc. and USA Technologies, Inc. for an additional three (3) months commencing September 1, 1999.

As compensation, USA Technologies, inc. agrees to pay Harmonic Research, Inc. an aggregate of \$15,000 payable at the rate of \$5,000 per month for the consulting period commencing September 1, 1999 to December 1, 1999 and to grant Harmonic Research, Inc. 150,000 two-year fully vested warrants executable at \$2.50 whose underlying stock is to be registered by October 1, 1999. Harmonic Research represents and warrants to USA Technologies, Inc. that it is an accredited investor as such term is defined in Rule 501 of the Securities Act of 1933.

We look forward to our continued and mutually rewarding relationship.

Very truly yours,

Harmonic Research, Inc.

By: /s/ Mason Sexton

Mason Sexton
Chairman

AGREED TO AND ACCEPTED:

USA Technologies, Inc., hereby accepts the terms and provisions of, and agrees to be bound by the terms and provisions of the foregoing letter, as of this 3rd day of August, 1999.

By: /s/ George R. Jensen

Mr. George R. Jensen, Jr.
Chairman & CEO

CONSENT OF INDEPENDENT AUDITORS

We consent to the reference to our firm under the caption "Experts" and to the use of our report dated August 17, 1998, except for Note 15, as to which the date is June 7, 1999, in the Registration Statement (Form SB-2 No. 333-00000) and related Prospectus of USA Technologies, Inc. dated August 4, 1999.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
August 4, 1999