

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

**AMENDMENT NO. 1  
TO  
FORM S-1**

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

**USA TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

Pennsylvania  
(State or other jurisdiction of incorporation or organization)

7359  
(Primary Standard Industrial Classification Code Number)

23-2679963  
(I.R.S. Employer Identification Number)

100 Deerfield Lane, Suite 140  
Malvern, Pennsylvania 19355  
(610) 989-0340  
(Address, including zip code, and telephone number,  
including area code, of registrant's principal executive offices)

George R. Jensen, Jr.  
Chief Executive Officer  
USA Technologies, Inc.  
100 Deerfield Lane, Suite 140  
Malvern, Pennsylvania 19355  
(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.  
One Commerce Square  
2005 Market Street, Suite 2340  
Philadelphia, PA 19103-7015  
(215) 665-9300

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

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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 check the following box: [X]

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

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

If this Form is a post-effective amendment filed pursuant to Rule 462(d) 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. [ ]

#### 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	2,100,017 shares(2)	\$7.20	\$15,120,122.40	\$1,617.85
	11,454 shares(3)	\$7.20	\$ 82,468.80	\$ 8.82
	30,520 shares(4)	\$7.20	\$ 219,744.00	\$ 23.51
	16,667 shares(5)	\$7.20	\$ 120,002.40	\$ 12.84
	54,494 shares(6)	\$7.20	\$ 392,356.80	\$ 41.98
	77,000 shares(7)	\$7.20	\$ 554,400.00	\$ 59.32
TOTAL	2,290,152 shares		\$16,489,094.40	\$1,764.32 (8)

- (1) Pursuant to Rule 457c, the registration fee has been calculated at the average of the bid and ask price within 5 days prior to the date of the filing of the registration statement.
- (2) Represents (i) 1,400,000 shares issued by us to certain investors (the "Buyers"), pursuant to Stock Purchase Agreements dated December 13, 2006 ("Stock Purchase Agreements"), and (ii) 700,017 shares issuable by us upon the exercise of warrants, which were issued pursuant to the Stock Purchase Agreements, and which are exercisable at any time through December 31, 2011.
- (3) Represents 11,454 shares issuable by us upon the exercise of five-year warrants, which were issued to William Blair & Co., LLC ("Blair"), under our Agreement with Blair dated November 19, 2006, as compensation for its services as the exclusive placement agent for the placement of the shares sold under the Stock Purchase Agreements.

- (4) Represents 30,520 shares issued to George R. Jensen, Jr., under his employment agreement.
- (5) Represents 16,667 shares issued to Stephen Herbert under his employment agreement.
- (6) This registration statement amends our registration statement on Form S-1, Commission File No. 333-130992, and pursuant to Rule 429 of the Securities Act of 1933, as amended, carries forward 54,494 shares issuable upon exercise of the 2005-G warrants.
- (7) This registration statement amends our registration statement on Form S-1, Commission File No. 333-130992, and pursuant to Rule 429 of the Securities Act of 1933, as amended, carries forward 77,000 shares issuable upon exercise of the 2006-A warrants.
- (8) \$1,609.55 of the filing fee was paid on January 9, 2007 at the time of filing this registration statement. \$64.14 of the filing fee was previously paid and is offset against the currently due filing fee in connection with the Company's registration statement No. 333-130992 filed on January 12, 2006 relating to the 54,495 shares described in footnote (6) to this table. \$90.63 of the filing fee was previously paid and is offset against the currently due filing fee in connection with the Company's registration statement No. 333-130992 filed on January 12, 2006 relating to the 77,000 shares described in footnote (7) to this table.

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.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission ("SEC") is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

**PROSPECTUS**

**USA TECHNOLOGIES, INC.**

2,290,152 shares of Common Stock

**THE OFFERING**

The resale by our selling shareholders of up to 2,290,152 shares of common stock in the over-the-counter market at the prevailing market price or in negotiated transactions. We will receive no proceeds from the sale of the shares by the selling shareholders. We will receive proceeds from the sale of shares issuable by us upon the exercise of warrants by a selling shareholder. Of the shares covered by this prospectus, an aggregate of 842,965 are shares underlying warrants. These warrants consist of the following: warrants to purchase up to 700,017 shares at \$6.40 per share at any time through December 31, 2011; warrants to purchase up to 11,454 shares at \$6.60 per share at any time through December 31, 2011; and warrants to purchase up to 131,494 shares at \$20 per share at any time through December 31, 2008.

Our common stock is included for quotation on the over-the-counter bulletin board under the symbol "USAT.OB." The closing bid price for the common stock on February 6, 2007, was \$6.75 per share.

THIS INVESTMENT INVOLVES A HIGH DEGREE OF RISK. YOU SHOULD PURCHASE SHARES ONLY IF YOU CAN AFFORD A COMPLETE LOSS. Please refer to Risk Factors beginning on Page 7.

Simultaneously with this offering, and in addition to the shares offered by this prospectus, certain other selling shareholders are concurrently offering for resale up to 2,360,855 shares through an additional prospectus dated December 6, 2006. Of such shares, an aggregate of 146,707 shares are being offered for resale in such other prospectus by four selling shareholders who are also selling shareholders in this prospectus. See the selling shareholder's table beginning on page 67 of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the 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 February 12, 2007.

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**OUR COMPANY**

USA Technologies, Inc. (the "Company", "We" and "Our") was incorporated in the Commonwealth of Pennsylvania in January 1992. The Company offers a suite of networked devices and associated wireless non-cash payment, control/access management, remote monitoring and data reporting services. As a result of the acquisition of the assets of Bayview Technology Group, LLC ("Bayview") in July 2003, our Company also manufactures and sells energy management products which reduce the power consumption of various equipment, such as refrigerated vending machines and glass front coolers, thus reducing the energy costs associated with operating this equipment.

**OUR BUSINESS**

Our networked devices and associated services enable the owners and operators of everyday, stand-alone, distributed assets, such as vending machines, personal computers, copiers, faxes, kiosks and laundry equipment, the ability to remotely monitor, control and report on the results of these distributed assets, as well as the ability to offer their customers alternative cashless payment options.

**OUR MARKET**

Our customers fall into the following categories; vending machine owners and/or operators, business center operators which include hotels and audio visual companies, commercial laundry operators servicing colleges and universities, brand marketers wishing to provide their products or services via kiosks or vending machines and equipment manufacturers such as consumer electronics, appliances, building control systems, factory equipment and computer peripherals that would like to incorporate the technological features of our networked devices (i.e. remote monitoring, reporting and control as well as cashless payments) into their products. Customers for our energy management products also include energy utility companies and operators of glass front coolers.

**RESEARCH AND DEVELOPMENT COSTS**

Research and development expenses, which are included in general and administrative and compensation expense in the Consolidated Statements of Operations, were approximately \$974,000, \$1,364,000, and \$688,000 for the years ended June 30, 2006, 2005 and 2004, respectively, and \$303,000 and \$220,000 for the three months ended September 30, 2006 and 2005, respectively.

## ABOUT OUR OFFERING

Our selling shareholders are, as of the date of this prospectus, as follows:

- \* the holders of 1,400,000 shares;
- \* holders of unexercised warrants which, if exercised, would represent 842,965 shares (based upon the price of our shares of \$6.75 on February 6, 2007, 711,471 of these warrants are in the money);
- \* 30,520 shares held by our Chairman and Chief Executive Officer, George R. Jensen, Jr.; and
- \* 16,667 shares held by our President and Chief Operating Officer, Stephen P. Herbert.

Based upon the 6,836,916 shares of Common Stock outstanding as of November 3, 2006, and taking into account the 1,400,000 shares referred to above that were purchased from us after November 3, 2006, and assuming all of the warrants are exercised, we would have 9,079,881 shares outstanding.

The shares covered by this prospectus would be offered by our selling shareholders at the market price at the time of resale. Our selling shareholders may also sell their shares to other investors in a transaction not on the open market. There is no requirement that our selling shareholders sell their shares pursuant to this prospectus.

We will not receive any of the proceeds raised by the offering. We would receive proceeds from the exercise of the warrants referred to above.

## RISK FACTORS

### RISKS RELATING TO OUR BUSINESS

**We have a history of losses since inception and if we continue to incur losses the price of our shares can be expected to fall.**

We have experienced losses since inception. We expect to continue to incur losses for the foreseeable future as we expend substantial resources on sales, marketing, and research and development of our products. From our inception through September 30, 2006, our cumulative losses are approximately \$131.6 million. For our fiscal years ended June 30, 2004, 2005 and 2006, we have incurred net losses of \$21,426,178, \$15,499,190, and \$14,847,076, respectively, and a net loss of \$3,680,314 million during the three months ended September 30, 2006. If we continue to incur losses, the price of our common stock can be expected to fall and our future operating prospects harmed.

**Our existence is dependent on our ability to raise capital.**

There is currently limited experience upon which to assume that our business will generate sufficient revenues to cover our expenses. From inception, we have generated funds primarily through the sale of securities. Although we believe we have adequate existing resources to provide for our funding requirements through at least June 30, 2007, there can be no assurances we will be able to continue to generate sufficient funds thereafter. We expect to raise funds in the future through sales of our debt or equity securities until such time, if ever, as we are able to operate profitably. During the

fiscal year ended June 30, 2006, cash used in operating activities was approximately \$924,000 per month. Using the prior fiscal year as a basis for estimating cash requirements for the year ending June 30, 2007 (which assumes a static level of revenues), cash requirements for the fiscal year 2007, including requirements for capital expenditures and repayments of long-term debt, would be approximately \$11,600,000. Subsequent to June 30, 2007, our inability to obtain needed funding can be expected to have a material adverse effect on our operations, future prospects and our ability to achieve profitability. If we fail to generate increased revenues or fail to sell additional securities, you may lose all or a substantial portion of your investment.

**We received an opinion from our auditor which raises substantial doubt about our ability to continue as a going concern.**

Our auditors, Goldstein Golub Kessler LLP, have included an explanatory paragraph in their report on our June 30, 2006 consolidated financial statements indicating that as of June 30, 2006, there is substantial doubt about our ability to continue as a going concern. We will require additional funds in the future, and there can be no assurance that any independent auditors' report on our future financial statements will not include a similar explanatory paragraph if we are unable to raise sufficient funds or generate sufficient cash from operations to cover the cost of our operations. The existence of the explanatory paragraph may adversely affect our relationship with prospective customers, suppliers and potential investors, and therefore could have a material adverse effect on our business, financial condition and results of operations.

**In addition to the debt we have already incurred, we may be required to incur further debt to meet future capital requirements of our business. Should we be required to incur additional debt, the restrictions imposed by the terms of our debt could adversely affect our financial condition and our ability to respond to changes in our business.**

If we incur additional debt, we may be subject to the following risks:

- § our vulnerability to adverse economic conditions and competitive pressures may be heightened;
- § our flexibility in planning for, or reacting to, changes in our business and industry may be limited;
- § we may be sensitive to fluctuations in interest rates if any of our debt obligations are subject to variable interest rates; and
- § our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, general corporate purposes or other purposes may be impaired.

We cannot assure you our leverage and such restrictions will not materially and adversely affect our ability to finance our future operations or capital needs or to engage in other business activities. In addition, we cannot assure you additional financing will be available when required or, if available, will be on terms satisfactory to us.



**We are obligated to make substantial principal and interest payments to the holders of the Senior Notes for which funds may not be available or would otherwise be used for working capital.**

As of September 30, 2006, we had \$320,000 of unsecured senior notes due on June 30, 2009, \$983,326 of unsecured senior notes due on June 30, 2007, \$2,962,516 of unsecured senior notes due on December 31, 2007, \$2,085,369 of unsecured senior notes due on December 31, 2008, \$1,520,000 of unsecured senior notes due on December 31, 2009, and \$1,912,000 of unsecured senior notes due on December 31, 2010. These notes accrue cash interest at the rate of twelve percent (12%) per year with the exception of the notes due June 30, 2007, December 31, 2010 and \$181,611 of the December 31, 2008 notes, which accrue cash interest at the rate of ten percent (10%) per year. As of September 30, 2006, we were required to make quarterly interest payments totaling approximately \$281,000 or \$1,124,000 each year.

Until the Senior Notes have been paid by us, they will be reflected as a liability on our financial statements, net of the related unamortized discount and other issuance costs.

Our ability to satisfy the debt obligations is dependent on our future performance, the success of our product lines and on our ability to raise capital. Our performance is also subject to financial, business and market factors affecting our business and operations.

We anticipate that the Senior Notes will either be converted into Common Stock or be paid from cash generated from operations, as well as proceeds from securities offerings. However, there can be no assurance that we will meet our obligations to pay quarterly interest on or the principal amount of the senior notes at maturity. The payment of the interest and principal on these notes would utilize our available working capital, which would not be available for other purposes.

**The loss of one or more of our key customers could significantly reduce our revenues and profits.**

We have derived, and believe we may continue to derive, a significant portion of our revenues from a limited number of large customers. Approximately 39% and 36% of the Company's accounts and finance receivables at June 30, 2006 and 2005, respectively, were concentrated with two and two customers, respectively. Approximately 29%, 11% and 13% of the Company's revenues for the year ended June 30, 2006, 2005 and 2004, respectively, were concentrated with two, one and one customer(s), respectively. Our customers may buy less of our products or services depending on their own technological developments, end-user demand for our products and internal budget cycles. A major customer in one year may not purchase any of our products or services in another year, which may negatively affect our financial performance. If any of our large customers significantly reduce or delay purchases from us or if we are required to sell products to them at reduced prices or unfavorable terms, our results of operations and revenue could be materially adversely affected.

**We depend on our key personnel and if they leave, our business could be adversely affected.**

We are dependent on key management personnel, particularly the Chairman and Chief Executive Officer, George R. Jensen, Jr. The loss of the services of Mr. Jensen or other executive officers would dramatically affect our business prospects. Certain of our employees are particularly valuable to us because they:

- § have specialized knowledge about our company and operations;
- § have specialized skills important to our operations; or
- § would be particularly difficult to replace.

We have entered into an employment agreement with Mr. Jensen that expires on June 30, 2009. We have also entered into employment agreements with other executive officers, each of which contain confidentiality and non-compete agreements. We have 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 President, Stephen P. Herbert. We do not have and do not intend to obtain key man life insurance coverage on any of our other executive officers. As a result, we are exposed to the costs associated with the death of these key employees.

We also may be unable to retain other existing senior management, sales personnel and development and engineering personnel critical to our ability to execute our business plan, which could result in harm to key customer relationships, loss of key information, expertise or know-how and unanticipated recruitment and training costs.

**Our dependence on proprietary technology and any perceived or actual inability to protect our intellectual property may adversely affect our ability to compete.**

Challenge to our ownership of our intellectual property could materially damage our business prospects. Our technology may infringe upon the proprietary rights of others. Our ability to execute our business plan is dependent, in part, on our ability to obtain patent protection for our proprietary products, maintain trade secret protection and operate without infringing the proprietary rights of others.

Through September 30, 2006, we have 29 pending patent applications, and intend to file applications for additional patents covering our future products, although there can be no assurance we will do so. In addition, there can be no assurance we will maintain or prosecute these applications. The United States Government and other countries have granted us 64 patents as of September 30, 2006. There can be no assurance that:

- § any of the remaining patent applications will be granted to us;
- § we will develop additional products that are patentable or do not infringe the patents of others;
- § any patents issued to us will provide us with any competitive advantages or adequate protection for our products;
- § any patents issued to us will not be challenged, invalidated or circumvented by others; or
- § any of our products would not infringe the patents of others.

If any of our products are found to have infringed any patent, there can be no assurance 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 the patented technology will be a commercial success or result in any profits to us.

If we are unable to adequately protect our proprietary technology, third parties may be able to compete more effectively against us, which could result in the loss of customers and our business being adversely affected. Patent and proprietary rights litigation entails substantial legal and other costs, and diverts company resources as well as the attention of our management. There can be no assurance we will have the necessary financial resources to appropriately defend or prosecute our rights in connection with any such litigation.

**Competition from others with greater resources could prevent USA from increasing revenue and achieving profitability.**

Competition from other companies that are well-established and have substantially greater resources may reduce our ability to generate revenues and increase our expenses. Many of our competitors have established reputations for success in the development, sale and service of products similar to ours. We face competition from the following groups:

- § companies 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, all of which directly compete with our products;
- § companies which have developed unattended, credit card activated control systems currently used in connection with public telephones, prepaid telephone cards, gasoline dispensing machines, or vending machines and are capable of developing control systems in direct competition with USA; and
- § businesses which provide access to the Internet and personal computers to hotel guests. Although these services are not credit card activated, such services would compete with USA's Business Express(R).

Competition may result in lower margins on our products or may reduce potential profits or result in a loss of some or all of our customer base. To the extent that our competitors are able to offer more attractive technology or better pricing, our ability to compete could be adversely affected.

**The termination of any of our relationships with third parties upon whom we rely for supplies and services critical to our products could adversely affect our business and delay achievement of our business plan.**

We depend on arrangements with third parties for a variety of component parts used in our products. We have contracted with Masterwork Electronics to assist us to develop and manufacture our e-Port(R) products and with various sources to manufacture our energy miser products. For other components, we do not have supply contracts with any of our third-party suppliers and we purchase components as needed from time to time. We have contracted with IBM to host our network in a secure, 24/7 environment to ensure reliability of our network services. If these business relationships are terminated, the implementation of our business plan may be delayed until an alternative supplier or service provider can be retained. If we are unable to find another source or one that is comparable, the content and quality of our products could suffer and our business, operating results and financial condition could be harmed.

**A disruption in the manufacturing capabilities of our third-party manufacturers, suppliers or distributors would negatively impact our ability to meet customer requirements.**

We depend upon third-party manufacturers, suppliers and distributors to deliver components free from defects, competitive in functionality and cost, and in compliance with our specifications and delivery schedules. Since we generally do not maintain large inventories of our products or components, any termination of, or significant disruption in, our manufacturing capability or our relationship with our third-party manufacturers or suppliers may prevent us from filling customer orders in a timely manner.

We have occasionally experienced, and may in the future experience, delays in delivery of products and delivery of products of inferior quality from third-party manufacturers. Although alternate manufacturers and suppliers are generally available to produce our products and product components, the number of manufacturers or suppliers of some of our products and components is limited, and qualifying a replacement manufacturer or supplier could take several months. In addition, our use of third-party manufacturers reduces our direct control over product quality, manufacturing timing, yields and costs. Disruption of the manufacture or supply of our products and components, or a third-party manufacturer's or supplier's failure to remain competitive in functionality, quality or price, could delay or interrupt our ability to manufacture or deliver our products to customers on a timely basis, which would have a material adverse effect on our business and financial performance.

**Our reliance on our telecommunication service provider exposes us to a number of risks over which we have no control, including risks with respect to increased prices and termination of essential services.**

The operation of our network depends upon the capacity, reliability and security of services provided to us by our telecommunication services provider, Cingular. We have no control over the operation, quality or maintenance of these services or whether the vendor will improve its services or continue to provide services that are essential to our business. In addition, our telecommunication services provider may increase its prices at which it provides services, which would increase our costs. If our telecommunication services provider were to cease to provide essential services or to significantly increase its prices, we could be required to find alternative vendors for these services. With a limited number of vendors, we could experience significant delays in obtaining new or replacement services, which could lead to slowdowns or failures of our network. In addition, we may have to replace our existing e-Port devices that are already installed in the marketplace. This could significantly harm our reputation and cause us to lose customers and revenues.

We have contracted with IBM to host our network in a secure, 24/7 environment to ensure reliability of our network services. If these business relationships are terminated, the implementation of our business plan may be delayed until an alternative supplier or service provider can be retained. If we are unable to find another source or one that is comparable, the content and quality of our products could suffer and our business, operating results and financial condition could be harmed.

**Our products may contain defects that may be difficult or even impossible to correct, which could result in lost sales, additional costs and customer erosion.**

We offer technically complex products which, when first introduced or released in new versions, may contain software or hardware defects that are difficult to detect and correct. The existence of defects and delays in correcting them could result in negative consequences, including the following:

- § delays in shipping products;
- § cancellation of orders;
- § additional warranty expense;
- § delays in the collection of receivables;
- § product returns;
- § the loss of market acceptance of our products;
- § diversion of research and development resources from new product development; and
- § inventory write-downs.

Even though we test all of our products, defects may continue to be identified after products are shipped. In past periods, we have experienced various issues in connection with product launches, including the need to rework certain products and stabilize product designs. Correcting defects can be a time-consuming and difficult task. Software errors may take several months to correct, and hardware errors may take even longer.

**We may accumulate excess or obsolete inventory that could result in unanticipated price reductions and write downs and adversely affect our financial results.**

Managing the proper inventory levels for components and finished products is challenging. In formulating our product offerings, we have focused our efforts on providing our customers products with greater capability and functionality, which requires us to develop and incorporate the most current technologies in our products. This approach tends to increase the risk of obsolescence for products and components we hold in inventory and may compound the difficulties posed by other factors that affect our inventory levels, including the following:

- § the need to maintain significant inventory of components that are in limited supply;
- § buying components in bulk for the best pricing;
- § responding to the unpredictable demand for products;
- § responding to customer requests for short lead-time delivery schedules;
- § failure of customers to take delivery of ordered products; and
- § product returns.

If we accumulate excess or obsolete inventory, price reductions and inventory write-downs may result, which could adversely affect our results of operation and financial condition.

**We may not be able to adapt to changing technology and our customers' technology needs.**

We face rapidly changing technology and frequent new service offerings by competitors that can render existing services obsolete or unmarketable. Our future depends, in part, on our ability to enhance existing services and to develop, introduce and market, on a timely and cost effective basis, new services that keep pace with technological developments and customer requirements. Developing new products and technologies is a complex, uncertain process requiring innovation and accurate anticipation of technological and market trends. When changes to the product line are announced, we will be challenged to manage possible shortened life cycles for existing products, continue to sell existing products and prevent customers from returning existing products. Our inability to respond effectively to any of these challenges may have a material adverse effect on our business and financial success.

**Our products may fail to gain widespread market acceptance. As a result, we may not generate sufficient revenues or profit margins to become successful.**

There can be no assurance that demand for our products will be sufficient to enable us to generate revenue or become profitable. Likewise, no assurance can be given that we will be able to install the TransActs and e-Ports at enough locations or sell equipment utilizing our network or our energy management products to enough locations to achieve significant revenues or that our operations can be conducted profitably. Alternatively, the locations which would utilize the network may not be successful locations and our revenues would be adversely affected. We may in the future lose locations utilizing our products to competitors, or may not be able to install our products at competitors' locations. In addition, there can be no assurance

that our products could evolve or be improved to meet the future needs of the market place.

**Our internal control over financial reporting may not be effective and our independent registered public accounting firm may not be able to certify as to its effectiveness, which could have a significant and adverse effect on our business and reputation.**

We are evaluating our internal control over financial reporting in order to allow management to report on, and our independent registered public accounting firm to attest to, our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002 and rules and regulations of the SEC thereunder, which we refer to as Section 404. We are currently performing the system and process evaluation and testing required (and any necessary remediation) in an effort to comply with management certification and auditor attestation requirements of Section 404. At the present time, we anticipate the management certification and auditor attestation requirements of Section 404 will initially apply to our Annual Report on Form 10-K for our fiscal year ended June 30, 2008. However, as we are still in the evaluation process, we may identify conditions that may result in significant deficiencies or material weaknesses in the future. A material weakness is a significant deficiency, as defined in Public Accounting Oversight Board Auditing Standard No. 2 or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the Company's annual or interim financial statements would not be prevented or detected by company personnel in the normal course of performing their assigned functions.

We cannot be certain as to the timing of completion of our evaluation, testing and any remediation actions or the impact of the same on our operations. If we are not able to implement the requirements of Section 404 in a timely manner or with adequate compliance, our internal controls would be considered ineffective for purposes of Section 404, our independent auditors may not be able to certify as to the effectiveness of our internal control over financial reporting and we may be subject to sanctions or investigation by regulatory authorities, such as the SEC. As a result, there could be a negative reaction in the financial markets due to a loss of confidence in the reliability of our financial statements. In addition, we may be required to incur costs in improving our internal control system and the hiring of additional personnel. Any such action could negatively affect our results.

**Credit card issuers have promulgated credit card security guidelines as part of their ongoing efforts to battle identity theft and credit card fraud.**

We continue to work with credit card issuers to assure that our products and services comply with these rules. These can be no assurances, however, that our products and services are invulnerable to unauthorized access or hacking. When there is unauthorized access to credit card data that results in financial loss, there is the potential that parties could seek damages from us.

**Security is vital to our customers and therefore breaches in the security of transactions involving our products or services could adversely affect our reputation and results of operations.**

Protection against fraud is of key importance to purchasers and end-users of our products. We incorporate security features, such as encryption software and secure hardware, into our products to protect against fraud in electronic payment transactions and to ensure the privacy and integrity of consumer data. Our products may be vulnerable to breaches in security due to defects in the security mechanisms, the operating system and applications or the hardware platform. Security vulnerabilities could jeopardize the security of information transmitted or stored using our products. In general, liability associated with security breaches of a certified electronic payment system belongs to the institution that acquires the financial transaction. In addition, we have not experienced any material security breaches affecting our business. However, if the security of the information in our products is compromised, our reputation and marketplace acceptance of our products will be adversely affected, which would adversely affect our results of operations, and subject us to potential liability.

**We are subject to laws and regulations that affect the products, services and markets in which we operate. Failure by us to comply with these laws or regulations would have an adverse effect on our business, financial condition, or results of operations.**

We are, among other things, subject to banking regulations and credit card association regulations. Failure to comply with these regulations may result in the suspension or revocation of our business, the limitation, suspension or termination of service, and/or the imposition of fines that could have an adverse effect on our financial condition. Additionally, changes to legal rules and regulations, or interpretation or enforcement thereof, could have a negative financial effect on us or our product offerings. The payment processing industry may become subject to regulation as a result of recent data security breaches that have exposed consumer data to potential fraud. To the extent this occurs, we could be subject to additional technical, contractual or other requirements as a condition of our continuing to conduct our payment processing business. Our failure to properly comply with these standards and regulations could result in lost product sales and significant costs associated with required remedial measures or production stoppages, any of which could have a material adverse effect on our business and financial performance.

#### **RISKS RELATING TO OUR COMMON STOCK**

**We do not expect to pay cash dividends in the foreseeable future and therefore investors should not anticipate cash dividends on their investment.**

The holders of our common stock and series A preferred stock are entitled to receive dividends when, and if, declared by our board of directors. Our board of directors does not intend to pay cash dividends in the foreseeable future, but instead intends to retain any and all earnings to finance the growth of the business. To date, we have not paid any cash dividends on the common stock or series A preferred stock and there can be no assurance that cash dividends will ever be paid on the common stock.



In addition, 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 September 30, 2006, the unpaid and cumulative dividends on the series A preferred stock equal \$8,602,418. The unpaid and cumulative dividends on the series A preferred stock are convertible into shares of common stock at the rate of \$1000 per share at the option of the shareholder. Through September 30, 2006, \$2,717,764 of unpaid and cumulative dividends on the Series A Preferred Stock were converted into 2,918 shares of common stock.

**The lack of an established trading market may make it difficult to transfer our stock and you may not be able to sell your shares on our trading market.**

Our Common Stock is traded on the OTC Bulletin Board, however, there is limited trading in the Common Stock. Until there is an established trading market, holders of Common Stock may find it difficult to dispose of, or to obtain accurate quotations for the price of the Common Stock.

**Sales of shares eligible for future sale from exercise of warrants and options and our 2006 Common Stock Agreement could depress the market price of our Common Stock.**

As of September 30, 2006, we had issued and outstanding options to purchase 178,558 shares of our common stock, warrants to purchase 202,923 shares, and 429,753 shares eligible for sale under our 2006 Common Stock Agreement with Steve Illes. The shares underlying 78,558 of these options, all of these warrants, and all of the shares underlying the 2006 Common Stock Agreement have been registered and may be freely sold upon issuance. Market sales of large amounts of our common stock, or the potential for those sales even if they do not actually occur, may have the effect of depressing the market price of our common stock. In addition, if our future financing needs require us to issue additional shares of common stock or securities convertible into common stock, or the increase of the number of shares eligible for sale to Mr. Illes under our agreements with him, the supply of common stock available for resale could be increased which could stimulate trading activity and cause the market price of our common stock to drop, even if our business is doing well.

**The limited prior public market and trading market may cause possible volatility in our stock price.**

There has only been a limited public market for our securities and there can be no assurance an active trading market in our securities will be maintained. The Over The Counter Bulletin Board (OTCBB) is an inter-dealer, over-the-counter market which provides significantly less liquidity than NASDAQ and the national securities exchanges, and quotes for securities on the OTCBB are not listed in the financial sections of newspapers as are those for NASDAQ and the national securities exchanges. In addition, the overall market for securities in recent years has experienced extreme price and volume fluctuations that have particularly affected the market prices of many smaller companies. The trading price of our Common Stock is expected to be subject to significant fluctuations including, but not limited to, the following:

- § quarterly variations in operating results and achievement of key business metrics;
- § changes in earnings estimates by securities analysts, if any;
- § any differences between reported results and securities analysts' published or unpublished expectations;
- § announcements of new contracts or service offerings by us or our competitors;
- § market reaction to any acquisitions, joint ventures or strategic investments announced by us or our competitors;
- § demand for our services and products;
- § shares being sold pursuant to Rule 144 or upon exercise of warrants; and
- § general economic or stock market conditions unrelated to our operating performance.

These fluctuations, as well as general economic and market conditions, may have a material or adverse effect on the market price of our Common Stock.

**There are delays in order communication on the OTCBB.**

Electronic processing of orders is not available for securities traded on the OTCBB and high order volume and communication risks may prevent or delay the execution of one's OTCBB trading orders. This lack of automated order processing may affect the timeliness of order execution reporting and the availability of firm quotes for shares of our Common Stock. Heavy market volume may lead to a delay in the processing of OTCBB security orders for shares of our Common Stock, due to the manual nature of the market. Consequently, one may not be able to sell shares of our Common Stock at the optimum trading prices.

**There is a risk of market fraud.**

OTCBB securities are frequent targets of fraud or market manipulation. Not only because of their generally low price, but also because the OTCBB reporting requirements for these securities are less stringent than for listed or NASDAQ traded securities, and no exchange requirements are imposed. Dealers may dominate the market and set prices that are not based on competitive forces. Individuals or groups may create fraudulent markets and control the sudden, sharp increase of price and trading volume and the equally sudden collapse of the market price for shares of our Common Stock.

**The substantial market overhang of our shares will tend to depress the market price of our shares.**

The substantial number of our shares currently eligible for sale in the open market will tend to depress the market price of our shares. As of September 30, 2006, these shares consisted of the following:

- § 6,614,569 shares of Common Stock
- § 5,203 shares of Preferred Stock
- § 8,603 shares issuable upon conversion of the accrued and unpaid dividends on the Series A Preferred Stock
- § 381,481 shares underlying Common Stock options and warrants
- § 140,000 shares issuable to Mr. Jensen, our Chief Executive Officer, under his employment agreement upon the occurrence of a USA Transaction

§ 659,007 shares underlying our Convertible Senior Notes

§ 429,753 shares issuable under the 2006 Common Stock Agreement with Steve Illes; and

§ 15,087 shares issuable under our 2006-A Stock Compensation Plan.

**Director and officer liability is limited.**

As permitted by Pennsylvania law, our by-laws limit the liability of our directors for monetary damages for breach of a director's fiduciary duty except for liability in certain instances. As a result of our by-law provisions and Pennsylvania law, shareholders may have limited rights to recover against directors for breach of fiduciary duty. In addition, our bylaws provide that we shall indemnify our directors and officers to the fullest extent permitted by law.

**Our publicly-filed reports are reviewed by the SEC from time to time and any significant changes required as a result of any such review may result in material liability to us, and have a material adverse impact on the trading price of our Common Stock**

The reports of publicly-traded companies are subject to review by the SEC from time to time for the purpose of assisting companies in complying with applicable disclosure requirements and to enhance the overall effectiveness of companies' public filings, and comprehensive reviews of such reports are now required at least every three years under the Sarbanes-Oxley Act of 2002. SEC reviews may be initiated at any time. While we believe that our previously filed SEC reports comply, and we intend that all future reports will comply in all material respects with the published SEC rules and regulations, we could be required to modify or reformulate information contained in prior filings as a result of an SEC review. Any modification or reformulation of information contained in such reports could be significant and result in material liability to us and have a material adverse impact on the trading price of our Common Stock.</P>

**USE OF PROCEEDS**

We will not receive any of the proceeds from the sales of our Common Stock by the selling shareholders. The selling shareholders entitled to receive the net proceeds from any sales of our common stock begins on page 67 of this prospectus. We will, however, receive proceeds from the exercise of any warrants by a selling shareholder.

As of the date of this prospectus, we would receive \$4,480,109 of proceeds from the exercise of all of the warrants at the stated exercise price of \$6.40 per share (all of which are in the money as of February 6, 2007), \$75,596 of proceeds from the exercise of all of the warrants at the stated exercise price of \$6.60 per share (all of which are in the money as of February 6, 2007), and \$2,629,900 of proceeds from the exercise of all of the warrants at the stated exercise price of \$20 per share (none of which are in the money as of February 6, 2007).

**SELECTED FINANCIAL DATA**

The following selected financial data for the five years ended June 30, 2006 are derived from the audited consolidated financial statements of USA Technologies, Inc. The data should be read in conjunction with the consolidated financial statements, related notes, and other financial information.

	Year ended June 30				
	2006	2005	2004	2003	2002
<b>OPERATIONS DATA</b>					
Revenues	\$ 6,414,803	\$ 4,677,989	\$ 5,632,815	\$ 2,853,068	\$ 1,682,701
Net loss	(14,847,076)	(15,499,190)	(21,426,178)	(21,965,499)	(17,314,807)
Cumulative preferred dividends	(783,289)	(784,113)	(786,513)	(793,586)	(822,561)
Loss applicable to common shares	\$ (15,630,365)	\$ (16,283,303)	\$ (22,212,691)	\$ (22,759,085)	\$ (18,137,368)
Loss per common share (basic and diluted)	\$ (3.15)	\$ (4.18)	\$ (7.70)	\$ (20.36)	\$ (50.39)
Cash dividends per common share	\$ --	\$ --	\$ --	\$ --	\$ --
<b>BALANCE SHEET DATA</b>					
Total assets	\$ 23,419,466	\$ 23,391,765	\$ 25,880,577	\$ 17,892,681	\$ 17,056,773
Convertible Senior Notes and other long-term debt	\$ 7,780,853	\$ 9,337,300	\$ 7,273,056	\$ 9,213,699	\$ 7,968,097
Shareholders' equity	\$ 11,177,064	\$ 9,309,185	\$ 14,108,662	\$ 3,692,083	\$ 3,395,892

	Three months ended	
	2006	2005
<b>September 30</b>		
<b>OPERATIONS DATA</b>		
Revenues	\$ 2,008,897	\$ 1,363,886
Net loss	(3,680,314)	(3,196,872)
Cumulative preferred dividends	(391,157)	(392,057)
Loss applicable to common shares	\$ (4,071,471)	\$ (3,588,929)
Loss per common share (basic and diluted)	\$ (0.63)	\$ (0.89)
Cash dividends per common share	\$ --	\$ --
<b>BALANCE SHEET DATA</b>		
Total assets	\$ 21,964,195	\$ 21,767,388
Convertible Senior Notes and other long-term debt	\$ 7,897,580	\$ 8,156,240
Shareholders' equity	\$ 9,657,776	\$ 8,119,225

(a) In May 2002 the Company acquired Stitch Networks Corporation. In July 2003 the Company acquired substantially all the assets of Bayview Technology Group, LLC. Both acquisitions have been accounted for using the purchase method and, accordingly, are included in the Company's results of operations from their respective dates of acquisition.

**QUARTERLY FINANCIAL DATA**

Unaudited quarterly results of operations for the years ended June 30, 2006 and 2005 and the three months ended September 30, 2006 follow and should be read in conjunction with the consolidated financial statements, related notes and other financial information and the Company's quarterly reports on Form 10-Q for the fiscal years 2006 and 2005 and the three months ended September 30, 2006.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
<b>YEAR ENDED JUNE 30, 2006</b>					
Revenues	\$ 1,363,886	\$ 1,957,753	\$ 1,618,776	\$ 1,474,388	\$ 6,414,803
Gross profit	\$ 314,927	\$ 787,882	\$ 687,749	\$ 219,788	\$ 2,010,346
Net loss	\$ (3,196,872)	\$ (2,864,091)	\$ (3,313,868)	\$ (5,472,245)	\$ (14,847,076)
Cumulative preferred dividends	\$ (392,057)	\$ --	\$ (391,232)	\$ --	\$ (783,289)
Loss applicable to common shares	\$ (3,588,929)	\$ (2,864,091)	\$ (3,705,100)	\$ (5,472,245)	\$ (15,630,365)
Loss per common share (basic and diluted)	\$ (0.89)	\$ (0.61)	\$ (0.74)	\$ (0.96)	\$ (3.15)
<b>YEAR ENDED JUNE 30, 2005</b>					
Revenues	\$ 1,032,578	\$ 1,135,449	\$ 1,122,330	\$ 1,387,632	\$ 4,677,989
Gross profit	\$ 130,534	\$ 342,705	\$ 566,720	\$ 159,357	\$ 1,119,316
Net loss	\$ (3,640,637)	\$ (3,805,004)	\$ (3,702,049)	\$ (4,351,500)	\$ (15,499,190)
Cumulative preferred dividends	\$ (392,057)	\$ --	\$ (392,056)	\$ --	\$ (784,113)
Loss applicable to common shares	\$ (4,032,694)	\$ (3,805,004)	\$ (4,094,105)	\$ (4,351,500)	\$ (16,283,303)
Loss per common share (basic and diluted)	\$ (1.14)	\$ (1.01)	\$ (1.02)	\$ (1.12)	\$ (4.18)
<b>THREE MONTHS ENDED SEPTEMBER 30, 2006</b>					
Revenues	\$ 2,008,897				
Gross profit	\$ 615,536				
Net loss	\$ (3,680,314)				
Cumulative preferred dividends	\$ (391,157)				
Loss applicable to common shares	\$ (4,071,471)				
Loss per common share (basic and diluted)	\$ (0.63)				

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's exposure to market risks for interest rate changes is not significant. Interest rates on its Senior Notes and long-term debt are generally fixed and its investments in cash equivalents and other securities are not significant. Market risks related to fluctuations of foreign currencies are not significant and the Company has no derivative instruments.

**CRITICAL ACCOUNTING POLICIES**

**GENERAL**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates. We believe the policies and estimates related to revenue recognition, software development costs, impairment of long-lived assets, goodwill and intangible assets, and investments represent our critical accounting policies and estimates. Future results may differ from our estimates under different assumptions or conditions.

**REVENUE RECOGNITION**

Revenue from the sale of equipment is recognized on the terms of freight-onboard shipping point, or upon installation and acceptance of the equipment if installation services are purchased for the related equipment. Transaction processing revenue is recognized upon the usage of the Company's cashless payment and control network. License fees for access to the Company's devices and network services are recognized on a monthly basis. Product revenues are recognized for the sale of products from Company owned vending machines when there is purchase and acceptance of product by the vending customer. In all cases, revenue is only recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed and determinable, and collection of the resulting receivable is reasonably assured. The Company estimates an allowance for product returns at the date of sale.

**SOFTWARE DEVELOPMENT COSTS**

The Company capitalizes software development costs pursuant to Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", after technological feasibility of the software is established and through the product's availability for general release to the Company's customers. All costs incurred in the research and development of new software and costs incurred prior to the establishment of technological feasibility are expensed as incurred. Amortization of software development costs commences when the product becomes available for general release to customers. Amortization of software development costs is calculated as the greater of the amount computed using (i) the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues of that product or (ii) the straight-line method over the remaining estimated economic life of the product. The Company reviews the unamortized software development costs at each balance sheet date and, if necessary, will write down the balance to net realizable value if the unamortized costs exceed the net realizable value of the asset.

During May 2000, the Company reached technological feasibility for the development of the multi-media e-Port(TM) product and related internal

network and, accordingly, the Company commenced capitalization of software development costs related to this product and network. Costs capitalized through 2002 were \$5.3 million, which included capitalized interest of approximately \$493,000 pursuant to SFAS No. 34, "Capitalization of Interest Costs".

During the fourth quarter of fiscal year 2002, the multi-media e-Port(TM) client product and enhanced network became available for general release to the Company's customers. During this quarter, management performed an evaluation of the commercial success and preliminary market acceptance of the multi-media e-Port(TM) and enhanced network and as a result of this evaluation the Company determined that the estimated future revenues less costs to complete and dispose of the multi-media e-Port client product was zero. Therefore, the Company wrote down \$2,663,000 of software development costs related to the multi-media e-Port client product. The unamortized balance of the software development costs after the impairment charge was amortized over an estimated useful life of two years and was fully amortized during the year ended June 30, 2004. Accumulated amortization was \$5,326,186 at September 30, 2006 and June 30, 2006, 2005, and 2004. Amortization expense was approximately \$999,000 during the year ended June 30, 2004. Such amortization is reflected in cost of sales in the accompanying consolidated statements of operations.

#### **IMPAIRMENT OF LONG LIVED ASSETS**

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets" ("FAS 144"), the Company reviews its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the carrying amount of an asset or group of assets exceeds its net realizable value, the asset will be written down to its fair value. In the period when the plan of sale criteria of FAS 144 are met, long-lived assets are reported as held for sale, depreciation and amortization cease, and the assets are reported at the lower of carrying value or fair value less costs to sell.

During the fourth quarter of fiscal year 2003, the Company reviewed certain long-lived assets (vending machines) and determined that such assets were impaired. These vending machines were used and intended for use in connection with the Company's program with Kodak to sell disposable cameras and film pursuant to the Kodak Vending Placement Agreement. Management determined that it was more likely than not that these vending machines would be disposed of before the end of their previously estimated useful lives. The estimated undiscounted cash flows for this group of assets were less than the carrying value of the related assets. As a result, the Company recorded a charge of approximately \$321,000 representing the difference between the fair value as determined from a quoted market price and the carrying value of the group of assets. Effective December 31, 2003, the Kodak agreement was terminated. As a result, the carrying value of the vending machines were further impaired and a charge of approximately \$367,000 was recorded as a component of the gain on contract settlement in the June 30, 2004 Consolidated Statement of Operations to reflect these assets at their realizable value. The remaining value of these vending machines was then recorded as assets held for sale in the Consolidated Balance Sheets as of June 30, 2004. During the year ended June 30, 2005, the Company wrote off the remaining value of the vending machines

that had not been sold during the year as a loss on contract settlement.

## **GOODWILL AND INTANGIBLE ASSETS**

Goodwill represents the excess of cost over fair value of the net assets purchased in acquisitions. The Company accounts for goodwill in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"). Under FAS 142, goodwill is not amortized to earnings, but instead is subject to periodic testing for impairment. The Company tests goodwill for impairment using a two-step process. The first step screens for potential impairment, while the second step measures the amount of impairment. The Company uses a discounted cash flow analysis to complete the first step in this process. Testing for impairment is to be done at least annually and at other times if events or circumstances arise that indicate that impairment may have occurred. The Company has selected April 1 as its annual test date. The Company has concluded there has been no impairment of goodwill as a result of its testing on April 1, 2004, April 2005 and April 1, 2006.

Patents, trademarks and the non-compete agreement are carried at cost less accumulated amortization, which is calculated on a straight-line basis over their estimated economic life. The Company reviews intangible for impairment whenever events or changes in circumstances indicate that they carrying amount may not be recoverable. An asset is considered to be impaired when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. The amount of the impairment loss, if any, is measured as the difference between the net book value of the asset and its estimated fair value.

Intangible assets include patents, trademarks and non-compete arrangements purchased in acquisitions. Amortization expense related to these intangible assets was \$1,236,600, \$1,236,600, and \$1,208,668 during the years ended June 30, 2006, 2005, and 2004, respectively and \$309,150 and \$309,150 for the three months ended September 30, 2006 and 2005, respectively.

## **INVESTMENTS**

The Company's accounts for investments in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("FAS 115"). Management determines the appropriate classifications of securities at the time of purchase and reevaluates such designation as of each balance sheet date. Available for sale securities are carried at fair value, with the unrealized gains and losses reported as a separate component of stockholders' equity in other comprehensive income (loss). A judgmental aspect of accounting for investments involves determining whether an other-than-temporary decline in value of the investment has been sustained. If it has been determined that an investment has sustained an other-than-temporary decline in its value, the investment is written down to its fair value, by a charge to earnings. Such evaluation is dependent on the specific facts and circumstances. Factors that are considered by the Company each quarter in determining whether an other-than-temporary decline in value has occurred include: the market value of the security in relation to its cost basis; the financial condition of the investee; and the intent and ability to retain the investment for a sufficient period of time to allow for recovery in the market value of the



investment. In evaluating the factors above for available-for-sale securities, management presumes a decline in value to be other-than-temporary if the quoted market price of the security is below the investment's cost basis for a period of six months or more. However, the presumption of an other-than-temporary decline in these instances may be overcome if there is persuasive evidence indicating that the decline is temporary in nature (e.g., strong operating performance of investee, historical volatility of investee, etc.).

During the year ended June 30, 2003, the Company issued 150,000 shares of its Common Stock (\$2,850,000) for an investment in 1,870,091 shares in the Jubilee Investment Trust, PLC ("Jubilee"), a United Kingdom Investment Trust whose shares trade on the London Stock Exchange. The Company agreed not to sell the Jubilee shares for a period of 90 days from January 24, 2003 and to sell a maximum of 10% of the Jubilee shares during each month thereafter. Jubilee agreed not to sell the Company's shares of Common Stock for a period of two years from the date of issuance unless agreed to by the Company.

During fiscal year 2004, the Company sold 1,669,091 of the Jubilee shares for net proceeds of \$1,471,140 and realized a gain of \$603,480, with the cost of the securities calculated by the specific identification method. An unrealized gain of \$3,080 and \$32,249 on the shares held by the Company was reflected in shareholders' equity as accumulated other comprehensive income at June 30, 2005 and 2004, respectively. During fiscal year 2006, the Company sold the remaining 70,000 shares for net proceeds of \$19,243 and realized a loss of \$16,087, with the cost of the securities calculated by the specific identification method.

#### **FORWARD LOOKING STATEMENTS**

This Prospectus contains certain forward looking statements regarding, among other things, the anticipated financial and operating results of the Company. For this purpose, forward looking statements are any statements contained herein that are not statements of historical fact and include, but are not limited to, those preceded by or that include the words, "believes," "expects," "anticipates," or similar expressions. Those statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. The forward looking information is based on various factors and was derived using numerous assumptions. Important factors that could cause the Company's actual results to differ materially from those projected, include, for example (i) the ability of the Company to generate sufficient sales to generate operating profits, or to sell products at a profit, (ii) the ability of the Company to raise funds in the future through sales of securities, (iii) whether the Company is able to enter into binding agreements with third parties to assist in product or network development, (iv) the ability of the Company to commercialize its developmental products, or if actually commercialized, to obtain commercial acceptance thereof, (v) the ability of the Company to compete with its competitors to obtain market share, (vi) the ability of the Company to obtain sufficient funds through operations or otherwise to repay its debt obligations including but not limited to Senior Notes, or to fund development and marketing of its products; (vii) the ability of the Company to obtain approval of its pending patent applications, (viii) the ability of the Company to satisfy its trade obligations included in accounts payable and accrued liabilities, (ix) the

ability of the Company to predict or estimate its future quarterly or annual revenues given the developing and unpredictable market for its products and the lack of established revenues; (x) the ability of the Company to retain key customers as a significant portion of its revenues is derived from a limited number of key customers; and (xi) the ability of a key customer to reduce or delay purchasing products from the Company. Although the Company believes that the forward looking statements contained herein are reasonable, it can give no assurance that the Company's expectations will be met.

## RESULTS OF OPERATIONS

### THREE MONTHS ENDED SEPTEMBER 30, 2006

Revenues for the three months ended September 30, 2006 were \$2,008,897 compared to \$1,363,886 for the corresponding three-month period in the previous fiscal year. This \$645,011 or 47% increase was primarily due to an increase in equipment sales of approximately \$598,000 and license and transaction fees of approximately \$47,000. The increase in equipment sales was due to an increase in sales of approximately \$150,000 of energy conservation equipment, approximately \$56,000 in sales of business centers, and approximately \$482,000 in e-Port vending equipment sales, primarily to MasterCard International in connection with the Philadelphia Coke initiative, offset by a decrease of approximately \$90,000 in laundry equipment.

Cost of sales for the period consisted of equipment costs of \$1,131,159 and network and transaction related costs of \$262,202. The increase in total cost of sales of \$344,402 or 33% over the prior year period was due to an increase in equipment costs of approximately \$286,000 and network and transaction related costs of approximately \$58,000.

Gross profit for the three months ended September 30, 2006 was \$615,536, compared to gross profit of \$314,927 for the corresponding three-month period in the previous fiscal year. This 95% increase is primarily due to the increased margins on our energy equipment sales as a result of the reduced costs of producing the equipment overseas.

General and administrative expense of \$1,425,868 increased by \$318,365 or 29% primarily due to an increase in legal fees of approximately \$134,000, an increase in public relations expenses of approximately \$74,000, an increase in product development costs of approximately \$56,000 and an increase in consultant costs of approximately \$44,000.

Compensation expense of \$1,921,188 increased by \$567,592 or 42% primarily due to an increase in salaries expense of approximately \$199,000 due to an increase in the number of employees, an increase in bonus expense of approximately \$301,000 due to non-cash charges from common stock and common stock option grants to our executive officers, and an increase in sales commissions of \$87,000 due to an increase in equipment sales.

Interest expense of \$554,365 decreased by \$107,034 or 16% due to a reduction in conversions to senior notes of approximately \$197,000 and a reduction in total senior note debt outstanding due to principal repayments.

### THREE MONTHS ENDED SEPTEMBER 30, 2005

Revenues for the three months ended September 30, 2005 were \$1,363,886 compared to \$1,032,578 for the corresponding three-month period in the previous fiscal year. This \$331,308 or 32% increase was primarily due to an increase in equipment sales of approximately \$307,000 and license and transaction fees of approximately \$24,000. The increase in equipment sales was due to an increase in sales of approximately \$64,000 of energy conservation equipment, approximately \$149,000 in laundry equipment, and approximately \$135,000 in e-Port vending equipment sales, offset by a decrease of approximately \$36,000 in sales of business centers.

Cost of sales for the period consisted of equipment costs of approximately \$856,000 and network and transaction related costs of \$193,000. The increase in cost of sales of \$146,915 or 16% over the prior year period was due to an increase in equipment costs of approximately \$414,000, offset by a decrease of approximately \$267,000 of network and transaction related costs.

Gross profit for the three months ended September 30, 2005 was \$314,927, compared to gross profit of \$130,534 for the corresponding three-month period in the previous fiscal year. This 141% increase is due to the combined effect of the increase in energy, laundry and vending equipment sales and the decrease in network and transaction related costs.

General and administrative expense of \$1,107,503 decreased by \$334,675 or 23% primarily due to a reduction in consulting fees of approximately \$250,000 and a reduction in public relations fees of approximately \$56,000.

Compensation expense of \$1,353,596 increased by \$53,574 or 4% primarily due to an increase in salaries expense of approximately \$40,000 due to an increase in the number of employees and annual salary increases.

The quarter ended September 30, 2005 resulted in a net loss of \$3,196,872 (approximately \$0.7 million of non-cash charges) compared to a net loss of \$3,640,637 (approximately \$0.8 million of non-cash charges) for the quarter ended September 30, 2004.

### FISCAL YEAR ENDED JUNE 30, 2006

Revenues for the fiscal year ended June 30, 2006 were \$6,414,803, an increase of \$1,736,814 or 37% from the fiscal year ended June 30, 2005. This increase was primarily attributed to increased sales in our energy, vending and laundry product lines. Revenues are discussed in more detail as follows:

Equipment sales: Revenues from equipment sales increased to \$5,198,360 from \$3,535,064 in the prior fiscal year, an increase of \$1,663,296 or 47%. This increase was primarily attributed to increased sales in our energy (\$784,000), vending (\$497,000) and laundry (\$311,000) equipment sales.

License and transaction fees: Revenues from license and transaction fees increased \$73,518 or 6% from \$1,142,925 to \$1,216,443 for the fiscal years ended June 30, 2005 and 2006, respectively. This increase was primarily due to an increase in license and transaction fees from our Intelligent Vending and eSuds products due to the increased number of devices connected to our USALive® network.

Cost of sales consisted of equipment, product and labor costs of approximately \$3,547,000 and \$2,431,000 for the fiscal years ended June 30, 2006 and 2005, respectively, an increase of \$1,116,000 and network and transaction related costs of approximately \$857,000 and \$1,048,000 for the years ended June 30, 2006 and 2005, respectively, a decrease of \$191,000. The total increase of \$925,000 or 27% in cost of sales from \$3,478,673 to \$4,404,457 for the years ended June 30, 2005 and 2006, respectively, was principally attributable to the increase in equipment sales.

Gross profit for the fiscal year ended June 30, 2006 was \$2,010,346, compared to \$1,199,316 for the fiscal year ended June 30, 2005. The increase of \$811,030 was due to an increase in sales of our higher margin energy management products.

Total operating expenses for the fiscal year ended June 30, 2006 was \$13,792,145, an increase of \$202,622 or 2% over the prior fiscal year. The components of operating expenses (General and administrative, Compensation, and Depreciation and amortization) and the causes of this increase are explained in further detail, below:

General and administrative expenses decreased from \$6,429,458 for the fiscal year ended June 30, 2005 to \$5,200,116 for the fiscal year ended June 30, 2006, a decrease of \$1,229,342 or 19%. The decrease is due to a reduction in consulting services of approximately \$918,000 and a reduction in public relations expenses of approximately \$204,000.

Compensation expense increased from \$5,559,945 to \$6,892,436 for the fiscal year ended June 30, 2005 and 2006, respectively, a \$1,332,491 or 24% increase over the prior fiscal year. This increase is primarily due to stock bonuses and options awarded to executives as well as stock options awarded to members of the board of directors. In addition, the Company increased the number of full-time employees during the fiscal year.

Depreciation and amortization expense for the fiscal year ended June 30, 2006 was \$1,699,593, compared to \$1,600,120 for the prior fiscal year, a \$99,473 or 6% increase. This increase was attributable to an increased amount of depreciation expense resulting from approximately \$842,000 in property, plant and equipment purchases during the fiscal year. The majority of the purchases relate to the purchase and implementation of Oracle's e-Business Suite, an enterprise management system.

Total interest expense decreased from \$3,127,751 to \$2,878,966 for the fiscal year ended June 30, 2005 and 2006, respectively, a decrease of \$248,785 or 8%. The decrease is a result of a reduction in the number of conversions of Senior Notes into shares of the Company's Common Stock by Senior Note Holders. In the prior fiscal year, these conversions resulted in additional interest expense due to the accelerated amortization of debt discount charged to interest expense at the time of the conversion of the Senior Notes.

For the fiscal year ended June 30, 2006, the Company recorded a contingent loss accrual related to a proposed settlement agreement with Swartz Private Equity, LLC, as more fully described above, resulting in a contingent loss of \$270,000. There were no such losses in the prior fiscal year.

The fiscal year ended June 30, 2006 resulted in a net loss of \$14,847,076 (approximately \$4.0 million of non-cash charges) compared to a net loss of \$15,499,190 (approximately \$3.6 million of non-cash charges) for the prior fiscal year.

#### **FISCAL YEAR ENDED JUNE 30, 2005**

Revenues for the fiscal year ended June 30, 2005 were \$4,677,989, a decrease of \$954,826 or 17% from the fiscal year ended June 30, 2004. This decrease was primarily attributed to a decrease in sales of our energy management products. Revenues are discussed in more detail as follows:

Equipment sales: Revenues from equipment sales decreased to \$3,535,064 from \$4,349,566 in the prior fiscal year, a decrease of \$814,502 or 19%. This decrease was primarily attributed to a decrease in sales of our energy management products of approximately \$1,000,000. This was a result of approximately \$686,000 in sales from three large customer orders in the current fiscal year as compared to approximately \$1,691,000 in sales from five large customer orders during fiscal year 2004.

License and transaction fees: Revenues from license and transaction fees increased \$165,274 or 17% from \$977,651 to \$1,142,925 for the fiscal years ended June 30, 2004 and 2005, respectively. This increase was primarily due to an increase in license and transaction fees from our Intelligent Vending products, which was offset by the decrease in revenues from the termination of the Kodak Vending Placement Agreement in the prior fiscal year.

Product sales and other: Revenues from product sales and other decreased to \$0 from \$305,598 in the prior fiscal year. This decrease was due to a decrease in camera and film sales from Company owned vending machines of approximately \$105,000 as a result of the termination of the Kodak Vending Placement Agreement and a decrease of \$200,000 relating to a one-time payment in the prior fiscal year related to the agreement with Unilever.

Cost of sales consisted of equipment, product and labor costs of approximately \$2,431,000 and \$2,503,000 for the fiscal years ended June 31, 2005 and 2004, respectively, a decrease of \$72,000; software development amortization of approximately \$0 and \$999,000 for the fiscal years ended June 30, 2005 and 2004, respectively; and network and transaction related costs of \$1,048,000 and \$828,000 for the years ended June 30, 2005 and 2004, respectively, an increase of \$220,000. The total decrease of \$851,019 or 20% in cost of sales from \$4,329,692 to \$3,478,673 for the years ended June 30, 2004 and 2005, respectively, was principally attributable to the decrease in equipment sales and the lack of software development costs.

Gross profit for the fiscal year ended June 30, 2005 was \$1,119,316, compared to \$1,303,123 for fiscal year ended June 30, 2004. The decrease of \$183,807 was due to a reduction in sales of our higher margin energy management products.

Total operating expenses for the fiscal year ended June 30, 2005 was \$13,589,523, a decrease of \$5,180,899 or 28% over the prior fiscal year. The components of operating expenses (General and administrative, Compensation, Depreciation and amortization and Loss on debt modification) and the causes of this decrease are explained in further detail, below:

General and administrative expenses decreased from \$6,747,824 for the fiscal year ended June 30, 2004 to \$6,429,458 for the fiscal year ended June 30, 2005, a decrease of \$318,366 or 5%. The decrease is due to decrease in bad debt expense and consulting fees, which is partially offset by increases in public relations expenses.

Compensation expense decreased from \$10,071,354 to \$5,559,945 for the fiscal year ended June 30, 2004 and 2005, respectively, a \$4,511,409 or 45% decrease over the prior fiscal year. This decrease is primarily due to the one-time issuance of 10,500,000 shares of Common Stock, valued at \$4,620,000, to the Company's Chief Executive Officer in connection with the amendment of his employment agreement in the prior fiscal year. Additionally compensation expense increased by approximately \$108,000 related to an increase in medical insurance costs.

Depreciation and amortization expense for the fiscal year ended June 30, 2005 was \$1,600,120, compared to \$1,632,330 for the prior fiscal year, a \$32,210 or 2% decrease. This decrease was attributable to assets becoming fully depreciated during the fiscal year ended June 30, 2005.

During the prior fiscal year, the Company incurred a charge of \$318,915 related to the modification of debt terms for certain 2003 and 2004 Senior Notes. This charge represents the unamortized debt discount that remained on the Senior Notes that were scheduled to mature in December 2003 and 2004, and whose terms were substantially modified when the note holders agreed to extend the maturity date of their notes in exchange for a reduction in the conversion rate on the note. There was no such comparable charge in the fiscal year ended June 30, 2005.

During the fiscal year ended June 30, 2004, the Company sold 1,669,091 shares of its investment in the Jubilee Investment Trust for net proceeds of \$1,471,140, resulting in a gain of \$603,480. There were no sales of such investments during the year ended June 30, 2005.

During the fiscal year ended June 30, 2004, a gain of \$429,204 was recorded relating to the termination of the Kodak Vending Placement Agreement. This gain is comprised of the payment from Kodak of approximately \$675,000 plus the cancellation of Stitch's obligation to the supplier of the vending machines of approximately \$124,000 less a write down of the carrying value of vending machines of approximately \$367,000 and a net write-off of amounts due to and from Kodak of \$3,000. During the year ended June 30, 2005, the Company wrote off the remaining value of the vending machines that had not been sold during the year as a loss on contract settlement totaling \$42,300.

Total interest expense decreased from \$5,032,351 to \$3,127,751 for the fiscal year ended June 30, 2004 and 2005, respectively, a decrease of \$1,904,600 or 38%. The decrease is a result of a reduction in the number of conversions of the Senior Notes into shares of the Company's Common Stock by Senior Note Holders. In the prior fiscal year, these conversions resulted in additional interest expense due to the accelerated amortization of debt discount charged to interest expense at the time of the conversion of the Senior Notes.

The fiscal year ended June 30, 2005 resulted in a net loss of \$15,499,190 (approximately \$3.6 million of non-cash charges) compared to a net loss of \$21,426,178 (approximately \$10.9 million of non-cash charges) for the prior fiscal year.

#### **FISCAL YEAR ENDED JUNE 30, 2004**

Revenues for the fiscal year ended June 30, 2004 were \$5,632,815, an increase of \$2,779,747 or 97% from the fiscal year ended June 30, 2003. This increase was primarily attributed to sales of the Company's energy management equipment during the fiscal year ended June 30, 2004. Such revenues did not exist in fiscal year ended June 30, 2003 since the acquisition of Bayview occurred in July 2003. The increase was also due to increases in the sale of our networked devices and related services. Revenues are discussed in more detail as follows:

**Equipment sales:** Revenues from equipment sales increased to \$4,349,566 from \$1,034,427 in the prior fiscal year, an increase of \$3,315,139 or 320%. This increase is mainly due to sales of approximately \$3,025,000 of the Company's energy management equipment for the fiscal year ended June 30, 2004. As noted above, such revenues did not exist in the prior fiscal year. In addition, sales of the Company's cashless technology equipment, which includes e-Port, e-Suds and Kiosk systems, increased to \$736,000, approximately \$349,000 or 90% over the prior fiscal year. The increases in sales were offset by a decrease in Business Center equipment sales of approximately \$59,000.

**License and transaction fees:** Revenues from license and transaction fees decreased \$395,922 or 29% from \$1,373,573 to \$977,651 for the fiscal years ended June 30, 2003 and 2004, respectively. This decrease was primarily due to a decrease in fees earned from the Kodak Vending Placement Agreement of approximately \$387,000, which resulted from the termination of the contract on December 31, 2003.

**Product sales and other:** Revenues from product sales and other decreased to \$305,598 from \$445,068, a decrease of \$139,470 or 31% from the prior fiscal year. This decrease was due to a decrease in camera and film sales from Company owned vending machines of approximately \$340,000 as a result of the termination of the Kodak Vending Placement Agreement. This decrease was offset by \$200,000 of revenue relating to the Strategic Alliance Agreement executed in October 2003 between the Company and Conopco, Inc dba Unilever Home & Personal Care North America.

Cost of sales consisted of equipment, product and labor costs of approximately \$2,503,000 and \$1,085,000 for the fiscal years ended June 31, 2004 and 2003, respectively, an increase of \$1,418,000; software development amortization of approximately \$999,000 and \$1,331,000 for the fiscal years ended June 30, 2004 and 2003, respectively, a decrease of \$332,000; and

network and transaction related costs of \$828,000 and \$555,000 for the years ended June 30, 2004 and 2003, respectively, an increase of \$273,000. The total increase of \$1,358,249 or 46% in cost of sales from \$2,971,443 to \$4,329,692 for the years ended June 30, 2003 and 2004, respectively, was principally attributable to the increase in equipment sales.

Gross profit for the fiscal year ended June 30, 2004 was \$1,303,123, compared to a gross loss of \$118,375 for fiscal year ended June 30, 2003. The increase of \$1,421,498 was due to increases in hardware sales, particularly the addition of energy management equipment sales, which yield a higher profit margin and were not present in the prior fiscal year, as well as a decrease of approximately \$332,000 related to the amortization of software development costs, which were fully amortized as of March 31, 2004.

Total operating expenses for the fiscal year ended June 30, 2004 was \$18,770,423, an increase of \$3,829,159 or 26% over the prior fiscal year. The components of operating expenses (General and administrative, Compensation, Depreciation and amortization and Loss on debt modification) and the causes of this increase are explained in further detail, below:

General and administrative expenses decreased from \$7,194,684 for the fiscal year ended June 30, 2003 to \$6,747,824 for the fiscal year ended June 30, 2004, a decrease of \$446,860 or 6%. The decrease is due to decreases of \$1,717,000 of professional fees, primarily related to business consulting, promotion and public relations and decreases of \$134,000 in IT consulting fees, offset by increases in overall general and administrative expenses of approximately \$1,184,000 related to the acquired energy management operations, as such expenses did not exist in the prior fiscal year, an increase of \$118,000 in expenses related to the recruitment of executive personnel, and an increase of \$164,000 in bad debt expense related to an increase in the allowance for uncollectible accounts as a result of the increase in sales and accounts receivable.

Compensation expense increased to \$10,071,354 for the fiscal year ended June 30, 2004, a \$5,098,144 or 103% increase over the prior fiscal year. This increase is primarily due to the one-time issuance of 10,500,000 shares of Common Stock, valued at \$4,620,000, to the Company's Chief Executive Officer in connection with the amendment of his employment agreement. Additionally, approximately \$845,000 and \$376,000 of this increase relates to additional compensation, including salaries, employee benefits and sales commissions, from the Bayview acquisition in July 2003 and existing operations, respectively. These increases were offset by a \$742,000 reduction in compensation expense due to a reduction in bonuses awarded during the fiscal year ended June 30, 2004 as compared to the prior year.

Depreciation and amortization expense for the fiscal year ended June 30, 2004 was \$1,632,330, compared to \$1,251,716 for the prior fiscal year, a \$380,614 or 30% increase. This increase was attributable to amortization of intangible assets of \$917,000 and depreciation of property and equipment of \$122,000 acquired from Bayview in July 2003, offset by a decrease in depreciation of approximately \$337,000 related to existing assets that have reached the end of their estimated useful life. Additionally there was an impairment charge of \$321,476 recorded on a group of vending machines during fiscal year 2003.



The Company incurred charges during the fiscal year ended June 30, 2004 and 2003 relating to the modification of debt terms for certain of the Senior Notes in the amount of \$318,915 and \$1,521,654, respectively. This charge reflects the write-off of the unamortized debt discount remaining for Senior Notes scheduled to mature in December 2003 and December 2004, for which the conversion and maturity terms were modified. The Company offered these note modifications to manage short-term cash flows, which resulted in a non-cash charge.

During the fiscal year ended June 30, 2004, the Company sold 1,669,091 shares of its investment in the Jubilee Investment Trust for net proceeds of \$1,471,140, resulting in a gain of \$603,480. During the fiscal year ended June 30, 2003, the Company determined that the decline in the market value of the investment in the Jubilee Investment Trust was "other than temporary." Accordingly, the Company recorded a loss of \$1,945,951 on the investment during fiscal year 2003.

During the fiscal year ended June 30, 2004, a gain of \$429,204 was recorded relating to the termination of the Kodak Vending Placement Agreement. This gain is comprised of the payment from Kodak of approximately \$675,000 plus the cancellation of Stitch's obligation to the supplier of the vending machines of approximately \$124,000 less a write down of the carrying value of vending machines of approximately \$367,000 and a net write-off of amounts due to and from Kodak of \$3,000.

Total interest expense increased from \$4,978,600 to \$5,032,351 for the fiscal year ended June 30, 2003 and 2004, respectively, an increase of \$53,751 or 1%. Although the average principal balances were lower on the Company's 12% Senior Notes during fiscal year ended June 30, 2004 versus 2003, as the result of conversions of the Senior Notes into shares of the Company's Common Stock by Senior Note Holders, interest expense increased due to the accelerated amortization of debt discount charged to interest expense at the time of the conversion of the Senior Notes.

The fiscal year ended June 30, 2004 resulted in a net loss of \$21,426,178 (approximately \$10.9 million of non-cash charges) compared to a net loss of \$21,965,499 (approximately \$12.6 million of non-cash charges) for the prior fiscal year.

#### **LIQUIDITY AND CAPITAL RESOURCES**

For the year ended June 30, 2006, net cash of \$11,082,407 was used by operating activities, primarily due to the net loss of \$14,847,076 offset by non-cash charges totaling \$3,966,080 for transactions involving the issuance of Common Stock for services, stock option compensation charges, depreciation and amortization of assets, amortization of debt discount, and a loss on the sale of an investment. In addition to these non-cash charges, the Company's net operating assets increased by \$419,925 (primarily a decrease in accounts payable and an increase in both accounts and finance receivables).

For the year ended June 30, 2006, net cash used in investing activities was \$823,227, comprised of purchases of property and equipment (primarily consisting of our purchase and implementation of Oracle's e-Business Suite, an enterprise management system), reduced slightly by the proceeds from the sale of an investment.

Proceeds from financing activities for the year ended June 30, 2006 provided \$12,674,554 of funds, which were necessary to support cash used in operating activities. Net proceeds of \$14,150,335 were realized from the issuance of Common Stock and the collection of Common Stock subscriptions receivable. Net proceeds of \$1,314,944 were realized from the issuance of Senior Notes. These proceeds were reduced by payments of long-term debt and Senior Notes totaling \$2,790,725, including \$927,405 of Senior Notes due December 31, 2005, and \$1,683,500 of Senior Notes due December 31, 2006.

For the three months ended September 30, 2006, net cash of \$2,998,171 was used by operating activities, primarily due to the net loss of \$3,680,314 offset by non-cash charges totaling \$1,018,673 for transactions involving the issuance of Common Stock for services, depreciation and amortization of assets, and amortization of debt discount. In addition to these non-cash charges, the Company's net operating assets decreased by \$336,530 primarily due to increases in accounts receivable and inventory offset by a decrease in accounts payable.

Proceeds from financing activities for the three months ended September 30, 2006 provided \$1,686,052 of funds, which were necessary to support cash used in operating and investing activities. Net proceeds of \$1,803,500 were realized from the issuance of Common Stock, offset by cash used to repay long-term debt (\$28,208) and Senior Notes (\$111,550).

The Company has incurred losses since inception. Cumulative losses through September 30, 2006 amounted to approximately \$131,600,000. The Company has continued to raise capital through equity and debt offerings to fund operations.

During the year ended June 30, 2006, cash used in operating activities was approximately \$925,000 per month. Using the prior fiscal year as a basis for estimating cash requirements for the year ending June 30, 2007 (which assumes a static level of revenues), cash requirements for the fiscal year 2007, including requirements for capital expenditures and repayments of long-term debt, would be approximately \$11,600,000.

As of September 30, 2006, the Company had approximately \$1,461,000 of cash and cash equivalents on hand.

On February 17, 2006, the Company entered into a Common Stock Purchase Agreement (the "2006 Common Stock Agreement") with Steve Illes. From October 1, 2006 through November 30, 2006, the Company issued an additional 429,753 shares of Common Stock under the 2006 Common Stock Agreement for total gross proceeds of \$1,991,151. As of November 30, 2006, no registered shares remain issuable under this agreement. The 2006-B Common Stock Agreement referred to below replaced the 2006 Common Stock Agreement and provided that no further shares are to be registered under the 2006 Common Stock Agreement.

On September 25, 2006, the Company entered into a new Common Stock Purchase Agreement (the "2006-B Common Stock Agreement") with Mr. Illes, pursuant to which he agreed to purchase shares with an aggregate purchase price not to exceed \$15,000,000.

Funding sources in place to meet the Company's cash requirements for the year ending June 30, 2007 are primarily comprised of approximately \$1,461,000 in cash and cash equivalents on hand as of September 30, 2006, the proceeds of \$1,991,151 received by the Company under the 2006 Stock Purchase Agreement subsequent to September 30, 2006, and the proceeds that are available under the 2006-B Common Stock Agreement referred to above. The Company believes these existing sources will provide sufficient funds to meet its cash requirements through at least June 30, 2007.

## COMMITMENTS

The Company conducts its operations from various facilities under operating leases. In March 2003, the Company entered into a lease for 12,864 square feet of space located in Malvern, Pennsylvania for its principal executive office and used for general administrative functions, sales activities, and product development. The lease term extends through December 31, 2008 and provides for escalating rent payments and a period of free rent prior to the commencement of the monthly lease payment in January 2004 of approximately \$25,000 per month. During April 2005, the Company entered into an amendment to the lease covering 4,385 additional square feet that is contiguous to its existing space. The lease term was extended to December 31, 2010, and the amendment provides for a period of free rent for the additional space with rent of approximately \$31,000 per month commencing in September 2005 with escalating rental payments thereafter.

The Company also leases 9,084 square feet of space, located in Malvern, Pennsylvania, on a month-to-month basis for a monthly payment of approximately \$8,000. During prior years, the facility was solely used to warehouse product. All product warehousing, shipping and customer support was transferred to this location from the executive office location during the first quarter of fiscal year 2005.

In December 2004, the Company entered into a lease for 2,837 square feet of space located in Denver, Colorado to be used for administrative functions, sales activities and product warehousing associated with our energy management products. The lease term extends through May 31, 2009 and provides for five months of free rent followed by rent payments of \$1,200 per month and escalating payments beginning on June 1, 2006. The lease provides for additional rent for a prorated share of operating costs for the entire facility.

During the fourth quarter of fiscal year 2006, the Company committed to purchase approximately \$1,334,000 of inventory from a third party manufacturer through December 31, 2007. The Company expects to begin taking delivery of the inventory during the third quarter of fiscal year 2007 upon completion of manufacturing.

## OTHER EVENTS

During December 2006, the Company sold 1,400,000 shares of Common Stock for \$6.00 per share for an aggregate of \$8,400,000 to 78 investors. For each share purchased in the offering, the investor also received a warrant to purchase one-half of a share. Pursuant to the offering, warrants to purchase an aggregate of 700,017 shares were issued. The warrants are exercisable at any time through December 31, 2011 at \$6.40 per share. As of the date of this prospectus, none of the warrants have been exercised. The offer and sale of the shares and the warrants was exempt from registration under Rule 506 promulgated under Section 4(2) of the Act. All of these investors are accredited investors. We have agreed to register the shares and the shares underlying the warrants for resale under the Act through December 14, 2007, and all of these shares are covered by this prospectus. The Stock Purchase Agreements entered into with the investors provide that if the registration statement is not declared effective by the SEC within 90 days from the date of the Stock Purchase Agreements, or by March 14, 2007, then the Company will pay to the investors as liquidated damages 1% of the purchase price for the shares for each month beyond 90 days that the registration statement is not effective with the maximum damages not to exceed 12% of the purchase price for the shares.

In connection with the above private placement offering, William Blair & Company, LLC, acted as exclusive placement agent. As compensation for its services, Blair received cash compensation of \$529,200 and warrants to purchase up to 11,454 shares at \$6.60 per share at any time through December 31, 2011. As of the date of this prospectus, none of the warrants have been exercised. Blair also received an expense reimbursement from us of \$12,576.08. We have agreed to register the shares underlying the warrants for resale under the Act through December 14, 2007, and these shares are covered by this prospectus. The offer and sale of the warrants was exempt from registration under Section 4(2) of the Act. The investor is an accredited investor. The offer and sale thereof did not involve any general advertising or solicitation and the securities contained appropriate restrictive legends under the Act.

During October and November 2005, the Company sold \$544,945 principal amount of 2005-G Convertible Senior Notes due December 31, 2008 to six investors. For each \$10,000 of senior notes purchased, the investor also received a purchase right to purchase up to 1,000 shares at \$20 per share at anytime prior to December 31, 2008. The Company issued purchase rights to acquire 54,494 shares. During January 2006, the holder of each purchase right agreed to exchange the purchase right for a warrant to purchase one share at \$20 at anytime prior to December 31, 2008. Pursuant thereto, warrants were issued for an aggregate of 54,494 shares. All of the shares underlying these warrants are covered by this prospectus. We had agreed to register the shares underlying the warrants under the Act for resale, and to keep the registration statement current and effective through November 30, 2006. In January 2007, we extended this date to December 31, 2008. The issuance by us of the warrants was exempt from registration under Section 3(a)(9) of the Act. All of the investors were existing holders of the purchase rights. No commission or remuneration was paid or given directly or indirectly for soliciting the exchange. As of the date of this prospectus, none of these warrants have been exercised.

In October and November 2005, the Company sold \$770,000 of principal amount of 10% Bridge Notes due January 6, 2006 to 8 investors. On January 6, 2006, the Bridge Notes were automatically exchanged for a like principal amount of new 2006-A Convertible Senior Notes due December 31, 2010. For each \$10,000 of 2006-A Convertible Senior Notes received in exchange for the Bridge Notes, the Company also issued purchase rights enabling the holder to purchase up to 1,000 shares of Common Stock at \$20 per share at anytime prior to December 31, 2008. The Company issued purchase rights to acquire 77,000 shares. During January 2006, the holder of each purchase right agreed to exchange the purchase right for a warrant to purchase one share at \$20 at anytime prior to December 31, 2008. Pursuant thereto, warrants were issued for an aggregate of 77,000 shares. All of the shares underlying these warrants are covered by this prospectus. The issuance by us of the warrants in exchange for the purchase rights was exempt from registration under Section 3(a)(9) of the Act. All investors were existing security holders of the Company. No commission or remuneration was paid or given directly or indirectly for soliciting the exchange. We had agreed to register the shares underlying the warrants under the Act for resale, and to keep the registration statement current and effective through November 30, 2006. In January 2007, we extended this date to December 31, 2008. As of the date of this prospectus, none of these warrants have been exercised.

Pursuant to the Employment Agreement dated May 11, 2006 between Mr. Jensen and the Company, the Company agreed to issue to Mr. Jensen an aggregate of 75,000 shares of Common Stock. These shares vest as follows: 25,000 on June 1, 2006; 25,000 on January 1, 2007; and 25,000 on June 1, 2007. The Company has agreed to include in this prospectus the 25,000 shares of Common Stock that vested on January 1, 2007. Pursuant to his Employment Agreement, Mr. Jensen also elected to have fifty percent of his base salary for the fiscal year ending June 30, 2007 paid through the issuance to him of 22,080 shares of Common Stock in lieu of cash. These shares vest as follows: 5,520 shares on July 1, 2006; 5,520 shares on October 1, 2006; 5,520 shares on January 1, 2007; and 5,520 shares on April 1, 2007. The Company has agreed to include in this prospectus the 5,520 shares that vested on January 1, 2007. The offer and sale of the shares to Mr. Jensen were exempt from registration under Section 4(2) of the Act.

Pursuant to the Employment Agreement dated May 11, 2006 between Mr. Herbert and the Company, the Company agreed to issue to Mr. Herbert an aggregate of 50,000 shares of Common Stock. These shares vest as follows: 16,667 on June 1, 2006; 16,667 on January 1, 2007; and 16,666 on June 1, 2007. The Company has agreed to include in this prospectus the 16,667 shares of Common Stock that vested on January 1, 2007. The offer and sale of the shares to Mr. Herbert were exempt from registration under Section 4(2) of the Act.

**OVERVIEW**

USA Technologies, Inc. (the "Company", "We" or "Our") was incorporated in the Commonwealth of Pennsylvania in January 1992. The Company offers a suite of networked devices and associated wireless non-cash payment, control/access management, remote monitoring and data reporting services, as well as energy management products. Our networked devices and associated services enable the owners and operators of everyday, stand-alone, distributed assets, such as vending machines, personal computers, copiers, faxes, kiosks and laundry equipment, the ability to remotely monitor, control and report on the results of these distributed assets, as well as the ability to offer their customers alternative cashless payment options. As a result of the acquisition of the assets of Bayview Technology Group, LLC ("Bayview") in July 2003, our Company also manufactures and sells energy management products which reduce the electrical power consumption of various existing equipment, such as refrigerated vending machines and glass front coolers, thus reducing the electrical energy costs associated with operating this equipment.

Our customers fall into the following categories: vending machine owners and operators, business center operators which include hotels and audio visual companies, commercial laundry operators servicing colleges and universities, brand marketers wishing to provide their products or services via kiosks or vending machines and equipment manufacturers that would like to incorporate the technological features of our networked devices (i.e. remote monitoring, reporting and control as well as cashless payments) into their products. Customers for our energy management products also include energy utility companies, schools and operators of glass front coolers.

**OUR TECHNOLOGY**

Our Company offers an end-to-end solution for control/access management, remote monitoring, turnkey cashless payment processing and data reporting for distributed assets such as vending machines, office equipment, laundry machines and kiosks. This solution consists of a device in the distributed asset (the "client device"), a connectivity medium, and our proprietary network.

**The Client Devices**

As part of the end-to-end solution, the Company offers its customers several different client devices to connect their distributed assets. These client devices range from software, or dynamic link libraries ("DLLs"), to hardware devices consisting of control boards, magnetic strip card readers, RFID readers, and/or receipt printers. The client device can be embedded inside the host equipment, such as software residing in the central processing unit of a Kiosk; it can be integrated as part of the host equipment, such as our e-Port(R) hardware that can be attached to the door of a vending machine; or it can be a peripheral, stand-alone terminal, such as our TransAct(TM) terminal for Business Express(R).

e-Port(R) is the Company's core client device, which is currently being utilized in vending and commercial laundry applications. Our e-Port(R) product facilitates cashless payments by capturing the payment media and transmitting the information to our network for authorization with the payment authority (e.g. credit card processors). Additional capabilities of our e-Port(R) consist of control/access management by authorized users, collection of audit information (e.g. product or service sold, date and time of sale and sales amount), diagnostic information of the host equipment, and transmission of this data back to our network for web-based reporting.

TransAct(R) is the Company's original cashless, transaction-enabling device developed for self-service business center equipment such as PC's, fax machines and copiers. Similar to e-Port(R), the TransAct(R) capabilities include control/access management, collection of sales data (e.g. date and time of sale, sales amount and product or service purchased), and transmission back to our network for reporting to customers.

### **The Connectivity Mediums**

Connectivity of our client devices (e-Port(R) and TransAct(R)) to the USALive(R) network is another component of the Company's end-to-end solution. The reliable, cost effective transfer of customer's business critical data is paramount to the services we deliver. Due to the importance of connectivity, and realizing that every customer's connectivity needs may be different (e.g. access, or lack thereof, to phone lines, local area networks ("LANs"), wide area networks ("WANs") and wireless data networks), the Company offers multiple connectivity solutions - phone line, Ethernet and wireless.

Increasing wireless connectivity options, coverage and reliability and decreasing costs, over the past few years have allowed us to service a greater number of customer locations, since many of our customer's host equipment, particularly within the vending industry, do not have access to any other communication medium. Additionally, we make it easy for our customers to deploy wireless solutions by being a single point of contact. By aggregating different wireless networks, we ensure our customers have reliable, cost effective nationwide coverage without the hassles of certification and administration of multiple wireless suppliers.

### **The Network**

USALive(R) is the network component of our end-to-end solution to which the Company's devices transmit their cashless payment information for processing as well as the valuable sales and diagnostic data for storage and reporting to our customers. Also, the network, through server-based software applications, provides remote management information and enables control of the networked device's functionality.

USALive(R) is the enabler of turnkey cashless payment processing for our customers. The network is certified with several cashless payment authorities, such as credit card processors and property management systems, facilitating the authorization and settlement of credit cards, debit cards, hotel room keys and student ids. The network can also act as its own payment processing authority for other cashless payment media, such as on-line stored value or employee payroll deduction. The network authorizes transactions, occurring at the host equipment, with the appropriate payment authority and

sends approval or decline responses back to the networked device to allow or terminate the transaction for the purchase of the product or service. The network consolidates successfully approved transactions from multiple devices, batches, and then transmits these batched transactions to the payment authority for settlement. By bundling and batching transactions from multiple networked devices and connecting to the appropriate payment authorities through one central dedicated processing medium, it reduces the fees charged by the payment authority.

USALive On-line(TM) is the web based reporting system that customers use to gain access to the valuable business information collected from the networked devices. The website's functionality includes: management of the distributed assets deployed in the field, such as new activations and location redeployments; user-defined reporting for miscellaneous payment types (e.g. cash, credit, etc), date and time product sold, and sales amount; and detailed bank account deposit information, by device, for easier bank reconciliation. The Company offers this service through either a Company branded website or Customer specific branded website.

## **OUR PRODUCTS AND SERVICES**

### **Intelligent Vending(R)**

Developed for the vending industry, Intelligent Vending(R) is our end-to-end vending solution. This system bundles e-Port(R), USALive(R), and its web-based remote monitoring, management, reporting and turnkey payment processing. Our latest improvement to Intelligent Vending(R) is the introduction of our e-Port(R) G-6. This device includes a radio frequency identification ("RFID") or "Tap & Go™" tag reader for added convenience to consumers.

Vending operators purchasing our Intelligent Vending(R) products and services will have the capability to conduct cashless transactions via credit cards, debit cards and other payment mediums such as employee/student ids and hotel room keys; to offer improved and expanded customer services by utilizing 'real-time', web-based reporting to keep machine inventory at a desirable level and consumer access to our 1-800 help-desk center for customer purchasing inquiries, both providing the end-user a more consistent user experience; to reduce operational costs through utilization of our remote monitoring technology, thereby maximizing the scheduling of service visits and limiting 'out-of-stock' machines; and to reduce theft and vandalism by providing 100% accountability of all sales transactions and reducing the cash reserves inside the machine.

### **e-Suds(TM)**

eSuds(TM) is our end-to-end solution developed for the commercial laundry industry. The eSuds(TM) system bundles e-Port(R) and USALive(R) to offer a cash-free payment option, web-based remote monitoring and management, an e-mail alert system to notify users regarding machine availability, cycle completion, and other events. eSuds(TM) also supports a variety of value-added services such as custom advertising or subscription-based payments.



Laundry operators purchasing our eSuds(TM) system will have the capability to conduct cashless transactions via credit cards, debit cards and other payment mediums such as student ids; to reduce operational costs through utilization of our remote monitoring technology, thereby maximizing the scheduling of service visits and increasing machine up-time. The system can also increase customer satisfaction through improved maintenance, higher machine availability, specialized services (i.e. email alerts to indicate that laundry cycle is finished) and the convenience of non-cash transactions. Installations have been completed at Carnegie Mellon University, Rutgers University, Case Western Reserve University, John Hopkins University and others. We are working with distributors to install eSuds(TM) at other colleges and universities based on the positive results of these installations.

### **Transact(R) And Business Express(R)**

TransAct(R), our original payment technology system developed for self-service business center devices, such as PCs, fax machines, and copiers, is a cashless transaction-enabling terminal that permits customers to use office equipment quickly and simply with the swipe of a major credit card. The TransAct(R) device can be sold as a stand-alone unit for customers wishing to integrate it with their own office equipment.

Business Express(R) is a bundled solution comprised of the TransAct(R) payment terminal and a suite of office equipment (i.e. PC, fax and copier). Business Express(R) enables hoteliers and others to offer unmanned business services 24/7/365. In addition, the Company offers the Public PC(TM), the Public Fax(TM) and the Public Copier(TM) to customers wishing to purchase a specific self-service product versus a complete bundled Business Center(R). The Company also provides additional value-added service and revenue generating opportunities with BEXPrint(TM), our proprietary technology that allows users, without access to a printer, to send a document to a secure web-site for storage, and then password retrieval of the document for printing at our Business Center locations, and our Kinko's relationship, which gives our Business Center users access to the nearest, convenient Kinko's center for their more advanced business center needs.

Although larger hotels are expected to provide business centers to its guests, operation of the center can be costly. In addition to the cost of operating a supervised business center, operating hours usually are limited due to staff availability. Business Express(R) provides a cost-effective solution.

### **Kiosk**

We provide an end-to-end solution that utilizes e-Port(R) and USALive(R) to offer a cash-free payment option and web-based remote monitoring and management for all kiosk types. Kiosks permit a host of new services to become available at the point-of-demand, such as Sony's self-service, PictureStation kiosks, where consumers can produce prints from their own digital media. Our solution also enables Kiosks to sell a variety of more expensive items.

Sony's PictureStation kiosks, which use our e-Port(R) software solution, have been installed in approximately 60 locations across the United States.

## Energy Management Products

With the acquisition of Bayview in July 2003, our Company offers energy conservation products ("Misers") that reduce the electrical power consumption of various types of existing equipment, such as vending machines, glass front coolers and other "always-on" appliances by allowing the equipment to selectively operate in a power saving mode when the full power mode is not necessary. Each of the Company's Miser products utilizes occupancy sensing technology to determine when the surrounding area is vacant or occupied. The Miser then utilizes occupancy data, room and product temperatures, and an energy saving algorithm to selectively control certain high-energy components (e.g. compressor and fan) to realize electrical power savings over the long-term use of the equipment. Customers of our VendingMiser(R) product benefit from reduced energy consumption and costs of up to 46% per machine, depending on regional energy costs, machine type, and utilization of the machine. Our Misers also reduce the overall stress loads on the equipment, helping to reduce associated maintenance costs.

The Miser family of energy-control devices, include:

VendingMiser(R) - installs in a cold drink vending machine and can reduce the electrical power consumption of the vending machine by an average of up to 46%.

CoolerMiser™ - reduces the electrical energy used by sliding glass or pull open glass-front coolers that contain non-perishable goods.

VM2IQ™ and CM2IQ™ - The second generation of the VendingMiser™ and CoolerMiser™ devices that is installed directly inside the machine and has the capability to control the cooling system and the advertising lights separately.

SnackMiser™ - reduces the amount of electricity used by non-refrigerated snack vending machines.

PlugMiser™ - reduces the amount of electricity used by all types of plug loads including those found in personal or modular offices (printers, personal heaters, and radios), video arcade games, and more.

## THE OPPORTUNITY

Everyday devices from vending machines and logistics equipment to refrigerators, security systems, and countless other devices can be better managed by embedding thin-client computing technology with network connectivity into each unit. Using wired and/or wireless networks and centralized, server-based software applications, managers can remotely monitor, control, and optimize a network of devices regardless of where they are located, resulting in a host of benefits including lower maintenance costs, improved inventory and transaction management, and increased operating efficiency.

This market opportunity is known by several different names, including Machine-to-Machine ("M2M") networking, Device Relationship Management ("DRM"), the Pervasive Internet and Device Networking. This industry is the convergence of computer-enabled devices and embedded systems, the Internet or other networking mediums, and centralized enterprise data-management tools. By connecting stand-alone devices into large-scale networks, new opportunities emerge between brand marketers, service providers, and their customers. Networked devices enable remote monitoring, cashless transactions, sales analysis, and optimized machine maintenance - all yielding higher return on investment for operators while increasing consumer satisfaction with improved and expanded services.

Brand marketers will be able to provide their products and services to customers wherever and whenever the need arises. They will no longer be limited to existing distribution channels and outlets. Just as beverage vending machines bring bottlers' products beyond the supermarket to the location where and when the customer wants them, a vast range of products and branding opportunities can be made available to customers at the point-of-need. In laundry, makers of detergent and fabric softener can have their products injected directly into a consumer's laundry, again putting their products at the point-of-need.

The market for networked device solutions is projected to be large and growing rapidly and includes a wide variety of segments such as the security and alarm, automated meter reading, fleet and asset management, and consumer telemetry markets. Networked devices will include personal devices (e.g. cell phones, PDAs), vehicles, containers, supply chain assets, medical devices, HVAC units, industrial machinery, home appliances, energy, accelerometers, pressure gauges, flow control indicators, biosensors, and countless other applications. According to an article, "Pervasive Internet", in M2M Magazine (Fall 2003), a minimum of 1.5 billion devices will be connected to the Internet worldwide by 2010. This represents a \$700 billion total opportunity including device enabling, monitoring, and providing value-added services made available by the M2M network, according to M2M Magazine.

We believe that an opportunity exists to combine our technology with world-class partners in order to deliver a best-in-class solution and emerge as a leader in the Device Networking industry. Our Company has begun addressing this opportunity by working in several initial verticals, which include vending, commercial laundry, self-service business centers and self-service kiosks. These services share several key attributes, specifically, they are all self-service, cash-based businesses that are distributed across broad geographic areas. We address the extremely broad range of Device Networking opportunities by licensing our technologies to equipment makers throughout a variety of market segments. Equipment makers will be able to merge our technology with their in-depth market expertise.

## **THE INDUSTRY**

Our current customers are primarily in the vending, commercial laundry, business center and kiosk industry sectors. While these industry sectors represent only a small fraction of the total Device Networking market, these are the areas where we have gained the most traction. In addition to being our primary markets, these sectors serve as a proof-of-concept for other Device Networking industry applications.

### **Vending**

Annual worldwide sales in the vending industry sector are estimated to be approximately \$143.5 billion, according to Vending Times Census of the Industry 2002. According to this Census, there are an estimated 8 million vending locations in the United States, and 30 million locations worldwide. The market segment that can be addressed by our end-to-end solution consists primarily of vended products retailing for \$1 or greater, which represents a Company estimated vended volume of approximately \$28 billion. Per census statistics, the overall market growth is 5% to 6% annually, while the addressable market segment for our end-to-end solution is growing more rapidly at 9% annually. Our VendingMiser(R) energy conservation product can serve the entire vending market.

### **Commercial Laundry**

The domestic commercial laundry industry is estimated to be \$5 billion in annual sales and 3.5 million commercial laundry machines in operation, according to Coin Laundry Association, October 2000 edition. The average annual growth rate for the commercial laundry sector is estimated to be between 10% and 12%. The Company believes the inline sale of additives (i.e. push-button selections for detergent and softener) may lead to a significant increase in this figure due to larger net margins over traditional industry standards. The addressable market is primarily the seven largest laundry operators, as well as several other small operators. These operators own and manage the equipment that is installed in multi-housing and college and university locations. The addressable market excludes those who own single laundromats.

## **Business Centers**

There are currently 52,000 hotels in the United States and 300,000 worldwide, per American Hotel & Lodging Association's website, [www.ahma.com](http://www.ahma.com). There is demand for business center availability in hotels, with ever-greater percentages of travelers needing and expecting use of computers, printers, fax machines, copiers, and other business services. We believe that there are 5,900 hotels in the primary addressable market - business oriented hotels with over 150 rooms - and 13,900 in the secondary market, hotels with 75 to 150 rooms. The growth rate for the overall market is 5% annually, with the addressable market gaining 8% annually.

## **Kiosk**

According to a report by Frost and Sullivan Consulting, Kiosks represent a \$500 million market. Kiosks are becoming increasingly popular as self-service "specialty" shops within larger retail environments. Value-added services, such as photo enlargement and custom imaging are a prominent example, located within many major retailers. Since pricing on these products is generally higher than \$1 or \$2, cashless payment options are essential.

## **SALES AND MARKETING**

The Company's sales strategy includes both direct sales and channel development, depending on the particular dynamics of each of our markets. Our marketing strategy is diversified and includes media relations, direct mail, conferences and client referrals. As of June 30, 2006, the Company was marketing and selling its products through its full time staff consisting of thirteen people.

### **Direct Sales**

We sell directly to the major operators in each of our target markets. Each of our target markets is dominated by a handful of large companies, and these companies comprise our primary customer base. In the vending sector, approximately ten large operators dominate the sector; in the commercial laundry sector, seven operators currently control the majority of the market. We also work directly with hoteliers for our TransAct(TM) and Business Express(R) products.

Within the vending industry, our customers include soft drink bottlers and independent vending operators throughout the United States. On the soft drink bottler side, heavy effort is being put into securing initial distribution agreements. Three of the premier national independent vending operators, the Compass Group (Canteen, Flik, Eurest, Restaurant Associates and other affiliates), ARAMARK and Sodexo, have installed approximately 130 e-Port(R) devices.

### **Channel Sales**

We currently engage in channel sales for our TransAct(TM) and Business Express(R) products. We also work with audio-visual companies that service major hotels.

## **Marketing**

Our marketing strategy consists of building our brand by creating a company and product presence at industry conferences and events, in order to raise visibility within our industry, create opportunity to conduct product demonstrations and consult with potential customers one-on-one; sponsoring of education workshops with trade associations such as National Automated Merchandiser Association ("NAMA"), to educate the industry on the importance and benefits of our solution and establish our position as the industry leader; develop several one-sheet case studies to illustrate the value of our products; the use of direct mail campaigns; advertising in vertically-oriented trade publications such as Vending Times, Automatic Merchandiser and Energy User News; and cultivate a network of State governments and utility companies to provide incentives or underwriting for our energy management products.

## **STRATEGIC RELATIONSHIPS**

### **Mastercard International**

In June 2006, Mastercard International and the Company signed an agreement to deploy 1,000 e-Port devices that accept Mastercard "PayPass™" in Coca-Cola vending machines owned and operated by the Philadelphia Coca-Cola Bottling Company. From July through September 2006, the Company has earned approximately \$400,000 from this agreement.

In November 2006, Mastercard International and the Company signed an agreement to deploy 5,000 e-Port devices that accept Mastercard "PayPass™". As of November 2006, the Company had not earned material revenues from this agreement.

### **Mars Electronics Inc. (MEI)**

In September 2004, MEI and the Company signed a technology licensing and sales agreement to bring a turnkey cash and credit card payment system to the vending market. Under the agreement, MEI licensed our intellectual property so operators can connect to USALive(R), our network for services and credit card transaction capability. As of November 2006, the Company has not earned material revenues from these agreements.

### **Cingular Wireless (formerly AT&T Wireless)**

In July 2004, we signed an agreement to use AT&T Wireless' digital wireless wide area network for transport of data, including credit card transactions and inventory management data. AT&T Wireless (now Cingular Wireless) is a provider of advanced wireless voice and data services for consumers and businesses, operating one of the largest digital wireless networks in North America and the fastest nationwide wireless data network in the United States.

## **MANUFACTURING**

The Company utilizes independent third party companies for the manufacturing of its products. The Company purchases other components of its business center (computers, printers, fax and copy machines) through various manufacturers and resellers. Our manufacturing process mainly consists of quality assurance of materials and testing of finished goods received from our contract manufacturers. We have not entered into a long-term contract with our contract manufacturers, nor have we agreed to commit to purchase certain quantities of materials or finished goods beyond those submitted under routine purchase orders, typically covering short-term forecasts.

## **COMPETITION**

The cashless vending, remote business service and energy conservation industries are each highly competitive markets. While the Company offers unique products and services within smaller niche markets of these industries, a number of competitors in the broader market may offer products and services within our niche market in the future. In the cashless vending market, we are aware of one direct competitor, Transaction Network Services, Inc. In the cashless laundry market, we are aware of one direct competitor, Mac-Gray Corporation. In the automated business center market, we are aware of three direct competitors. In the energy management market, we are not aware of any direct competitors for our Miser products.

The businesses which have developed unattended, credit card activated control systems currently in use in non-vending machine applications (e.g., gasoline dispensing, public telephones, prepaid telephone cards and ticket dispensing machines), might be capable of developing products or utilizing their existing products in direct competition with our e-port control systems targeted to the vending industry. The Company is also aware of several businesses that make available use of the Internet and use of personal computers to hotel guests in their hotel rooms. Such services might compete with the Company's Business Express, and the locations may not order the Business Express, or if ordered, the hotel guest may not use it. Finally, the production of highly efficient vending machines and glass front coolers or alternative energy conservation products may reduce or replace the need for our energy management products.

The Company's key competitive factors include our unique products, our integrated services, product performance and price. Our competitors 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. Any increase in competition in the future may result in reduced sales and/or 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.

## **CUSTOMER CONCENTRATIONS**

Approximately 39% and 36% of the Company's accounts and finance receivables at June 30, 2006 and 2005, respectively, were concentrated with two and two customers, respectively, and 26% as of September 30, 2006 was concentrated with one customer. Approximately 29%, 11% and 13% of the Company's revenues for the year ended June 30, 2006, 2005 and 2004, respectively, were concentrated with two, one and one customer(s), respectively. Approximately 24% and 32% of the Company's revenues for the three months ended September 30, 2006 and 2005, respectively, were concentrated with one customer and two customers (16% with one customer and 16% with another customer), respectively. The Company's customers are principally located in the United States.

## **TRADEMARKS, PROPRIETARY INFORMATION AND PATENTS**

The Company received federal registration approval of the following trademarks: Business Express, Express Solutions, C3X, TransAct, Public PC, PC Express, Copy Express, Credit Card Copy Express, Credit Card Computer Express, Credit Card Printer Express, Credit Card Microfiche Express, Credit Card Debit Express, The Office That Never Sleeps, Intelligent Vending, e-Port, Dial-A-Vend, Dial-A-Snack, Dial-A-Vend.com, USALive and e-Port The Next Generation in Vending. The Company has two trademarks pending registration, VM2IQ and CM2IQ. Through its wholly owned subsidiary, Stitch Networks, the Company has secured three registered trademarks, including eVend.net, eSuds.net, and Stitch Networks, and one trademark, E-ppliance, which is pending registration. In addition, due to the July 2003 acquisition of Bayview, the Company has secured the VendingMiser trademark and the trademark SnackMiser is pending federal registration.

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, that they will be recognized as trade secrets by a court of law, or that others will not capitalize on certain aspects of the Company's technology.

Through August 31, 2006, 59 United States patents and 5 Foreign patents have been issued to the Company, 21 United States patents and 8 Foreign patents are pending and 2 patents have received notices of allowance.

The list of issued patents is as follows:

- o U.S. Patent No. 5,619,024 entitled "Credit Card and Bank Issued Debit Card Operating System and Method for Controlling and Monitoring Access of Computer and Copy Equipment";
- o U.S. Patent No. 5,637,845 entitled "Credit and Bank Issued Debit Card Operating System and Method for Controlling a Prepaid Card Encoding/Dispensing Machine";
- o U.S. Patent No. D423,474 entitled "Dataport";
- o U.S. Patent No. D415,742 entitled "Laptop Dataport Enclosure";



- o U.S. Patent No. D418,878 entitled "Sign Holder";
- o U.S. Patent No. 6,056,194 entitled "System and Method for Networking and Controlling Vending Machines";
- o U.S. Patent No. D428,047 entitled "Electronic Commerce Terminal Enclosure";
- o U.S. Patent No. D428,444 entitled "Electronic Commerce Terminal Enclosure for a Vending Machine";
- o U.S. Patent No. 6,119,934 entitled "Credit Card, Smart Card and Bank Issued Debit Card Operated System and Method for Processing Electronic Transactions";
- o U.S. Patent No. 6,152,365 entitled "Credit and Bank Issued Debit Card Operated System and Method for Controlling a Vending Machine";
- o U.S. Patent No. D437,890 entitled "Electronic Commerce Terminal Enclosure with a Hooked Fastening Edge for a Vending Machine";
- o U.S. Patent No. D441,401 entitled "Electronic Commerce Terminal Enclosure with Brackets";
- o U.S. Patent No. 6,321,985 entitled "System and Method for Networking and Controlling Vending Machines";
- o U.S. Patent No. 6,505,095 entitled "System for Providing Remote Audit, Cashless Payment, and Interactive Transaction Capabilities in a Vending Machine" (Stitch);
- o U.S. Patent No. 6,389,337 entitled "Transacting e-commerce and Conducting e-business Related to Identifying and Procuring Automotive Service and Vehicle Replacement Parts" (Stitch);
- o U.S. Patent No. 6,021,626 entitled "Forming, Packaging, Storing, Displaying and Selling Clothing Articles"; and
- o U.S. Patent No. 6,622,124 entitled "Method of transacting an electronic mail, an electronic commerce, and an electronic business transaction by an electronic commerce terminal operated on a transportation vehicle";
- o U.S. Patent No. 6,615,186 entitled "Communicating interactive digital content between vehicles and internet based data processing resources for the purpose of transacting e-commerce or conducting e-business";
- o U.S. Patent No. 6,615,183 entitled "Method of warehousing user data entered at an electronic commerce terminal";
- o U.S. Patent No. 6,611,810 entitled "Store display window connected to an electronic commerce terminal";
- o U.S. Patent No. 6,609,103 entitled "Electronic commerce terminal for facilitating incentive-based purchasing on transportation vehicles";

- o U.S. Patent No. 6,609,102 entitled "Universal interactive advertising and payment system for public access electronic commerce and business related products and services";
- o U.S. Patent No. D478,577 entitled "Transceiver base unit";
- o U.S. Patent No. 6,606,605 entitled "Method to obtain customer specific data for public access electronic commerce services";
- o U.S. Patent No. 6,606,602 entitled "Vending machine control system having access to the internet for the purposes of transacting e-mail, e-commerce, and e-business, and for conducting vending transactions";
- o U.S. Patent No. 6,604,087 entitled "Vending access to the internet, business application software, e-commerce, and e-business in a hotel room";
- o U.S. Patent No. 6,604,086 entitled "Electronic commerce terminal connected to a vending machine operable as a telephone";
- o U.S. Patent No. 6,604,085 entitled "Universal interactive advertising and payment system network for public access electronic commerce and business related products and services";
- o U.S. Patent No. 6,601,040 entitled "Electronic commerce terminal for wirelessly communicating to a plurality of communication devices";
- o U.S. Patent No. 6,601,039 entitled "Gas pump control system having access to the Internet for the purposes of transacting e-mail, e-commerce, and e-business, and for conducting vending transactions";
- o U.S. Patent No. 6,601,038 entitled "Delivery of goods and services resultant from an electronic commerce transaction by way of a pack and ship type company";
- o U.S. Patent No. 6,601,037 entitled "System and method of processing credit card, e-commerce, and e-business transactions without the merchant incurring transaction processing fees or charges worldwide";
- o U.S. Patent No. D477,030 entitled "Vending machine cashless payment terminal";
- o U.S. Patent No. D476,037 entitled "User interface bracket for a point of sale terminal";
- o U.S. Patent No. D476,036 entitled "Printer bracket for point of sale terminal";
- o U.S. Patent No. D475,751 entitled "User interface bracket for a point of sale terminal";
- o U.S. Patent No. D475,750 entitled "Paper guide for a point of sale terminal";
- o U.S. Patent No. D475,414 entitled "Printer bracket for point of sale terminal";

- o U.S. Patent No. 5,844,808 entitled "Apparatus and methods for monitoring and communicating with a plurality of networked vending machines";
- o U.S. Patent No. 6,581,396 entitled "Refrigerated vending machine exploiting expanded temperature variance during power-conservation mode";
- o U.S. Patent No. 6,389,822 entitled "Refrigerated vending machine exploiting expanded temperature variance during power-conservation mode";
- o U.S. Patent No. 6,243,626 entitled "External power management device with current monitoring precluding shutdown during high current"; and
- o U.S. Patent No. 5,477,476 entitled "Power conservation system for computer peripherals";
- o U.S. Patent No. 6,629,080 entitled "Transaction processing method of fulfilling an electronic commerce transaction by an electronic commerce terminal system";
- o U.S. Patent No. D480,948 entitled "Mounting bracket for mounting a cashless payment terminal to a vending machine";
- o U.S. Patent No. 6,643,623 entitled "A method of transacting an electronic mail, an electronic commerce, and an electronic business transaction by an electronic commerce terminal using a gas pump";
- o U.S. Patent No. 6,684,197 entitled "Method of revaluing a private label card using an electronic commerce terminal (as amended)";
- o U.S. Patent No. 6,754,641 entitled "Dynamic identification interchange method for exchanging one form of identification for another";
- o U.S. Patent No. 6,763,336 entitled "Method of transacting an e-mail, an e-commerce, and an e-business transaction by an electronic commerce terminal using a wirelessly networked plurality of portable devices";
- o U.S. Patent No. 6,801,836 entitled "Power-conservation based on indoor/outdoor and ambient-light determinations";
- o U.S. Patent No. 6,807,532 entitled "Method of soliciting a user to input survey data at an electronic commerce terminal";
- o U.S. Patent No. 6,853,894 entitled "Global network based vehicle safety and security telematics";
- o U.S. Patent No. 6,856,820 entitled "An in-vehicle device for wirelessly connecting a vehicle to the internet and for transacting e-commerce and e-business";
- o U.S. Patent No. 6,895,310 entitled "Vehicle related wireless scientific instrumentation telematics";
- o U.S. Patent No. 6,898,942 entitled "Method and apparatus for conserving power consumed by a refrigerated appliance";

- o U.S. Patent No. 6,931,869 entitled "Refrigerated vending machine exploiting expanded temperature variance during power-conservation mode";
- o U.S. Patent No. 6,975,926 entitled "Method and apparatus for power management control of a compressor-based appliance that reduces electrical power consumption on an appliance";
- o U.S. Patent No. 7,003,289 entitled "Communication interface device for managing wireless data transmission between a vehicle and the internet";
- o U.S. Patent No. 7,076,329 entitled "Cashless vending transaction management by a Vend Assist mode of operation";
- o Canadian Patent No. D199-1014 entitled "Sign holder";
- o Canadian Patent No. D199-1038 entitled "Laptop data port enclosure";
- o Canadian Patent No. 2,291,015 entitled "Universal interactive advertising and payment system for public access electronic commerce and business related products and services";
- o Australian Patent No. 2001263356 entitled "Refrigerated vending machine exploiting expanded temperature variance during power-conservation mode"; and
- o Mexican Patent No. 234363 entitled "Refrigerated vending machine exploiting expanded temperature variance during power-conservation mode".

The Company believes that the U.S. patent No. 6,505,095 entitled "System for providing remote audit, cashless payment, and interactive transaction capabilities in a vending machine" is important in protecting its intellectual property used in its e-Port(R) control system targeted to the vending industry. The patent expires in July 2021.

#### **RESEARCH AND DEVELOPMENT**

Research and development expenses, which are included in general and administrative and compensation expense in the Consolidated Statements of Operations, were approximately \$974,000, \$1,364,000, and \$688,000 for the years ended June 30, 2006, 2005 and 2004, respectively, and \$303,000 and \$220,000 for the three months ended September 30, 2006 and 2005, respectively.

#### **EMPLOYEES**

On November 30, 2006, the Company had 57 full-time employees and 2 part-time employees.

## PROPERTY

The Company conducts its operations from various facilities under operating leases. In March 2003, the Company entered into a lease for 12,864 square feet of space located in Malvern, Pennsylvania for its principal executive office and used for general administrative functions, sales activities, and product development. The lease term extends through December 31, 2008 and provides for escalating rent payments and a period of free rent prior to the commencement of the monthly lease payment in January 2004 of approximately \$25,000 per month. During April 2005, the Company entered into an amendment to the lease covering 4,385 additional square feet that is contiguous to its existing space. The lease term was extended to December 31, 2010, and the amendment provides for a period of free rent for the additional space with rent of approximately \$31,000 per month commencing in September 2005 with escalating rental payments thereafter.

The Company also leases 9,084 square feet of space, located in Malvern, Pennsylvania, on a month-to-month basis for a monthly payment of approximately \$8,000. During prior years, the facility was solely used to warehouse product. All product warehousing, shipping and customer support was transferred to this location from the executive office location during the first quarter of fiscal year 2005.

In December 2004, the Company entered into a lease for 2,837 square feet of space located in Denver, Colorado, to be used for administrative functions, sales activities and product warehousing associated with our energy management products. The lease term extends through May 31, 2009 and provides for five months of free rent followed by rent payments of \$1,200 per month and escalating payments beginning on June 1, 2006. The lease provides for additional rent for a prorated share of operating costs for the entire facility.

## MANAGEMENT

### DIRECTORS AND EXECUTIVE OFFICERS

Our Directors and executive officers, on August 31, 2006, together with their ages and business backgrounds were as follows:

Name	Age	Position(s) Held
George R. Jensen, Jr.	57	Chief Executive Officer, Chairman of the Board of Directors
Stephen P. Herbert	43	Chief Operating Officer and President, Director
David M. DeMedio	35	Chief Financial Officer
William L. Van Alen, Jr. (1)(2)	73	Director
Steven Katz (1)(2)	58	Director
Douglas M. Lurio	49	Director
Albert Passner	67	Director
Stephen W. McHugh (2)	50	Director

(1) Member of Compensation Committee

(2) Member of Audit Committee

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 our Chief Executive Officer and a Director since our inception in January 1992. Mr. Jensen 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 \$35 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 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. Mr. Jensen is also a Director of The Noah Fund, a publicly traded mutual fund.

Stephen P. Herbert was elected a Director in April 1996, and joined USA on a full-time basis on May 6, 1996. Prior to joining us 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.

David M. DeMedio joined USA Technologies on a full-time basis in March 1999 as Controller. In the Summer of 2001, Mr. DeMedio was promoted to Director of Financial Services where he was responsible for the sales and financial data reporting to customers, the Company's turnkey banking services and maintaining and developing relationships with credit card processors and card associations. In July 2003, Mr. DeMedio served as interim Chief Financial Officer through April, 2004. From April, 2004 until April 12, 2005, Mr. DeMedio served as Vice President - Financial & Data Services. On April 12, 2005, he was appointed as the Company's Chief Financial Officer. From 1996 to March 1999, prior to joining the Company, Mr. DeMedio had been employed by Elko, Fischer, Cunnane and Associates, LLC as a supervisor in its' accounting and auditing and consulting practice. Prior thereto, Mr. DeMedio held various accounting positions with Intelligent Electronics, Inc., a multi-billion reseller of computer hardware and configuration services. Mr. DeMedio graduated with a Bachelor of Science in Business Administration from Shippensburg University and is a Certified Public Accountant.

William L. Van Alen, Jr., joined the Board of Directors of USA 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.

Steven Katz joined the Board of Directors in May 1999. He 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 PriceWaterhouse & Co. in audit, tax and management advisory services; two years of corporate planning with Revlon, 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. Mr. Katz is also a Director of Health Systems Solutions Inc., Vivid Learning Systems Inc., Nanoscience Technologies Inc. and Biophan Technologies Inc., all publicly traded companies.

Douglas M. Lurio joined the Board of Directors of USA in June 1999. Mr. Lurio is President of Lurio & Associates, P.C., attorneys-at-law, which he founded in 1991. He specializes in the practice of corporate and securities law. Prior thereto, he was a partner with Dilworth, Paxson LLP. Mr. Lurio received 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.

Albert Passner joined the Board of Directors of USA in April 2006. Mr. Passner is a consultant in the fields of physics and engineering. He was a former member of the technical staff at Lucent/AT&T Bell Labs where he participated in many projects including designing systems in electronics, optics, lasers, pulsed magnets, electron-optics, cryogenics and thin films. He has authored and co-authored more than fifty scientific publications.

Stephen W. McHugh joined the Board of Directors of USA in June 2006. Mr. McHugh was appointed by the Board to fill the vacancy on the Board caused by the death of William W. Sellers. Mr. McHugh is the President and co-founder of Santa Barbara Infrared, Inc., a designer and manufacturer of military and commercial Electro-Optical test equipment that was recently acquired by HEICO Corporation. Mr. McHugh formerly was a mechanical engineer and technical sales expert at Electro Optical Industries where he designed optical and mechanical instruments for the test of infrared camera systems.



The following table sets forth certain information with respect to compensation paid or accrued by the Company during the fiscal years ended June 30, 2004, June 30, 2005 and June 30, 2006 to each of the executive officers and employee of the Company named below:

**SUMMARY COMPENSATION TABLE**

Name and Principal Position	Fiscal Year	Annual Compensation			Long Term Compensation	
		Salary	Bonus(1)	Other Annual Compensation (2)	Restricted Stock Awards (\$)	Securities Underlying Options (#)
George R. Jensen, Jr. Chief Executive Officer & Chairman of the Board	2006	\$ 270,288	\$ 200,000	\$ 18,563	\$ 400,000(6)	75,000
	2005	\$ 250,000	—	\$ 17,875	—	—
	2004	\$ 217,500	\$ 4,870,000(3)	\$ 17,875	—	—
Stephen P. Herbert Chief Operating Officer & President	2006	\$ 246,673	\$ 133,336	\$ 18,563	\$ 266,664(6)	18,000
	2005	\$ 231,923	—	\$ 17,875	—	—
	2004	\$ 192,692	\$ 225,000	\$ 17,875	—	—
H. Brock Kolls (5) Senior Vice-President, Research & Development	2006	\$ 171,346	\$ 30,000	\$ 12,375	—	—
	2005	\$ 165,000	\$ 110,000	\$ 11,917	—	—
	2004	\$ 156,923	\$ 60,000	\$ 63,205	—	—
David M. DeMedio (4) Chief Financial Officer	2006	\$ 162,385	—	\$ 20,112	—	7,000
	2005	\$ 131,689	\$ 11,000	\$ 7,800	—	3,000
Wendy Jenkins Vice-President of Marketing	2006	\$ 130,850	\$ 20,000	\$ 16,200	—	—
	2005	\$ 103,653	\$ 26,000	\$ 14,850	—	—
	2004	\$ 65,384	—	\$ 10,500	—	—

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(1) Fiscal year 2006 includes 25,000 shares that vested on June 1, 2006 valued at \$8.00 per share for Mr. Jensen; 16,667 shares that vested on June 1, 2006 valued at \$8.00 per share for Mr. Herbert, a \$30,000 cash bonus for Mr. Kolls, and a \$20,000 cash bonus for Ms. Jenkins. Fiscal year 2005 includes a \$110,000 cash bonus for Mr. Kolls, cash bonuses totaling \$11,000 for Mr. DeMedio, and a \$20,000 cash bonus and \$6,000 stock bonus for Ms. Jenkins. Fiscal year 2004 includes 105,000 shares valued at \$44 per share, in connection with the amendment of his employment agreement, and a \$250,000 cash bonus for Mr. Jensen; a \$225,000 cash bonus for Mr. Herbert; and a \$60,000 cash bonus for Mr. Kolls.

(2) Represents cash payments authorized to reimburse certain executive officers for tax payments incurred from the award of a previous bonus as well as car allowance payments.

(3) Prior to July 2003, Mr. Jensen's employment agreement provided that upon the occurrence of a USA Transaction he would receive that number of shares equal to seven percent of all of the then issued and outstanding shares on a fully converted basis. During July 2003, the Company and Mr. Jensen agreed to amend Mr. Jensen's employment agreement so that upon the occurrence of a USA Transaction he would receive only 140,000 shares. Under the new amended agreement, the 140,000 shares became subject to dilution (i.e., did not increase in order to reflect subsequent issuances by the Company of its shares). Under the prior agreement, the number of shares to be issued to Mr. Jensen was not subject to dilution (i.e., would be increased in order to reflect subsequent issuances by the Company of its shares) and was based upon the actual total number of shares outstanding at the time of a USA Transaction.

For example, if a USA Transaction occurred while there were 4,750,000 shares then outstanding on a fully converted basis, Mr. Jensen would have received 332,500 shares under his prior agreement rather than the fixed number of 140,000 shares under his new amended agreement.

During July 2003, the Company issued to Mr. Jensen an aggregate of 105,000 shares of restricted Common Stock, 25,000 shares of which were issued as compensation to Mr. Jensen, and 80,000 shares of which were issued to Mr. Jensen in connection with the employment agreement amendment described above. In accordance with generally accepted accounting principles, the Company was required to value all of these shares at \$44 per share or an aggregate of \$4,620,000.

(4) Employment as Chief Financial Officer commenced on April 12, 2005.

(5) During May 2006, Mr. Kolls notified the Company that he was resigning as an employee effective as of June 30, 2006, and requested that his employment agreement not be renewed.

(6) Under the terms of Mr. Jensen's existing employment agreement with us, he received an award of 75,000 shares of restricted stock upon his signing of the agreement in May 2006. These shares vest as follows: 25,000 on June 1, 2006; 25,000 on January 1, 2007; and 25,000 on June 1, 2007. As of June 30, 2006, based upon a price per share of \$7.80, the closing bid price for our common stock as of such date, the value of the restricted stock held by Mr. Jensen was \$390,000. This stock will be treated like all other shares of our stock, including the right to receive any dividends declared on our common stock. The 25,000 shares that vested on June 1, 2006 are reflected in the Bonus column of the above table.

Under the terms of Mr. Herbert's existing employment agreement with us, he received an award of 50,000 shares of restricted stock upon his signing of the agreement in May 2006. These shares vest as follows: 16,667 on June 1, 2006; 16,667 on January 1, 2007; and 16,666 on June 1, 2007. As of June 30, 2006, based upon a price per share of \$7.80, the closing bid price for our common stock as of such date, the value of the restricted stock held by Mr. Herbert was \$259,997. This stock will be treated like all other shares of our stock, including the right to receive any dividends declared on our common stock. The 16,667 shares that vested on June 1, 2006 are reflected in the Bonus column of the above table.

**OPTION GRANTS IN LAST FISCAL YEAR  
(Individual Grants)**

Name	Number of securities underlying options granted(1)	Percent of total options granted to employees in fiscal year	Exercise base price (\$/share)	Expiration date
George R. Jensen, Jr.	75,000	75%	\$7.50	(2)
Stephen P. Herbert	18,000	18%	\$7.50	(2)
David M. DeMedio	7,000	7%	\$7.50	(2)

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(1) Conditioned upon continued employment, the options vest as follows: one-third on May 11, 2006, one-third on June 30, 2007, and one-third on June 30, 2008.

(2) The options expire five years from the date of vesting.

**TOTAL OPTIONS EXERCISED IN FISCAL YEAR ENDED JUNE 30, 2006 AND YEAR END VALUES**

The following table gives information for options exercised by an executive officer and an employee in fiscal year 2006, and the number of options held by the executive officer and the employee at fiscal year end:

Name	Shares Acquired		Number of Securities Underlying Unexercised Options at FY-End (#)Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options at FY-End (\$ )Exercisable/ Unexercisable
	On Exercise (#)	Value Realized (\$)		
George R. Jensen, Jr.	0	0	25,000/50,000	7,500/15,000
Stephen P. Herbert	0	0	6,000/12,000	1,800/3,600
David M. DeMedio	0	0	3,834/6,166	700/1,400

## EXECUTIVE EMPLOYMENT AGREEMENTS

On May 11, 2006, the Company and Mr. Jensen entered into an Amended and Restated Employment Agreement pursuant to which the term of Mr. Jensen's employment with the Company was extended to June 30, 2009. Effective May 11, 2006, Mr. Jensen's base salary was increased to \$325,000 per annum. 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. Mr. Jensen was granted the right (exercisable at any time prior to the 60th day following the commencement of each fiscal year) to elect to have one-half of his base salary for each of the fiscal years ending June 30, 2007, June 30, 2008, and June 30, 2009 paid in shares of Common Stock rather than cash. Mr. Jensen has elected to receive shares in lieu of cash for one-half of his base salary for the fiscal year ending June 30, 2007. As a result of such election, 22,080 shares will be issued to him which will vest as follows: 5,520 on July 1, 2006; 5,520 on October 1, 2006; 5,520 on January 1, 2007; and 5,520 on April 1, 2007. Mr. Jensen was also granted 75,000 shares of Common Stock and an additional amount of options to purchase up to 75,000 shares of Common Stock at \$7.50 per share. The 75,000 shares of Common Stock vest as follows: 25,000 on June 1, 2006; 25,000 on January 1, 2007; and 25,000 on June 1, 2007. The options vest as follows: 25,000 on May 11, 2006; 25,000 on June 30, 2007; and 25,000 on June 30, 2008. The options may be exercised at any time within 5 years of vesting. All of the shares granted to or to be issued to Mr. Jensen under his employment agreement, and the shares underlying the options granted to Mr. Jensen, are not and will not be registered under the Securities Act of 1933, as amended, and constitute restricted securities as such term is defined in Rule 144 promulgated under the 1933 Act. In October 2006, the Company granted to Mr. Jensen piggyback registration rights under the Act for the shares described above for a period of five years following the vesting of any of such shares and for the shares underlying any of the options described above for a period of five years following the vesting of any such options.

As previously provided in his employment agreement, upon the occurrence of a "USA Transaction" (as defined below), the Company will issue to Mr. Jensen 140,000 shares of Common Stock subject to adjustment for stock splits or combinations ("Jensen Shares"). The Jensen Shares are not reflected or included in the number of issued and outstanding shares of the Company on a fully diluted basis in this prospectus. Mr. Jensen is not required to pay any additional consideration for the Jensen Shares. At the time of any USA Transaction, all of the Jensen Shares 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 Jensen Shares are irrevocable and fully vested, have no expiration date, and will not be

affected by the termination of Mr. Jensen's employment with the Company for any reason whatsoever.

On May 11, 2006, the Company and Mr. Herbert entered into an Amended and Restated Employment Agreement pursuant to which the term of Mr. Herbert's employment with the Company was extended to June 30, 2009. Effective May 11, 2006, Mr. Herbert's base salary was increased to \$285,000 per annum. 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. In the event that a USA Transaction (as defined in Mr. Jensen's employment agreement) shall occur, then Mr. Herbert has the right to terminate his agreement upon 30 days notice to USA. Mr. Herbert was granted the right to elect to have one-half of his base salary for each of the fiscal years ending June 30, 2007, June 30, 2008, and June 30, 2009 paid in shares of Common Stock rather than cash. Mr. Herbert was also granted 50,000 shares of Common Stock and an additional amount of options to purchase up to 18,000 shares of Common Stock at \$7.50 per share. The 50,000 shares of Common Stock vest as follows: 16,667 on June 1, 2006; 16,667 on January 1, 2007; and 16,666 on June 1, 2007. The options vest as follows: 6,000 on May 11, 2006; 6,000 on June 30, 2007; and 6,000 on June 30, 2008. The options may be exercised at any time within 5 years of vesting. All of the shares granted to or to be issued to Mr. Herbert under his employment agreement, and the shares underlying the options granted to Mr. Herbert, are not and will not be registered under the Securities Act of 1933, as amended, and constitute restricted securities as such term is defined in Rule 144 promulgated under the 1933 Act. In October 2006, the Company granted to Mr. Herbert piggyback registration rights under the Act for the shares described above for a period of five years following the vesting of any of such shares and for the shares underlying any of the options described above for a period of five years following the vesting of any such options.

On May 11, 2006, the Company and Mr. DeMedio entered into an amendment to his Employment Agreement pursuant to which the term of Mr. DeMedio's employment with the Company was extended to June 30, 2008. Effective May 11, 2006, Mr. DeMedio's base salary was increased to \$165,000 per annum. Mr. DeMedio was granted the right to elect to have one-half of his base salary for each of the fiscal years ending June 30, 2007, and June 30, 2008 paid in shares of Common Stock rather than cash. Mr. DeMedio was also granted options to purchase up to 7,000 shares of Common Stock at \$7.50 per share. The options vest as follows: 2,334 on May 11, 2006; 2,333 on June 30, 2007; and 2,333 on June 30, 2008. The options may be exercised at any time within 5 years of vesting. All of the shares underlying the options granted to Mr. DeMedio under his employment agreement are not and will not be registered under the Securities Act of 1933, as amended, and constitute restricted securities as such term is defined in Rule 144 promulgated under the 1933 Act. In October 2006, the Company granted to Mr. DeMedio piggyback registration rights under the Act for the shares underlying any of the options described above for a period of five years following the vesting of any such options.

Mr. Kolls entered into an employment agreement with the Company that required Mr. Kolls or the Company to deliver written notice of termination at least sixty days prior to June 30, 2006, or the agreement would be automatically renewed until June 30, 2007. During May 2006, Mr. Kolls notified the Company that he was resigning as an employee effective as of June 30, 2006, and requested that his employment agreement not be renewed for another year. The Company does not believe that Mr. Kolls' resignation was timely. The agreement provided for an annual base salary of \$165,000 per year. Mr. Kolls was entitled to a payment of \$5,000 upon each of the following: (i) filing of a new patent application by USA for which he is listed as the inventor; (ii) granting of any such patent application; and (iii) issuance of a patent for any patent application that had been filed prior to April 20, 2004. Mr. Kolls is also entitled to receive such bonus or bonuses, as may be awarded to him by the Board of Directors. The Agreement required Mr. Kolls to devote his full time and attention to the business and affairs of the Company, and obligated him not to engage in any investments or activities which would compete with the Company during the term of his agreement and for a period of one year thereafter. In the event that a USA Transaction (as defined in Mr. Jensen's employment agreement) occurred, then Mr. Kolls had the right to terminate his agreement upon 30 days notice to USA.

#### **COMPENSATION OF DIRECTORS**

Members of the Board of Directors receive cash and equity compensation for serving on the Board of Directors, as determined from time to time by the Compensation Committee with subsequent approval thereof by the Board of Directors.

During fiscal year 2006, we paid each of Messrs. Sellers, Van Alen, Katz and Lurio \$20,000 each for serving as a Director during the fiscal year and \$10,000 each for serving on Board Committees.

On April 21, 2006, we granted options to purchase up to 12,000 shares to each of Messrs. Sellers, Van Alen, Katz, and Lurio, and options to purchase up to 6,000 shares to Mr. Passner, a new director as of April 12, 2006. These options have an exercise price of \$7.50 per share and are exercisable at any time within five years following the date of vesting. The options granted to Mr. Sellers and Mr. Van Allen are fully vested. Of the options granted to Mr. Katz and Mr. Lurio, 6,000 vest immediately, 3,000 vest on April 1, 2007, and 3,000 vest on April 1, 2008. Of the options granted to Mr. Passner, 3,000 vest on April 1, 2007, and 3,000 vest on April 1, 2008.

In conjunction with the appointment of Stephen McHugh to the Board of Directors on June 20, 2006, the Company granted Mr. McHugh options to purchase up to 6,000 shares with an exercise price of \$8.00 per share. The options vest as follows: 3,000 on June 20, 2007 and 3,000 on June 20, 2008. The options are exercisable at any time within five years of vesting.

In October 2006, the Company granted to each of the holders of the above options piggyback registration rights under the Act for the shares underlying each of the options described above for a period of five years following the vesting of any such options.

**PRINCIPAL SHAREHOLDERS**

**COMMON STOCK**

The following table sets forth, as of June 30, 2006, the beneficial ownership of the Common Stock of each of the Company's directors and executive officers, the other employees named in the summary compensation table set forth above, 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, subject to community property laws where applicable:

Name and Address of Beneficial Owner	Number of Shares of Common Stock Beneficially Owned(1)	Percent of Class(2)
George R. Jensen, Jr. 100 Deerfield Lane, Suite 140 Malvern, Pennsylvania 19355	132,210(3)	1.81 %
Stephen P. Herbert 100 Deerfield Lane, Suite 140 Malvern, Pennsylvania 19355	46,527(4)	*
Haven Brock Kolls, Jr. 100 Deerfield Lane, Suite 140 Malvern, Pennsylvania 19355	5,537(5)	*
David M. DeMedio 100 Deerfield Lane, Suite 140 Malvern, Pennsylvania 19355	7,535(8)	*
Douglas M. Lurio 2005 Market Street, Suite 2340 Philadelphia, Pennsylvania 19103	15,280(7)	*
Steven Katz 440 South Main Street Milltown, New Jersey 08850	12,350(6)	*
William L. Van Alen, Jr. P.O. Box 727 Edgemont, Pennsylvania 19028	63,023(9)	*
Albert Passner 3 Disbrow Ct East Brunswick, New Jersey 08816	0	*

Stephen W. McHugh	0	*
100 Deerfield Lane, Suite 140 Malvern, Pennsylvania 19355		
Wendy Jenkins	2,819(10)	*
100 Deerfield Lane, Suite 140 Malvern, Pennsylvania 19355		
Wellington Management Company, LLP	710,000(11)	9.71 %
75 State Street Boston, Massachusetts 02109		
All Directors and Executive Officers As a Group (9 persons)	285,281	3.90 %

\*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, shares issuable upon the conversion of Convertible Senior Notes, or shares of Common Stock issuable upon exercise of warrants and options currently exercisable, or exercisable within 60 days of June 30, 2006, are deemed to be beneficially owned for purposes hereof.

(2) On June 30, 2006 there were 6,327,175 shares of Common Stock and 521,542 shares of Preferred Stock issued and outstanding. For purposes of computing the percentages under this table, it is assumed that all shares of issued and outstanding Preferred Stock have been converted into 5,215 shares of Common Stock, and that all of the options to acquire Common Stock which have been issued and are fully vested as of June 30, 2006 (or within 60-days of June 30, 2006) have been converted into 87,142 shares of Common Stock. For purposes of computing such percentages it has also been assumed that all of the remaining Common Stock Warrants have been exercised for 219,481 shares of Common Stock; that all of the Senior Notes have been converted into 669,635 shares of Common Stock; and that all of the accrued and unpaid dividends on the Preferred Stock as of June 30, 2006 have been converted into 8,226 shares of Common Stock. Therefore, 7,316,874 shares of Common Stock were treated as issued and outstanding for purposes of computing the percentages under this table. Does not reflect or include the shares issuable to Mr. Jensen upon a "USA Transaction".

(3) Includes 2,000 shares of Common Stock beneficially owned by his spouse. Does not include the right granted to Mr. Jensen under his Employment Agreement to receive Common Stock upon the occurrence of a USA Transaction (as defined therein). See "Executive Employment Agreements". Includes 60,000 shares owned by George R. Jensen, Jr. Grantor Retained Unitrust dated July 14, 2003 over which Mr. Jensen retains beneficial ownership. Includes 25,000 shares underlying vested stock options.

(4) Includes 10 shares of Common Stock beneficially owned by his child and 4,000 shares of Common Stock beneficially owned by his spouse. Includes 6,000 shares underlying vested stock options.



(5) Includes 120 shares of Common Stock owned by Mr. Kolls' spouse and 1,500 shares issuable to his spouse upon conversion of her Senior Note.

(6) Includes 6,000 shares underlying vested stock options.

(7) Includes 2,250 shares issuable upon conversion of Senior Notes. Includes 6,000 shares underlying vested stock options.

(8) Includes 565 shares of Common Stock issuable to Mr. DeMedio upon conversion of his Senior Notes, 3,834 shares underlying vested stock options and 375 shares underlying stock options that vest within 60 days of June 30, 2006.

(9) Includes 17,339 shares of Common Stock issuable to Mr. Van Alen upon conversion of his Senior Notes, 5,333 shares issuable upon the exercise of warrants and 100 shares of Common Stock beneficially owned by his spouse. Includes 12,000 shares underlying vested stock options.

(10) Includes 790 shares underlying vested stock options.

(11) Wellington Management Company, LLP ("Wellington Management"), in its capacity as an investment adviser, may be deemed to have beneficial ownership of 710,000 shares of common stock that are owned by numerous investment advisory clients, none of which is known to have such interest with respect to more than five percent of the class of shares. Wellington Management has shared voting authority over 456,000 shares and shared dispositive power over 710,000 shares. Wellington Management is a registered investment adviser under the Investment Advisers Act of 1940, as amended.

#### **PREFERRED STOCK**

There were no shares of Preferred Stock that were beneficially owned by the Company's directors, executive officers, or the other employee named in the Summary Compensation Table set forth above.

#### **CERTAIN TRANSACTIONS**

During the fiscal year ended June 30, 2006 and the three months ended September 30, 2006, the Company incurred charges to Lurio & Associates, P.C., of which Mr. Lurio is President and a shareholder, for professional fees of approximately \$258,000 and \$118,000, respectively, for legal services rendered to the Company by such law firm. Mr. Lurio is a Director of the Company. As of June 30 and September 30, 2006, the Company had accrued approximately \$28,000 and \$35,000, respectively, for these services.

During fiscal year 2006, William Van Alen, Jr., a Director, invested \$33,333 in the 2008-C Senior Note offering and received warrants to purchase 3,333 shares of Common Stock at \$10 per share, pursuant to his investment in this offering. Mr. Van Alen also invested \$20,000 in the 2010-B Senior Note offering and received warrants to purchase 2,000 shares of Common Stock at \$10 per share, pursuant to his investment in this offering.

## SELLING SHAREHOLDERS

Each of the selling shareholders listed below is, as of the date hereof, the holder of our common stock or has the right to acquire the number of shares of common stock set forth opposite such selling shareholder's name. The issuance of the common stock to each of the selling shareholders was or will be a transaction exempt from the registration requirements of the Act and various state securities laws.

We have agreed, at our expense, to register all of the common stock for resale by the selling shareholders under the Act. We expect to incur expenses of approximately \$35,000 in connection with the registration statement of which this prospectus is a part.

The number of shares that may be actually sold by a selling shareholder will be determined by the selling shareholder. The selling shareholders are under no obligation to sell all or any portion of the shares offered, nor are the selling shareholders obligated to sell such shares immediately under this prospectus. Particular selling shareholders may not have a preset intention of selling their shares and may offer less than the number of shares indicated. Because the selling shareholder may sell all, some or none of the shares of common stock that the selling shareholder holds, no estimate can be given as to the number of shares of our common stock that will be held by the selling shareholder upon termination of the offering. Shares of common stock may be sold from time to time by the selling shareholders or by pledgees, donees, transferees or other successors in interest.

The following table sets forth information with respect to each selling shareholder and the 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 us, except as noted below.

**SELLING SHAREHOLDERS' TABLE**

Selling Shareholder	Common Stock Offered Hereby	Beneficial Ownership		
		Before Offering Number	After Offering Number	Percent
Milwaukee Jewish Federation of Milwaukee County (1)	10,080	10,080	0	*
STRATTEC Security Corporation Retirement Plan (1)	5,328	5,328	0	*
Frautschi Small Cap Growth (1)	33,336	33,336	0	*
Springfield Police & Fire Pension System (1)	20,195	20,195	0	*
Manitowoc Company Pension Plan (1)	7,505	7,505	0	*
Paul M. Posner (1)	7,529	7,529	0	*
Lyndhurst Associates (1)	12,747	12,747	0	*
Henry Posner III (1)	6,659	6,659	0	*
Posner Partners (1)	8,045	8,045	0	*
Eva Renee Posner GST Exempt Trust (1)	498	498	0	*
Eva Renee Posner Non Exempt Trust (1)	3,111	3,111	0	*
Matthew Martin Posner GST Exempt Trust (1)	500	500	0	*
Matthew Martin Posner Non Exempt Trust (1)	3,107	3,107	0	*
W. Jerome Frautschi Revocable Trust (1)	5,748	5,748	0	*
James J. Bakke 1987 Trust (1)	1,961	1,961	0	*
Bader and Co. No. S (1)	8,628	8,628	0	*
Bader and Co. No. E (1)	11,417	11,417	0	*
Daniel Bader 1992 Investment Trust (1)	1,970	1,970	0	*
MFP III (1)	10,005	10,005	0	*
Klitsner & Co. No. B (1)	2,250	2,250	0	*
Jewish Home and Care Center Foundation, Inc.(1)	3,368	3,368	0	*
Pleasant T. Rowland Revocable Trust (1)	6,234	6,234	0	*
PTR Foundation (1)	4,023	4,023	0	*
University of California Regents-Growth (1)	98,231	98,231	0	*
BBRN Investments (1)	1,883	1,883	0	*
Rosenblum Family LP (1)	809	809	0	*
Racine Community Foundation (1)	2,094	2,094	0	*
Pritzker Family Foundation (1)	2,241	2,241	0	*
Anthony Pritzker Family Foundation (1)	2,222	2,222	0	*
Stockbridge 1, LLC (1)	46,568	46,568	0	*
David Bader 1992 Investment Trust (1)	1,877	1,877	0	*
David Bader CRUT (1)	806	806	0	*
The Wasie Foundation (1)	3,299	3,299	0	*
Dr. Lewis and Patricia Chamoy (1)	1,847	1,847	0	*
Don Davis (1)	2,346	2,346	0	*
Rock-Tenn Company (1)	16,466	16,466	0	*
FST Small/Mid Cap Growth Series I (1)	2,205	2,205	0	*
FST Small/Mid Cap Growth Series II (1)	3,441	3,441	0	*
Chris White (1)	1,701	1,701	0	*
Des Moines University (1)	8,528	8,528	0	*
Telex (1)	2,228	2,228	0	*

The Belk Foundation (1)	3,627	3,627	0	*
Christopher L. Doerr (1)	1,815	1,815	0	*
West Central Initiative (1)	2,520	2,520	0	*
Charlotte C. Weber 1968 Trust (1)	1,091	1,091	0	*
Florida State Board of Administration (1)	228,423	228,423	0	*
Genesee County (1)	28,055	28,055	0	*
Lindquist & Vennum (1)	4,260	4,260	0	*
California State Automobile Association (1)	49,161	49,161	0	*
Katherine & David Bradley (1)	2,181	2,181	0	*
HCA The Healthcare Company (1)	80,153	80,153	0	*
Daniel Bader & Co. No. L (1)	2,145	2,145	0	*
West Bend Mutual (1)	13,955	13,955	0	*
Children's Hospital of New Orleans (1)	49,476	49,476	0	*
Marion Bradley Glass Trust (1)	5,658	5,658	0	*
Marion Bradley Glass Via Partition Trust (1)	7,322	7,322	0	*
Schwab 1994 CRUT (1)	7,605	7,605	0	*
Catholic Health Initiatives-Master Trust (1)	110,343	110,343	0	*
CHI Operating Investment Program (1)	182,385	182,385	0	*
CHI-First Initiatives Insurance, Ltd. (1)	16,719	16,719	0	*
United Brotherhood of Carpenters Pension Fund (1)	37,752	37,752	0	*
Medtronic Inc. & Participating Employees Master Trust (1)	48,851	48,851	0	*
MidAmerican Energy Company (1)	49,124	49,124	0	*
Quad Graphics (1)	9,221	9,221	0	*
City of Tampa (1)	26,321	26,321	0	*
CSAA Corporate Pension (1)	48,500	48,500	0	*
IAMAW (1)	76,098	76,098	0	*
University of Dayton (1)	32,706	32,706	0	*
Lake Beulah Holdings LLC (1)	1,514	1,514	0	*
SF Capital Partners Ltd. (2)	225,000	225,000	0	*
Public Sector Pension Investment Board (3)	37,500	111,500	74,000	*
New York Nurses Association Pension Plan (3)	22,500	22,500	0	*
The Government of Singapore Investment Corporation Pte Ltd (3)	165,000	185,000	20,000	*
Harbour Holdings Ltd. (4)	52,800	52,800	0	*
Skylands Special Investment LLC (4)	25,500	25,500	0	*
Skylands Quest LLC (4)	8,100	8,100	0	*
Skylands Special Investment II LLC (4)	3,600	3,600	0	*
United Capital Management, Inc. (5)	60,000	60,000	0	*
William Blair & Co., LLC (6)	11,454	11,454	0	*
George R. Jensen, Jr.(7)	30,520	234,290	203,770	2.24%
Stephen P. Herbert(8)	16,667	91,860	75,193	*
William Recktenwald (9)	4,000	4,000	0	*
Crestview Capital Master LLC (9)(10)	33,333	33,333	0	*
Michael J. O'Brien, Sr. (9)	3,000	3,000	0	*
Thomas A. Katcher (9)	1,800	1,800	0	*
William L. Van Alen, Jr. (9)(11)	5,333	68,022	62,689	*
Robert Allen Pett (9)	9,028	9,028	0	*
The Nutmeg Group LLC (9)(12)	20,000	20,000	0	*
Daniel E. and JoAnn G. Spealman (9)	10,000	10,000	0	*

Fusion Capital Fund II LLC (9)(13)	20,000	20,000	0	*
Nite Capital LP (9)(14)	20,000	20,000	0	*
Deborah L. and Robert F. Jones (9)	3,000	3,000	0	*
Martin Lipper (9)	1,000	1,000	0	*
Lawrence Berk (9)	1,000	1,000	0	*
TOTAL	<u>2,290,152</u>			

\* Less than 1%.

- (1) Represents shares purchased at \$6.00 per share and shares underlying warrants exercisable at \$6.40 per share issued to the selling shareholder as part of our December 2006 private placement offering.

Each of these selling shareholders is a client of Cortina Asset Management LLC, an investment advisor registered under the Investment Advisors Act of 1940, as amended. Cortina, in such capacity, holds voting and/or dispositive power over the shares held by the selling shareholder and, therefore, is deemed to share beneficial ownership over those shares. The natural person who exercises sole and/or shared voting or dispositive powers with respect to the shares beneficially owned by Cortina Asset Management LLC is Joseph A. Frohwa.

- (2) Represents shares purchased at \$6.00 per share and shares underlying warrants exercisable at \$6.40 per share issued to the selling shareholder as part of our December 2006 private placement offering.

The natural person who exercises sole and/or shared voting or dispositive powers with respect to the shares and/or warrants held of record by the entity is Brian H. Davidson.

- (3) Represents shares purchased at \$6.00 per share and shares underlying warrants exercisable at \$6.40 per share issued to the selling shareholder as part of our December 2006 private placement offering.

Each of these selling shareholders is a client of Wellington Management Company, LLP, an investment advisor registered under the Investment Advisors Act of 1940, as amended. Wellington, in such capacity, holds voting and/or dispositive power over the shares held by the selling shareholder and, therefore, is deemed to share beneficial ownership over those shares.

Simultaneously with this offering, and in addition to the shares offered by this prospectus, Public Sector Pension Investment Board is concurrently offering for resale up to 74,000 shares and The Government of Singapore Corporation Pte Ltd. is concurrently offering for resale up to 20,000 shares through an additional prospectus dated December 6, 2006.

- (4) Represents shares purchased at \$6.00 per share and shares underlying warrants exercisable at \$6.40 per share issued to the selling shareholder as part of our December 2006 private placement offering.

The natural person who exercises sole and/or shared voting or dispositive powers with respect to the shares and/or warrants held of record by the entity is Pamela A. Cavanaugh.

- (5) Represents shares purchased at \$6.00 per share and shares underlying warrants exercisable at \$6.40 per share issued to the selling shareholder as part of our December 2006 private placement offering.

The natural person who exercises sole and/or shared voting or dispositive powers with respect to the shares and/or warrants held of record by the entity is James A. Lustig.

- (6) Represents shares underlying warrants that were received by the selling shareholder as compensation for acting as the exclusive placement agent in connection with our December 2006 private placement offering. The natural person who exercises sole and/or shared voting or dispositive powers with respect to the shares and/or warrants held of record by the entity is Rob Metzger. The selling shareholder, William Blair & Co., LLC, is a registered broker-dealer under the Securities Exchange Act of 1934.

- (7) Represents shares issued to him under his employment agreement. Mr. Jensen is our Chairman and Chief Executive Officer. Simultaneously with this offering, and in addition to the shares offered by this prospectus, Mr. Jensen is concurrently offering for resale up to 36,040 shares through an additional prospectus dated December 6, 2006.
- (8) Represents shares issued to him under his employment agreement. Mr. Herbert is our President and Chief Operating Officer. Simultaneously with this offering, and in addition to the shares offered by this prospectus, Mr. Herbert is concurrently offering for resale up to 16,667 shares through an additional prospectus dated December 6, 2006.
- (9) Represents shares underlying warrants exercisable at any time prior to December 31, 2008 at \$20 per share that were issued to the selling shareholders in January 2006.
- (10) The natural person who exercises sole and/or shared voting or dispositive powers with respect to the shares held of record by the entity is Stewart R. Flink.
- (11) Mr. Van Alen is a Director of the Company.
- (12) The natural person who exercises sole and/or shared voting or dispositive powers with respect to the shares held of record by the entity is Randall Goulding.
- (13) The natural person who exercises sole and/or shared voting or dispositive powers with respect to the shares held of record by the entity is Joshua B. Schienfeld.
- (14) The natural person who exercises sole and/or shared voting or dispositive powers with respect to the shares held of record by the entity is Keith Goodman.

**MARKET FOR COMMON STOCK**

The Common Stock of the Company is currently traded on the OTC Electronic Bulletin Board under the symbol USAT.

The high and low bid prices on the OTC Electronic Bulletin Board for the Common Stock were as follows. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

Year ended June 30, 2007	High	Low
First Quarter (through September 30, 2006 )	\$ 6.30	\$ 6.00

Year ended June 30, 2006		
First Quarter (through September 30, 2005 )	\$ 16.80	\$ 12.00
Second Quarter (through December 31, 2005 )	\$ 13.10	\$ 8.50
Third Quarter (through March 31, 2006 )	\$ 14.00	\$ 10.10
Fourth Quarter (through June 30, 2006 )	\$ 8.95	\$ 6.50

Year ended June 30, 2005		
First Quarter (through September 30, 2004 )	\$ 18.10	\$ 11.70
Second Quarter (through December 31, 2004 )	\$ 16.40	\$ 9.50
Third Quarter (through March 31, 2005 )	\$ 28.00	\$ 10.80
Fourth Quarter (through June 30, 2005 )	\$ 20.00	\$ 13.30

On August 31, 2006 there were 1,293 record holders of the Common Stock and 506 record holders of the 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 Common Stock or Preferred Stock. No dividend may be paid on the Common Stock until all accumulated and unpaid dividends on the Preferred Stock have been paid. As of September 30, 2006, such accumulated unpaid dividends amounted to \$8,602,418.

As of September 30, 2006, equity securities authorized for issuance by the Company with respect to compensation plans were as follows:

Plan category	Number of securities to be issued upon exercises of outstanding options and warrants	Weighted average exercise price of outstanding options and warrants	Number of securities remaining available for future issuance
Equity compensation plans approved by security holders	None	Not applicable	None
Equity compensation plans not approved by security holders	178,558(a)	\$8.64	155,087(b)

a) Represents stock options outstanding as of September 30, 2006 for the purchase of shares of Common Stock of the Company expiring at various times from July 2006 through June 2013. Of such options, 163,900 were granted to employees and directors of the Company and 14,658 to former option holders of Stitch Networks Corporation. Exercise prices for all the options outstanding were at prices that were either equal to or greater than the market price of the Company's Common Stock on the dates the options were granted.

b) Represents 140,000 shares of Common Stock issuable to the Company's Chief Executive Officer under the terms of his employment agreement plus 15,087 shares of Common Stock issuable under the Company's 2006-A Stock Compensation Plan.

In July 2003 the Company and the Company's Chief Executive Officer (CEO) amended the terms of his employment agreement. Under the terms of the previous Executive Employment Agreement, the CEO would have been granted seven percent (non-dilutive) of all the then issued and outstanding shares of the Company's Common Stock in the event a "USA Transaction" (as defined) occurs, which among other events includes a change in control of the Company. The amended terms of the Executive Employment Agreement, eliminated the seven percent (non-dilutive) right to receive Common Stock upon a "USA Transaction", and granted the CEO an aggregate of 140,000 shares of Common Stock in the event a "USA Transaction" occurs. In exchange for the amendment of these terms, the Company issued an aggregate of 105,000 shares of its Common Stock to the CEO. In connection with this amendment, the CEO also entered into a lock-up agreement pursuant to which he shall not sell 25,000 of these shares for a one-year period and 80,000 of these shares for a two-year period. The CEO will not be required to pay any additional consideration for these shares of Common Stock. At the time of a "USA Transaction", all of the 140,000 shares to be issued to the CEO in connection with this amendment are automatically deemed to be issued and outstanding, and will be entitled to be treated as any other issued and outstanding shares of Common Stock. The right to receive the shares is irrevocable and fully vested, and the rights have no expiration date and will not be affected by the termination of the CEO's employment with the Company for any reason whatsoever. The shares issuable to Mr. Jensen are not reflected or included in the number of issued and outstanding shares of the Company on a fully diluted basis in this prospectus.

The Company's Board of Directors established and authorized the 2006-A Stock Compensation Plan in June 2006 for use in compensating employees, directors and consultants through the issuance of shares of Common Stock of the Company. There were 25,000 shares authorized under the Plan. The underlying shares for the Plan have been registered with the Securities and Exchange Commission as an employee benefit plan under Form S-8. As of September 30, 2006 there were 15,087 shares available for future issuance under the Plan.

As of September 30, 2006, shares of Common Stock reserved for future issuance were as follows:

- § 178,558 shares issuable upon the exercise of stock options at exercise prices ranging from \$7.50 to \$100 per share
- § 202,923 shares issuable upon the exercise of common stock warrants at exercise prices ranging from \$7 to \$20 per share



- § 13,806 shares issuable upon the conversion of outstanding Preferred Stock and cumulative Preferred Stock dividends
- § 659,007 shares issuable upon the conversion of Senior Notes having an aggregate face value of \$9,783,211
- § 429,753 shares issuable to Steve Illes under the 2006 Common Stock Agreement
- § 15,087 shares issuable the 2006-A Stock Compensation Plan; and
- § 140,000 shares issuable to Mr. Jensen under his employment agreement upon the occurrence of a USA Transaction

#### **PLAN OF DISTRIBUTION**

The selling shareholders are free to offer and sell the common shares at such times, in such manner and at such prices as the selling shareholders may determine. The types of transactions in which the common shares are sold may include transactions in the over-the-counter market (including block transactions), negotiated transactions, the settlement of short sales of common shares, or a combination of such methods of sale. The sales will be at market prices prevailing at the time of sale or at negotiated prices. Such transactions may or may not involve brokers or dealers.

The selling shareholders may effect such transactions by selling common stock directly to purchasers or through broker-dealers, who may act as agents or principals. Such broker-dealers may receive compensation in the form of discounts, concessions, or commissions from the selling shareholders. They may also receive compensation from the purchasers of common shares for whom such broker-dealers may act as agents or to whom they sell as principal, or both (which compensation as to a particular broker-dealer might be in excess of customary commissions).

The selling shareholders and any broker-dealers or agents that are involved in selling the shares may be deemed to be "underwriters" within the meaning of the Act in connection with such sales. In such event, any commissions received by such broker-dealers and profit on the resale of the shares purchased by them may be deemed to be underwriting discounts under the Act.

The selling shareholders also may resell all or a portion of the common shares in open market transactions in reliance upon Rule 144 under the Act, provided they meet the criteria and conform to the requirements of such Rule. We have 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. In some circumstances, we have agreed to indemnify the selling shareholders against certain losses and liabilities, including liabilities under the Act.

We have advised the selling shareholders that while they are engaged in a distribution of the shares included in this prospectus they are required to comply with Regulation M promulgated under the Securities Exchange Act of 1934, as amended. With certain exceptions, Regulation M precludes the selling shareholders, any affiliated purchasers, and any broker-dealer or other person who participates in such distribution from bidding for or purchasing, or attempting to induce any person to bid for or purchase any security which is the subject of the distribution until the entire distribution is complete.

## DESCRIPTION OF SECURITIES

### GENERAL

We are authorized to issue up to 640,000,000 shares of common stock, no par value, and 1,800,000 shares of undesignated preferred stock. As of the date hereof, 900,000 preferred shares have been designated as series A convertible preferred stock, no par value. As of September 30, 2006, there were 6,614,569 shares of common stock issued and outstanding and 520,392 shares of series A preferred stock issued and outstanding which are convertible into 5,203 shares of common stock. Through September 30, 2006, a total of 590,758 shares of preferred stock have been converted into 6,671 shares of Common Stock and \$2,718,764 of accrued and unpaid dividends thereon have been converted into 2,919 shares of Common Stock.

### 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 USA, including the election of directors. There is no cumulative voting for directors;
- § does not have any preemptive rights to subscribe for or purchase shares, obligations, warrants, or other securities of USA; and
- § is 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 series A preferred stock have been paid. Upon any liquidation, dissolution or winding up of USA, holders of shares of common stock are entitled to receive pro rata all of the assets of USA available for distribution, subject to the liquidation preference of the series A preferred stock of \$10 per share and any unpaid and accumulated dividends on the series A preferred stock.

### 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., 100 shares of series A preferred stock equals 1 vote);

§ are entitled to vote on all matters submitted to the vote of the shareholders of USA, including the election of directors; and

§ 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 (\$0.75) and August 1 (\$0.75) 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 September 30, 2006, such accumulated unpaid dividends amounted to \$8,602,418.

Each share of Series A Preferred Stock is convertible at any time into 1/100<sup>th</sup> of a 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 \$1,000 per share of Common Stock at the time of conversion and whether or not such dividends have then been declared by USA. As of September 30, 2006 a total of 590,758 shares of series A Preferred Stock have been converted into common stock and accrued and unpaid dividends thereon have been converted into 2,919 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 USA. Upon any liquidation, dissolution, or winding-up of USA, the holders of Series A Preferred Stock are entitled to receive a distribution in preference to the Common Stock in the amount of \$10 per share plus any accumulated and unpaid dividends.

We have 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 per share plus any and all unpaid and accumulated dividends thereon. Upon notice by USA of such call, the holders of the series A preferred stock so called will have the opportunity to convert their shares and any unpaid and accumulated dividends thereon into shares of common stock. The \$11 per share figure was the redemption price approved by the Directors and shareholders of USA at the time the series A preferred stock was created and first issued. We currently have no plans to redeem the preferred stock.

#### **SENIOR NOTES**

As of September 30, 2006, we had \$983,326 of unsecured senior notes due on June 30, 2007, \$2,962,516 of unsecured senior notes due on December 31, 2007, \$2,085,369 of unsecured senior notes due on December 31, 2008, \$1,520,000 of unsecured senior notes due one December 31, 2009, and \$1,912,000 of unsecured senior notes due on December 31, 2010. The principal amount of each senior note which is not voluntarily converted shall be payable on the maturity date thereof, 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 maturity, with the exception of the Senior Notes due June 30, 2007 and December 31, 2010 and \$181,611 of the December 31, 2008 notes, which accrue interest at the rate of 10% per annum. The senior notes are senior to all existing equity securities of USA, including the series A preferred stock.

The principal amount of each Senior Note due June 30, 2007 is convertible at any time at into shares of Common Stock at the rate of \$10 per share. The principal amount of each Senior Note due December 31, 2007 is convertible at any time into shares of Common Stock at the rate of \$20 per share. \$181,611 of the Senior Notes due December 31, 2008 are convertible at anytime into shares of Common Stock at a rate of \$10 per share and the remaining \$1,903,758 principal amount of each Senior Note due December 31, 2008 is convertible at anytime into shares of Common Stock at the rate of \$20 per share. The principal amount of each Senior Note due December 31, 2009 is convertible at anytime into shares of Common Stock at the rate of \$20 per share. The principal amount of each Senior Note due December 31, 2010 is convertible at anytime into shares of Common Stock at the rate of \$10 per share.

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 USA as follows: Upon any distribution of its assets in a liquidation or dissolution of USA, or in bankruptcy, reorganization, insolvency, receivership or similar proceedings relating to USA, 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 USA 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 USA 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 USA 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 USA at any time so requires, the Lender shall execute, upon request of USA, 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 USA with respect to any future bank or other financial institutional indebtedness of USA or (b) any indebtedness created, incurred, or assumed, by USA secured by a lien on any of our assets.

Notwithstanding anything herein to the contrary, Senior Indebtedness does not include:

- § unsecured accounts payable to trade creditors of USA incurred in the ordinary course of business;
- § any debt owed by USA to any officer, director or stockholder of USA;

- § any obligation of Borrower issued or contracted for as payment in consideration of the purchase by USA 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 USA was a party;
- § any operating lease obligations of USA;
- § any other indebtedness which by its terms is subordinated to the senior note; or
- § 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.

#### **COMMON STOCK PURCHASE WARRANTS**

As of September 30, 2006, there were outstanding warrants to purchase 71,429 shares at \$7 per share and warrants to purchase up to 131,494 shares at \$20 per share.

The exercise price of the warrants and the number of shares of Common Stock issuable upon exercise of the 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 USA, or other similar transaction, the warrant holders shall, at the option of USA, 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 warrants do not confer upon the holder any voting or any other rights of a shareholder of USA. Upon notice to the warrant holders, USA has the right, at any time and from time to time, to reduce the exercise price or to extend the warrant termination date.

#### **SHARES ELIGIBLE FOR FUTURE SALE**

Of the 6,614,569 shares of common stock issued and outstanding on September 30, 2006, all are freely transferable without further registration under the Act (other than shares held by "affiliates" of the Company). As of September 30, 2006, there were 520,392 shares of preferred stock issued and outstanding, all of which are freely transferable without further registration under the Act (other than shares held by "affiliates" of USA).

The shares of preferred stock issued and outstanding as of September 30, 2006 are convertible into 5,203 shares of common stock all of which would be fully transferable without further registration under the Act (other than shares held by "affiliates" of USA).

Shares of our common stock which are not freely tradeable under the Act are known as "restricted securities" and cannot be resold without registration under the Act or pursuant to Rule 144 promulgated thereunder.

In general, under Rule 144 as currently in effect, a person (or persons whose shares are required to be aggregated), including any affiliate of USA, 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 SEC. 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 USA. 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 USA, 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"), our By-laws provide that Directors 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 our 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 USA pursuant to the foregoing provisions, or otherwise, we have been advised that in the opinion of the SEC 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 our stock is American Stock Transfer & Trust Company, 40 Wall Street, New York, New York 10005.

#### **LEGAL MATTERS**

The validity of the common stock has been passed upon for us by Lurio & Associates, P.C., Philadelphia, Pennsylvania 19103.

## EXPERTS

The consolidated financial statements and schedule of USA Technologies, Inc. at June 30, 2006 and 2005, and for each of the two years ended June 30, 2006 and 2005 appearing in this Prospectus and Registration Statement have been audited by Goldstein Golub Kessler LLP, independent registered public accounting firm, 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 on the authority of such firm as experts in accounting and auditing.

The consolidated statement of operations, shareholders' equity, and cash flows and schedule of USA Technologies, Inc. at June 30, 2004 and for the year ended June 30, 2004 appearing in this Prospectus and Registration Statement have been audited by Ernst & Young LLP, independent registered public accounting firm, 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 on the authority of such firm as experts in accounting and auditing.

### WHERE YOU CAN FIND ADDITIONAL INFORMATION

We file annual, quarterly and other reports, proxy statements and other information with the Securities and Exchange Commission. Anyone may inspect a copy of the registration statement or any other reports we file, without charge at the public reference facility maintained by the Securities and Exchange Commission in Room 1024, 450 Fifth Street, NW, Washington, DC 20549. Copies of all or any part of the registration statement may be obtained from that facility upon payment of the prescribed fees. The public may obtain information on the operation of the public reference room by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission maintains a website at <http://www.sec.gov> that contains reports, proxy and information statements, and other information regarding registrants that file electronically with the Securities and Exchange Commission.

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

You can find additional information concerning us on our website <http://www.usatech.com>. Information on our website is not and should not be considered a part of this prospectus.

**FINANCIAL STATEMENTS**

**USA TECHNOLOGIES, INC.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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Board of Directors and Shareholders of  
USA Technologies, Inc.

We have audited the accompanying consolidated balance sheets of USA Technologies, Inc. as of June 30, 2006 and 2005 and the related consolidated statement of operations, shareholders' equity, and cash flows for the years then ended. Our audits also included the June 30, 2006 and 2005 balances in the financial statement schedule listed in Item 15(b). These consolidated financial statements and the schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of USA Technologies, Inc. at June 30, 2006 and 2005 and the consolidated results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related June 30, 2006 and 2005 balances in the consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations that raise substantial doubt about its ability to continue as a going concern. Management's plan in regard to these matters is also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As disclosed in note 1, the Company changed its method of accounting for stock-based compensation effective July 1, 2005.

*/s/ Goldstein Golub Kessler LLP*

New York, NY  
*September 1, 2006, except for Note 16, last paragraph, which is dated September 20, 2006*

We have audited the accompanying consolidated statement of operations, shareholders' equity, and cash flows for the year ended June 30, 2004. Our audit also included the June 30, 2004 balances in the financial statement schedule listed in Item 15(b). These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated results of operations and cash flows of USA Technologies, Inc. for the year ended June 30, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the June 30, 2004 balances in the related consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

The accompanying financial statements have been prepared assuming that USA Technologies, Inc. will continue as a going concern. As more fully described in Note 2 to the financial statements, the Company has an accumulated deficit and has incurred recurring operating losses. These conditions 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  
September 10, 2004*

**USA Technologies, Inc.**  
**Consolidated Balance Sheets**

	June		September 30
	2006	2005	2006
			(unaudited)
<b>Assets</b>			
<b>Current assets:</b>			
Cash and cash equivalents	\$ 2,866,801	\$ 2,097,881	\$ 1,461,059
Accounts receivable, less allowance for uncollectible accounts of \$229,000, \$196,000 and \$292,000, respectively	1,022,114	744,041	1,207,660
Finance receivables	418,184	255,595	426,832
Inventory	1,410,812	1,697,236	1,469,298
Prepaid expenses and other current assets	209,108	240,324	239,875
Subscriptions receivable	--	35,723	--
Investment	--	39,467	--
<b>Total current assets</b>	<b>5,927,019</b>	<b>5,110,267</b>	<b>4,804,724</b>
Finance receivables, less current portion	289,389	269,722	289,762
Property and equipment, net	1,119,304	684,927	1,095,105
Intangibles, net	8,358,632	9,595,232	8,049,482
Goodwill	7,663,208	7,663,208	7,663,208
Other assets	61,914	68,409	61,914
<b>Total assets</b>	<b>\$ 23,419,466</b>	<b>\$ 23,391,765</b>	<b>\$ 21,964,195</b>
<b>Liabilities and shareholders' equity</b>			
<b>Current liabilities:</b>			
Accounts payable	\$ 2,448,611	\$ 3,265,928	\$ 2,359,433
Accrued expenses	2,012,938	1,479,352	2,049,406
Current obligations under long-term debt	89,917	100,646	67,369
Convertible Senior Notes	851,486	1,252,161	884,122
<b>Total current liabilities</b>	<b>5,402,952</b>	<b>6,098,087</b>	<b>5,360,330</b>
Convertible Senior Notes, less current portion	6,805,403	7,897,314	6,917,702
Long-term debt, less current portion	34,047	87,179	28,387
<b>Total liabilities</b>	<b>12,242,402</b>	<b>14,082,580</b>	<b>12,306,419</b>
<b>Commitments and contingencies (Note 16)</b>			
<b>Shareholders' equity:</b>			
<b>Preferred Stock, no par value:</b>			
Authorized shares- 1,800,000			
Series A Convertible Preferred-			
Authorized shares- 900,000			
Issued and outstanding shares- 521,542, 522,742, and 520,392, respectively			
(liquidation preference of \$13,441,681, \$12,688,713, and \$13,806,338, respectively)	3,694,360	3,702,856	3,686,218
<b>Common Stock, no par value:</b>			
Authorized shares- 640,000,000, 560,000,000, and 640,000,000, respectively			
Issued and outstanding shares- 6,327,175, 4,335,679, and 6,614,569, respectively	138,110,126	121,598,475	140,294,294
Subscriptions receivable	--	(233,850)	--
Accumulated other comprehensive income	--	3,080	--
Accumulated deficit	(130,627,422)	(115,761,376)	(134,322,736)
<b>Total shareholders' equity</b>	<b>11,177,064</b>	<b>9,309,185</b>	<b>9,657,776</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 23,419,466</b>	<b>\$ 23,391,765</b>	<b>\$ 21,964,195</b>

See accompanying notes.

**USA Technologies, Inc.**  
**Consolidated Statements of Operations**

	Year ended June 30			Three months ended September 30	
	2006	2005	2004	2006	2005
	(unaudited)				
<b>Revenues:</b>					
Equipment sales	\$ 5,198,360	\$ 3,535,064	\$ 4,349,566	\$ 1,670,807	\$ 1,072,370
License and transaction fees	1,216,443	1,142,925	977,651	338,090	291,516
Product sales and other	-	-	305,598	-	-
<b>Total revenues</b>	<b>6,414,803</b>	<b>4,677,989</b>	<b>5,632,815</b>	<b>2,008,897</b>	<b>1,363,886</b>
<b>Cost of sales (including amortization of software development costs- Note 2)</b>					
	4,404,457	3,478,673	4,329,692	1,393,361	1,048,959
<b>Gross profit</b>	<b>2,010,346</b>	<b>1,199,316</b>	<b>1,303,123</b>	<b>615,536</b>	<b>314,927</b>
<b>Operating expenses:</b>					
General and administrative	5,200,116	6,429,458	6,747,824	1,425,868	1,107,503
Compensation	6,892,436	5,559,945	10,071,354	1,921,188	1,353,596
Depreciation and amortization	1,699,593	1,600,120	1,632,330	426,972	409,793
Loss on debt modification	-	-	318,915	-	-
<b>Total operating expenses</b>	<b>13,792,145</b>	<b>13,589,523</b>	<b>18,770,423</b>	<b>3,774,028</b>	<b>2,870,892</b>
<b>Operating loss</b>	<b>(11,781,799)</b>	<b>(12,390,207)</b>	<b>(17,467,300)</b>	<b>(3,158,492)</b>	<b>(2,555,965)</b>
<b>Other income (expense):</b>					
Interest income	99,776	61,068	40,789	32,543	20,492
Gain (loss) on investment	(16,087)	-	603,480	-	-
Gain (loss) on contract settlement	-	(42,300)	429,204	-	-
Legal loss contingency	(270,000)	-	-	-	-
<b>Interest expense:</b>					
Coupon or stated rate	(1,365,860)	(1,256,999)	(1,179,322)	(297,380)	(345,002)
<b>Non-cash interest and amortization of debt</b>					
discount	(1,513,106)	(1,870,752)	(3,853,029)	(256,985)	(316,397)
<b>Total interest expense</b>	<b>(2,878,966)</b>	<b>(3,127,751)</b>	<b>(5,032,351)</b>	<b>(554,365)</b>	<b>(661,399)</b>
<b>Total other income (expense)</b>	<b>(3,065,277)</b>	<b>(3,108,983)</b>	<b>(3,958,878)</b>	<b>(521,822)</b>	<b>(640,907)</b>
<b>Net loss</b>	<b>(14,847,076)</b>	<b>(15,499,190)</b>	<b>(21,426,178)</b>	<b>(3,680,314)</b>	<b>(3,196,872)</b>
<b>Cumulative preferred dividends</b>					
	(783,289)	(784,113)	(786,513)	(391,157)	(392,057)
<b>Loss applicable to common shares</b>					
	\$ (15,630,365)	\$ (16,283,303)	\$ (22,212,691)	\$ (4,071,471)	\$ (3,588,929)
<b>Loss per common share (basic and diluted)</b>					
	\$ (3.15)	\$ (4.18)	\$ (7.70)	\$ (0.63)	\$ (0.89)
<b>Weighted average number of common shares outstanding (basic and diluted)</b>					
	4,965,501	3,894,204	2,884,761	6,451,553	4,027,657

See accompanying notes.

**USA Technologies, Inc.**  
**Consolidated Statements of Shareholders' Equity**

	SERIES A CONVERTIBLE PREFERRED STOCK	COMMON STOCK	ACCUMULATED OTHER COMPREHENSIVE INCOME	ACCUMULATED DEFICIT	TOTAL
Balance, June 30, 2003	\$ 3,715,246	\$ 78,790,405	\$ --	\$ (78,813,568)	\$ 3,692,083
Issuance of 17 shares of Common Stock from the conversion of 1,750 shares of Preferred Stock	(12,390)	12,390	--	--	--
Conversion of cumulative preferred dividends into 22 shares of Common Stock at \$1000 per share	--	22,440	--	(22,440)	--
Exercise of 321,793 Common Stock Warrants and Options	--	2,800,472	--	--	2,800,472
Issuance of 142,048 shares of Common Stock from the conversion of 12% Senior Notes	--	2,840,978	--	--	2,840,978
Issuance of 16,157 shares of Common Stock in exchange for salaries and professional services	--	422,092	--	--	422,092
Issuance of 105,000 shares of Common Stock to executive in connection with employment agreement	--	4,620,000	--	--	4,620,000
Issuance of 531,778 shares of Common Stock from various private placement offerings at varying prices per share, less issuance costs of \$253,071	--	9,389,263	--	--	9,389,263
Issuance of 10,612 shares of Common Stock and related common Stock Warrants in lieu of cash payment for interest on the 12% senior Notes	--	478,496	--	--	478,496
Debt discount relating to beneficial conversion feature on 12% Senior Notes	--	1,981,007	--	--	1,981,007
Issuance of 201,700 shares of Common Stock in connection with the Bayview acquisition	--	9,278,200	--	--	9,278,200
Comprehensive Loss:					
Net loss	--	--	--	(21,426,178)	(21,426,178)
Unrealized gain on investment	--	--	32,249	--	32,249
Total comprehensive loss					(21,393,929)
Balance, June 30, 2004	\$ 3,702,856	\$ 110,635,743	\$ 32,249	\$ (100,262,186)	\$ 14,108,662

See accompanying notes.

**USA Technologies, Inc.**  
**Consolidated Statements of Shareholders' Equity (Continued)**

	SERIES A CONVERTIBLE PREFERRED STOCK	COMMON STOCK	SUBSCRIPTIONS RECEIVABLE	ACCUMULATED OTHER COMPREHENSIVE INCOME	ACCUMULATED DEFICIT	TOTAL
<b>Exercise of 109,942 Common Stock</b>						
Warrants at \$10 per share, net	\$	-- \$ 1,094,658	\$	-- \$	-- \$	-- \$ 1,094,658
<b>Issuance of 90,351 shares of Common</b>						
Stock from the conversion of 12%						
Senior Notes	--	931,208	--	--	--	931,208
<b>Issuance of 8,005 shares of Common</b>						
Stock for employee compensation	--	107,670	--	--	--	107,670
<b>Issuance of 384,504 shares of Common</b>						
Stock to an accredited investor at varying prices per share, less						
issuance costs of \$291,166	--	3,779,454	--	--	--	3,779,454
<b>Issuance of 233,333 shares of Common</b>						
Stock from a private placement at varying prices per share, less						
issuance costs of \$73,103	--	3,426,897	(233,850)	--	--	3,193,047
<b>Cancellation of 7,000 shares of Common</b>						
Stock in connection with the Bayview acquisition						
	--	(322,000)	--	--	--	(322,000)
<b>Debt discount related to the beneficial conversion feature on various Senior</b>						
Notes issued	--	1,944,845	--	--	--	1,944,845
<b>Comprehensive loss:</b>						
Net loss	--	--	--	--	(15,499,190)	(15,499,190)
Unrealized loss on investment	--	--	--	(29,169)	--	(29,169)
<b>Total comprehensive loss</b>						<b>(15,528,359)</b>
Balance, June 30, 2005	\$	3,702,856	\$ 121,598,475	\$ (233,850)	\$ 3,080	\$ (115,761,376) \$ 9,309,185

See accompanying notes.

**USA Technologies, Inc.**  
**Consolidated Statements of Shareholders' Equity (Continued)**

	SERIES A CONVERTIBLE			ACCUMULATED		
	PREFERRED	COMMON	SUBSCRIPTIONS	OTHER	ACCUMULATED	TOTAL
	STOCK	STOCK	RECEIVABLE	COMPREHENSIVE	DEFICIT	
				INCOME		
<b>Issuance of 1,754,428 shares of Common</b>						
Stock to an accredited investors at						
varying prices per share	\$ --	\$ 13,747,261	\$ --	\$ --	\$ --	\$ 13,747,261
<b>Exercise of 36,800 2005-D Common Stock</b>						
Warrants at \$10 per share	--	368,000	--	--	--	368,000
<b>Cancellation of 15,590 shares of Common</b>						
Stock issued as part of the 2005-D						
private placement	--	(233,850)	233,850	--	--	--
<b>Conversion of 1,200 shares of Preferred</b>						
Stock to 12 shares of Common Stock	(8,496)	8,496	--	--	--	--
<b>Conversion of \$18,320 of cumulative</b>						
preferred dividends into 18 shares						
of Common Stock at \$1000 per share	--	18,320	--	--	(18,970)	(650)
<b>Issuance of 59,247 shares of Common</b>						
Stock from the conversion of						
Senior Notes	--	667,469	--	--	--	667,469
<b>Debt discount related to the beneficial</b>						
conversion feature on Senior Notes						
	--	552,263	--	--	--	552,263
<b>Issuance of special purchase rights in</b>						
conjunction with the 2008-C and 2010-A						
Senior Notes	--	428,941	--	--	--	428,941
<b>Issuance of 9,500 shares of Common</b>						
Stock for employee compensation	--	79,195	--	--	--	79,195
Stock option compensation charges	--	875,556	--	--	--	875,556
<b>Repayment of fractional shares from</b>						
reverse stock split						
	--	--	--	--	--	--
<b>Comprehensive loss:</b>						
Net loss	--	--	--	--	(14,847,076)	(14,847,076)
Unrealized loss on investment	--	--	--	(3,080)	--	(3,080)
<b>Total comprehensive loss</b>						(14,850,156)
<b>Balance, June 30, 2006</b>	<b>\$ 3,694,360</b>	<b>\$ 138,110,126</b>	<b>\$ --</b>	<b>\$ --</b>	<b>\$ (130,627,422)</b>	<b>\$ 11,177,064</b>
<b>(Unaudited)</b>						
<b>Issuance of 285,818 shares of Common</b>						
Stock to an accredited investor at						
varying prices per share	--	1,803,500	--	--	--	1,803,500
<b>Conversion of 1,150 shares of Preferred</b>						
Stock to 11 shares of Common Stock	(8,142)	8,142	--	--	--	--
<b>Conversion of \$15,000 of cumulative</b>						
preferred dividends into 15 shares of						
Common Stock at \$1,000 per share	--	15,000	--	--	(15,000)	--
<b>Issuance of 50 shares of Common Stock</b>						
from the conversion of Senior Notes						
	--	500	--	--	--	500
<b>Charges incurred in connection with the</b>						
issuance of Common Stock for employee						
compensation	--	262,683	--	--	--	262,683
<b>Charges incurred in connection with</b>						
stock options						
	--	94,343	--	--	--	94,343
<b>Net loss</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>(3,680,314)</b>	<b>(3,680,314)</b>
<b>Balance, September 30, 2006 (unaudited)</b>	<b>\$ 3,686,218</b>	<b>\$ 140,294,294</b>	<b>\$ --</b>	<b>\$ --</b>	<b>\$ (134,322,736)</b>	<b>\$ 9,657,776</b>

See accompanying notes.

**USA Technologies, Inc.**  
**Consolidated Statements of Cash Flows**

	Year ended June 30			Three months ended	
				September 30	
	2006	2005	2004	2006 Unaudited	2005 Unaudited
<b>OPERATING ACTIVITIES:</b>					
Net loss	\$ (14,847,076)	\$ (15,499,190)	\$ (21,426,178)	\$ (3,680,314)	\$ (3,196,872)
Adjustment to reconcile net loss to net cash used in operating activities:					
Charges incurred in connection with the issuance of Common Stock for employee compensation	79,195	107,670	5,042,092	262,683	7,200
Charges incurred in connection with stock option compensation	875,556	--	--	94,343	3,511
Interest expense on the Senior Notes paid through the issuance of Common Stock	--	--	478,496	--	--
Non-cash interest and amortization of debt discount	1,513,106	1,870,752	3,374,533	256,985	316,397
Depreciation	462,993	363,520	469,418	117,822	100,643
Amortization	1,236,600	1,236,600	2,207,329	309,150	309,150
Loss (gain) on sale of investment	17,144	--	(603,478)	--	--
Loss (gain) on contract settlement	--	42,300	(429,204)	--	--
Loss on debt modification	--	--	318,915	--	--
Gain on repayment of Senior Notes	--	--	--	(22,310)	--
Changes in operating assets and liabilities:					
Accounts receivable	(278,073)	27,680	(711,848)	(185,546)	(135,007)
Finance receivables	(182,256)	(221,181)	(73,353)	(9,021)	19,972
Inventory	286,424	10,448	(1,249,784)	(58,486)	130,505
Prepaid expenses and other assets	37,711	(85,541)	(1,732)	(30,767)	51,321
Accounts payable	(817,317)	336,437	843,680	(89,178)	(471,547)
Accrued expenses	533,586	(90,016)	(796,342)	36,468	(36,106)
Net cash used in operating activities	(11,082,407)	(11,900,521)	(12,557,456)	(2,998,171)	(2,900,833)
<b>INVESTING ACTIVITIES:</b>					
Purchase of property and equipment, net	(842,470)	(248,043)	(358,033)	(93,623)	(165,495)
Cash paid in connection with Bayview acquisition	--	--	(727,970)	--	--
Cash received from the sale of Investment	19,243	--	1,471,140	--	--
Cash received from contract settlement	--	--	674,649	--	--
Cash received from the sale of assets held for sale	--	23,700	41,400	--	--
Net cash provided by (used in) investing activities	(823,227)	(224,343)	1,101,186	(93,623)	(165,495)

See accompanying notes.



## Consolidated Statements of Cash Flows (Continued)

	Year ended June 30			Three months ended	
	2006	2005	2004	September 30	
				2006	2005
<b>FINANCING ACTIVITIES:</b>				Unaudited	Unaudited
Net proceeds from the issuance					
of Common Stock and the					
exercise of Common Stock					
Warrants	\$ 14,114,612	\$ 8,004,436	\$ 11,889,735	\$ 1,803,500	\$ 1,807,990
Collection of subscriptions					
receivable	35,723	300,000	1,013,400	--	35,723
Net proceeds from the issuance					
of Senior Notes	1,314,944	3,305,790	--	--	--
Repayment of long-term debt and					
Senior Notes	(2,790,725)	(406,695)	(812,106)	(117,448)	(46,018)
Net cash provided by financing					
activities	12,674,554	11,203,531	12,091,029	1,686,052	1,797,695
Net increase (decrease) in cash					
and cash equivalents	768,920	(921,333)	634,759	(1,405,742)	(1,268,633)
Cash and cash equivalents at					
beginning of year	2,097,881	3,019,214	2,384,455	2,866,801	2,097,881
Cash and cash equivalents at end					
of year	\$ 2,866,801	\$ 2,097,881	\$ 3,019,214	\$ 1,461,059	\$ 829,248
Supplemental disclosures of					
cash flow information:					
Cash paid for interest	\$ 1,430,115	\$ 1,187,833	\$ 1,098,727	\$ 286,022	\$ 355,039
Purchases of equipment with					
long-term debt	\$ 54,900	\$ 197,450	\$ --	\$ --	\$ --
Conversion of Convertible					
Preferred Stock to Common Stock	\$ 8,496	\$ --	\$ 12,390	\$ 8,142	\$ 7,788
Conversion of Cumulative					
Preferred Dividends to Common					
Stock	\$ 18,320	\$ --	\$ 22,440	\$ 15,000	\$ 17,320
Subscriptions receivable	\$ --	\$ 35,723	\$ 300,000	\$ --	\$ --
Conversion of Senior Notes					
to Common Stock	\$ 667,469	\$ 931,208	\$ 2,840,978	\$ 500	\$ 197,143
Issuance (cancellation) of					
Common Stock in connection					
with Bayview acquisition	\$ --	\$ (322,000)	\$ 9,278,200	\$ --	\$ --
Beneficial conversion feature					
related to Senior Notes	\$ 552,263	\$ 1,944,845	\$ 1,981,007	\$ --	\$ --
Debt discount related to					
issuance of purchase rights	\$ 428,941	\$ --	\$ --	\$ --	\$ --

See accompanying notes.

## 1. BUSINESS

USA Technologies, Inc. (the "Company") was incorporated in the Commonwealth of Pennsylvania in January 1992. The Company offers a suite of networked devices and associated wireless non-cash payment, control/access management, remote monitoring and data reporting services, as well as energy management products. Our networked devices and associated services enable the owners and operators of everyday, stand-alone, distributed assets, such as vending machines, personal computers, copiers, faxes, kiosks and laundry equipment, the ability to remotely monitor, control and report on the results of these distributed assets, as well as the ability to offer their customers alternative cashless payment options. As a result of the acquisition of the assets of Bayview Technology Group, LLC ("Bayview") in July 2003 (Note 4), our Company also manufactures and sells energy management products which reduce the electrical power consumption of various existing equipment, such as refrigerated vending machines and glass front coolers, thus reducing the electrical energy costs associated with operating this equipment.

## 2. ACCOUNTING POLICIES

### REVERSE STOCK SPLIT

On February 7, 2006, our shareholders approved a 1-for-100 reverse stock split of our Common Stock. The effective date of the reverse stock split was February 17, 2006. On the effective date of the reverse stock split, (i) each 100 shares of outstanding Common Stock was reduced to one share of Common Stock; (ii) the number of shares of Common Stock into which each outstanding warrant, or option is exercisable was proportionately reduced on a 100-to-1 basis; (iii) the exercise price of each outstanding warrant, or option was proportionately increased on a 1-to-100 basis; (iv) the number of shares of Common Stock into which each share of Series A Preferred Stock is convertible was reduced from 1 share to one-hundredth of a share, and each share is entitled to one-hundredth of a vote rather than one vote per share as previously provided; (v) the conversion rate of the accrued and unpaid dividends on the Series A Preferred Stock was increased from \$10.00 to \$1,000.00 per share of Common Stock; (vi) and the conversion price of each convertible senior note proportionately increased on a 1-to-100 basis, and the number of shares into which each convertible senior note would be convertible was decreased on a 100-to-1 basis. The number of our authorized shares of Common Stock remains unchanged at 640,000,000. All of the share numbers, share prices, exercise prices, and conversion prices have been adjusted, on a retroactive basis, to reflect this 1-for-100 reverse stock split.

### BASIS OF FINANCIAL STATEMENT PRESENTATION

The financial 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 financial statements do not include any adjustments to recorded asset values that might be necessary should the Company be unable to continue in existence. The Company has incurred recurring operating losses of \$14.8 million, \$15.5 million and \$21.4 million during the fiscal years ended June 30, 2006, 2005 and 2004, respectively and a loss of \$3.7 million (unaudited) during the three months ended September 30, 2006. Cumulative losses from its inception through June 30, 2006 amounted to approximately \$127.9 million. Cumulative losses through September 30, 2006 amounted to approximately \$131.6 million (unaudited). Losses have continued through December 2006 and are expected to continue during fiscal year 2007. The Company's ability to meet its future obligations is dependent upon the success of its products and services in the marketplace. Until the Company's products and services can generate sufficient operating revenues, the Company will be required to raise capital to meet its cash flow requirements. These factors raise substantial 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, the issuance of Common Stock (Note 12), the exercise of outstanding Common Stock warrants (Note 13), the issuance of debt (Note 10) and raising funds in the capital markets, as needed.

## 2. ACCOUNTING POLICIES (CONTINUED)

### INTERIM FINANCIAL INFORMATION

The consolidated financial statements and disclosures included herein for the three months ended September 30, 2006 and 2005 are unaudited. These financial statements and disclosures have been prepared by the Company in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended September 30, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2007.

### CONSOLIDATION

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Stitch Networks Corporation ("Stitch") and USAT Capital Corp LLC ("USAT Capital"). All significant intercompany accounts and transactions have been eliminated in consolidation.

### USE OF ESTIMATES

The preparation of the financial statements in conformity with U.S. 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.

### RECLASSIFICATION

Certain amounts in the prior period financial statements have been reclassified to conform to the current period presentation.

### CASH EQUIVALENTS

Cash equivalents represent all highly liquid investments with original maturities of three months or less. Cash equivalents are comprised of certificates of deposit and a money market fund. The Company maintains its cash in bank deposit accounts, which may exceed federally insured limits at times.

### ACCOUNTS RECEIVABLE

Accounts receivable are reported at their outstanding unpaid principal balances reduced by an allowance for doubtful accounts. The Company estimates doubtful accounts for accounts receivable and finance receivables based on historical bad debts, factors related to specific customers' ability to pay and current economic trends. The Company writes off accounts receivable against the allowance when management determines the balance is uncollectible and the Company ceases collection efforts. Management believes that the allowance accrued is adequate to provide for normal credit losses.

### FINANCE RECEIVABLES

The Company offers extended payment terms to certain customers for equipment sales. The Company does not require collateral or other security to support credit sales, but provides an allowance for credit losses and discontinues the accrual of interest, if necessary. Finance receivables are carried at their contractual amount and charged off against the allowance for credit losses when management determines that recovery is unlikely and the Company ceases collection efforts. The Company recognizes a portion of the loan payments as interest income based on the effective interest rate method in the accompanying Consolidated Statement of Operations.

## 2. ACCOUNTING POLICIES (CONTINUED)

### INVENTORY

Inventory consists of finished goods and packaging materials. Through November 30, 2005, inventory was stated at the lower of cost (first-in, first-out basis) or market. Due to the implementation of a new accounting system on December 1, 2005, the Company's inventory is stated at the lower of cost (average cost basis) or market. The Company determined that the change in accounting principle was not material and therefore has excluded the current and cumulative effect of the change and pro forma disclosures.

### PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost. Property and equipment are depreciated on the straight-line basis over the estimated useful lives of the related assets. Leasehold improvements are amortized on the straight-line basis over the lesser of the estimated useful life of the asset or the respective lease term.

### GOODWILL AND INTANGIBLE ASSETS

Goodwill represents the excess of cost over fair value of the net assets purchased in acquisitions. The Company accounts for goodwill in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"). Under FAS 142, goodwill is not amortized to earnings, but instead is subject to periodic testing for impairment. The Company tests goodwill for impairment using a two-step process. The first step screens for potential impairment, while the second step measures the amount of impairment. The Company uses a discounted cash flow analysis to complete the first step in this process. Testing for impairment is to be done at least annually and at other times if events or circumstances arise that indicate that impairment may have occurred. The Company has selected April 1 as its annual test date. The Company has concluded there has been no impairment of goodwill as a result of its testing on April 1, 2004, April 2005 and April 1, 2006.

Patents, trademarks and the non-compete agreement are carried at cost less accumulated amortization, which is calculated on a straight-line basis over their estimated economic life. The Company reviews intangible for impairment whenever events or changes in circumstances indicate that they carrying amount may not be recoverable. An asset is considered to be impaired when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. The amount of the impairment loss, if any, is measured as the difference between the net book value of the asset and its estimated fair value.

### SOFTWARE DEVELOPMENT COSTS

The Company capitalizes software development costs pursuant to Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", after technological feasibility of the software is established and through the product's availability for general release to the Company's customers. All costs incurred in the research and development of new software and costs incurred prior to the establishment of technological feasibility are expensed as incurred. Amortization of software development costs commences when the product becomes available for general release to customers. Amortization of software development costs is calculated as the greater of the amount computed using (i) the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues of that product or (ii) the straight-line method over the remaining estimated economic life of the product. The Company reviews the unamortized software development costs at each balance sheet date and, if necessary, will write down the balance to net realizable value if the unamortized costs exceed the net realizable value of the asset.

During May 2000, the Company reached technological feasibility for the development of the multi-media e-Port(TM) product and related internal network and, accordingly, the Company commenced capitalization of software development costs related to this product and network. Costs capitalized through 2002 were \$5.3 million, which included capitalized interest of approximately \$493,000 pursuant to SFAS No. 34, "Capitalization of Interest Costs".

## 2. ACCOUNTING POLICIES (CONTINUED)

### SOFTWARE DEVELOPMENT COSTS (CONTINUED)

During the fourth quarter of fiscal year 2002, the multi-media e-Port(TM) client product and enhanced network became available for general release to the Company's customers. During this quarter, management performed an evaluation of the commercial success and preliminary market acceptance of the multi-media e-Port(TM) and enhanced network and as a result of this evaluation the Company determined that the estimated future revenues less costs to complete and dispose of the multi-media e-Port client product was zero. Therefore, the Company wrote down \$2,663,000 of software development costs related to the multi-media e-Port client product. The unamortized balance of the software development costs after the impairment charge was amortized over an estimated useful life of two years and was fully amortized during the year ended June 30, 2004. The gross amount of software development costs and the accumulated amortization was \$5,326,186 at June 30, 2006, 2005, and 2004 and at September 30, 2006 (unaudited). Amortization expense was approximately \$999,000 during the year ended June 30, 2004. Such amortization is reflected in cost of sales in the accompanying consolidated statements of operations.

### INVESTMENT

The Company accounts for investments in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Management determines the appropriate classifications of securities at the time of purchase and reevaluates such designation as of each balance sheet date. Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported as a separate component of shareholders' equity in accumulated other comprehensive income (loss). If the investment sustains an other-than-temporary decline in fair value, the investment is written down to its fair value by a charge to earnings.

### IMPAIRMENT OF LONG LIVED ASSETS

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets" ("FAS 144"), the Company reviews its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the carrying amount of an asset or group of assets exceeds its net realizable value, the asset will be written down to its fair value. In the period when the plan of sale criteria of FAS 144 are met, long-lived assets are reported as held for sale, depreciation and amortization cease, and the assets are reported at the lower of carrying value or fair value less costs to sell.

During the fourth quarter of fiscal year 2003, the Company reviewed certain long-lived assets (vending machines) and determined that such assets were impaired. These vending machines were used and intended for use in connection with the Company's program with Kodak to sell disposable cameras and film pursuant to the Kodak Vending Placement Agreement. Management determined that it was more likely than not that these vending machines would be disposed of before the end of their previously estimated useful lives. The estimated undiscounted cash flows for this group of assets were less than the carrying value of the related assets. As a result, the Company recorded a charge of approximately \$321,000 representing the difference between the fair value as determined from a quoted market price and the carrying value of the group of assets. Effective December 31, 2003, the Kodak agreement was terminated (Note 14). As a result, the carrying value of the vending machines were further impaired and a charge of approximately \$367,000 was recorded as a component of the gain on contract settlement in the June 30, 2004 Consolidated Statement of Operations to reflect these assets at their realizable value. The remaining value of these vending machines was then recorded as assets held for sale in the Consolidated Balance Sheets as of June 30, 2004. During the year ended June 30, 2005, the Company wrote off the remaining value of the vending machines that had not been sold during the year as a loss on contract settlement.

## 2. ACCOUNTING POLICIES (CONTINUED)

### **FAIR VALUE OF FINANCIAL INSTRUMENTS**

The carrying value of cash and cash equivalents, accounts receivable, finance receivables-current portion, other current assets, accounts payable and accrued expenses reported in the consolidated balance sheets equal or approximate fair value due to their short maturities. The fair value of the Company's long-term Finance Receivables and Long-Term Debt approximates book value as such instruments are at market rates currently available to the Company. The fair value of the Senior Notes approximates the principal amount as such instruments are at market rates currently available to the Company.

### **CONCENTRATION OF CREDIT RISK**

Financial instruments that subject the Company to a concentration of credit risk consist principally of cash and cash equivalents and accounts and finance receivables. The Company maintains cash and cash equivalents with various financial institutions. Approximately 39% and 36% of the Company's accounts and finance receivables at June 30, 2006 and 2005, respectively, were concentrated with two and two customers, respectively, and 26% (unaudited) as of September 30, 2006 was concentrated with one customer. Approximately 29%, 11% and 13% of the Company's revenues for the year ended June 30, 2006, 2005 and 2004, respectively, were concentrated with two (19% with one customer and 10% with another customer), one and one customer, respectively. Approximately 24% (unaudited) and 32% (unaudited) of the Company's revenues for the three months ended September 30, 2006 and 2005, respectively, were concentrated with one customer and two customers (16% with one customer and 16% with another customer), respectively. The Company's customers are principally located in the United States.

### **REVENUE RECOGNITION**

Revenue from the sale of equipment is recognized on the terms of freight-on-board shipping point, or upon installation and acceptance of the equipment if installation services are purchased for the related equipment. Transaction processing revenue is recognized upon the usage of the Company's cashless payment and control network. License fees for access to the Company's devices and network services are recognized on a monthly basis. Product revenues are recognized for the sale of products from Company owned vending machines when there is purchase and acceptance of product by the vending customer. In all cases, revenue is only recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed and determinable, and collection of the resulting receivable is reasonably assured. The Company estimates an allowance for product returns at the date of sale.

### **WARRANTY COSTS**

The Company generally warrants its products for one to three years. Warranty costs are estimated and recorded at the time of sale based on historical warranty experience, if available.

### **SHIPPING AND HANDLING**

Shipping and handling fees billed to our customers in connection with sales are recorded as revenue. The costs incurred for shipping and handling of our product are recorded as cost of sales.

### **RESEARCH AND DEVELOPMENT EXPENSES**

Research and development expenses are expensed as incurred. Research and development expenses, which are included in general and administrative and compensation expense in the consolidated statements of operations, were approximately \$974,000, \$1,364,000, and \$688,000 for the years ended June 30, 2006, 2005 and 2004, respectively, and \$303,000 (unaudited) and \$220,000 (unaudited) for the three months ended September 30, 2006 and 2005, respectively.

## 2. ACCOUNTING POLICIES (CONTINUED)

### SHARE-BASED PAYMENT

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" ("FAS 123(R)"), which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award.

On July 1, 2005, the Company adopted FAS123(R) using the Modified Prospective Application method. For outstanding nonvested share-based awards as of July 1, 2006, compensation expense for the portion of the award for which the requisite services have not been rendered will be recognized in the Statement of Operations as the services are rendered. Compensation expense will be recognized based on the grant-date fair value of the share-based award as previously calculated under FAS 123 at the time of the grant, however, the Company is required to adjust the compensation expense for expected forfeitures. Awards granted subsequent to July 1, 2005 will be based on the guidance provided by FAS 123(R).

Due to the adoption of FAS 123(R), the Company has recognized \$14,044 of compensation expense related to a single grant of 3,000 common stock options during the prior fiscal year for which were not fully vested as of the date of adoption. The remainder of the common stock options that were outstanding at the date of adoption were fully vested as of the date of adoption. There was no impact on cash flows or basic and diluted earnings per share.

The pro-forma disclosures required by FAS 123 have not been included for the years ended June 30, 2005 and 2004 as the fair value of the options granted were not considered to be material.

There were no common stock options granted during the quarter ended September 30, 2006 and 2005. The Company recorded stock compensation expense of \$262,683 (unaudited) and \$7,200 (unaudited) related to Common Stock grants to employees and \$94,343 (unaudited) and \$3,511 (unaudited) related to the vesting of Common Stock options during the quarter ended September 30, 2006 and 2005, respectively.

### LOSS PER COMMON SHARE

Basic earnings per share is calculated by dividing income (loss) applicable to common shares by the weighted average common shares outstanding for the period. Diluted earnings per share is calculated by dividing income (loss) applicable to common shares by the weighted average common shares outstanding for the period plus the dilutive effect (unless such effect is anti-dilutive) of potential common shares (approximately 1,081,000 and 1,250,000 shares as of June 30, 2006 and 2005, respectively). No exercise of stock options, purchase rights, stock purchase warrants, or the conversion of senior notes, debentures, preferred stock, or cumulative preferred dividends was assumed during the three fiscal years ended June 30, 2006 or the three months ended September 30, 2006 and 2005 because the assumed exercise of these securities would be anti-dilutive.

### RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109 ("FIN 48"), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company has not completed its evaluation of the impact of the adoption of FIN 48.

### 3. INVESTMENT IN JUBILEE INVESTMENT TRUST, PLC

During the year ended June 30, 2003, the Company issued 150,000 shares of its Common Stock (\$2,850,000) for an investment in 1,870,091 shares in the Jubilee Investment Trust, PLC ("Jubilee"), a United Kingdom Investment Trust whose shares trade on the London Stock Exchange. The Company agreed not to sell the Jubilee shares for a period of 90 days from January 24, 2003 and to sell a maximum of 10% of the Jubilee shares during each month thereafter. Jubilee agreed not to sell the Company's shares of Common Stock for a period of two years from the date of issuance unless agreed to by the Company.

During fiscal year 2004, the Company sold 1,669,091 of the Jubilee shares for net proceeds of \$1,471,140 and realized a gain of \$603,480, with the cost of the securities calculated by the specific identification method. An unrealized gain of \$3,080 and \$32,249 on the shares held by the Company was reflected in shareholders' equity as accumulated other comprehensive income at June 30, 2005 and 2004, respectively. During fiscal year 2006, the Company sold the remaining 70,000 shares for net proceeds of \$20,300 and realized a loss of \$17,144, with the cost of the securities calculated by the specific identification method.

### 4. ACQUISITIONS

#### **BAYVIEW TECHNOLOGY GROUP, LLC**

On July 11, 2003, the Company acquired substantially all of the assets of Bayview. Under the terms of the asset purchase agreement, the Company issued to Bayview 200,000 shares of its restricted Common Stock and cash of \$631,247 to settle an obligation of Bayview. The definitive agreement also provided for the Company to assume certain obligations under a royalty agreement expiring May 31, 2006. Approximately \$149,000, \$112,000 and \$169,000 of royalty expense was recorded during the years ended June 30, 2006, 2005 and 2004, respectively, in connection with this agreement. In connection with this transaction, the Company also agreed to issue 1,700 shares of its restricted Common Stock to a consultant who provided certain services to the Company in connection with this acquisition.

The acquisition allows the Company to offer energy conservation products that reduce the power consumption of various types of equipment, such as vending machines, glass front coolers and other "always-on" appliances by allowing the equipment to operate in power saving mode when the full power mode is not necessary.

The acquisition cost of Bayview was \$10,030,894, which principally was comprised of the issuance of 200,000 shares of restricted Common Stock valued at \$9,200,000 and a cash payment of \$631,247. The value of the 200,000 shares of Common Stock was determined based on the average market price of the Company's Common Stock over the two-day period before and after the definitive agreement date of July 11, 2003. The purchase price also included acquisition related costs of \$199,647.

The following table summarizes the final purchase price allocation to reflect the fair values of the assets acquired and liabilities assumed at the date of acquisition.

Current assets	\$	7,628
Property and equipment		244,704
Intangible assets		9,449,000
Goodwill		329,562
Total assets acquired	\$	<u>10,030,894</u>



#### 4. ACQUISITIONS (CONTINUED)

##### **BAYVIEW TECHNOLOGY GROUP, LLC (CONTINUED)**

Of the \$9,449,000 of Bayview acquired intangible assets, \$7,424,000 was assigned to patents that are subject to amortization over a 10-year period, \$1,011,000 was assigned to a non-compete agreement that is subject to amortization over a 5-year period and \$1,014,000 was assigned to trademarks and trade names that are not subject to amortization.

Of the 200,000 shares issued to Bayview, 7,000 shares were placed into an escrow account to be issued to one owner of Bayview if certain Bayview stock options were exercised. This agreement called for these shares to be returned to the Company if the Bayview stock options were not exercised. During the three months ended September 30, 2004, the Company determined that the Bayview stock options would not be exercised and the shares previously issued into escrow would be cancelled. Therefore, the Company decreased the purchase price by \$322,000 due to the return and cancellation of the 7,000 shares held in escrow. The decrease in the purchase price resulted in a reduction of goodwill and shareholders' equity of \$322,000 in the three months ended September 30, 2004.

The acquisition was accounted for using the purchase method and, accordingly, the results of operations of Bayview have been included in the accompanying consolidated statements of operations since the date of acquisition. Results of operations of the Company for year ended June 30, 2004 would not have been significantly different than reported had the acquisition taken place July 1, 2003 as the acquisition occurred on July 11, 2003. Pro-forma combined results for the year ended June 30, 2003 would have been as follows had the acquisition taken place July 1, 2002 - revenues of \$8,487,190; net loss of \$22,478,740; loss applicable to common shares of \$23,272,326; loss per common share (basic and diluted) of \$17.66.

##### **STITCH NETWORKS CORPORATION**

On May 14, 2002, USA Acquisition Corp., a wholly owned subsidiary of the Company acquired Stitch pursuant to an Agreement and Plan of Merger by and among the Company, USA Acquisition Corp., Stitch and the stockholders of Stitch. Additionally, on May 14, 2002, the Company's shareholders voted to increase the number of authorized shares of Common Stock to 150,000,000. The Company acquired Stitch to strengthen its position as a leading provider of wireless remote monitoring and cashless and mobile commerce solutions and to increase the Company's revenue base. These revenues would include product revenues and monthly service and transaction fees. Additionally, the acquisition of the Stitch technology enhanced the Company's existing technology and complemented the revenue and transaction processing revenue of the Company's existing products. Certain Stitch personnel were believed to possess some key strengths in several disciplines that the Company believed to be of great value in its plans for growth.

The acquisition was accounted for using the purchase method and, accordingly, the results of the operations of Stitch have been included in the accompanying consolidated statements of operations since the acquisition date. The purchase price consisted of the issuance of 227,623 shares of the Company's Common Stock in exchange for the outstanding shares of Stitch, and the issuance of warrants to purchase up to 75,874 shares of the Company's Common Stock at \$40 per share at any time through June 30, 2002. The purchase price also included the assumption of outstanding Stitch stock options that were converted into options to purchase an aggregate of 24,753 shares of the Company's Common Stock at \$16.50 per share at any time prior to May 14, 2007, warrants to purchase up to 4,125 shares of the Company's Common Stock at \$40 per share at any time through June 30, 2002 and other acquisition related expenses. None of the warrants issued in connection with the acquisition were exercised. A total of 48,000 shares of the Common Stock issued to the former stockholders of Stitch were held in escrow to secure the former stockholder's indemnification obligations under the Agreement and Plan of Merger. Such shares are subject to cancellation if there is a breach of the indemnification (as defined). The value of the marketable equity securities issued in connection with this acquisition was determined based on the average market price of the Company's Common Stock over a two-day period before and after April 10, 2002, the date the definitive agreement to acquire Stitch was entered into. Such valuation was in accordance with EITF 99-12: "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination".

4. ACQUISITIONS (CONTINUED)

**STITCH NETWORKS CORPORATION (CONTINUED)**

The following table summarizes the final purchase price allocation of the fair value of the assets and liabilities assumed at the date of acquisition:

Current assets	\$ 2,710,000
Property and equipment	1,700,000
Goodwill	7,946,000
Intangibles	2,920,000
Current liabilities	(1,554,000)
Long-term debt (Note 9)	(3,976,000)
	<u>\$ 9,746,000</u>

In connection with the acquisition, the Company determined that it would vacate office space previously occupied by Stitch. Accordingly, in connection with this acquisition, the Company accrued the remaining lease exit costs relating to the lease in the amount of approximately \$354,000 as part of the cost of purchasing Stitch. In November 2003, Stitch and the lessor of the office space reached an agreement that required Stitch to pay the lessor \$55,000 as consideration to release Stitch from any further obligations under the lease. In addition, a security deposit of approximately \$9,000 was retained by the lessor. Accordingly, the difference between estimated lease exit costs recorded in conjunction with the acquisition and actual consideration paid was recorded as a reduction of goodwill in the amount of \$290,000 during the year ended June 30, 2004.

**INTANGIBLE ASSETS**

Amortization expense relating to all acquired intangible assets was \$1,236,600, \$1,236,600 and \$1,208,668 during the years ended June 30, 2006, 2005 and 2004, respectively, and \$309,150 (unaudited) and \$309,150 (unaudited) for the three months ended September 30, 2006 and 2005, respectively. The intangible asset balance and related accumulated amortization consisted of the following:

	September 30, 2006 (unaudited)		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
<b>Intangible assets:</b>			
Trademarks	\$ 2,064,000	\$ (459,375)	\$ 1,604,625
Patents	9,294,000	(3,208,972)	6,085,028
Non-Compete agreement	1,011,000	(651,171)	359,829
Total	<u>\$ 12,369,000</u>	<u>\$ (4,319,518)</u>	<u>\$ 8,049,482</u>

	June 30, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
<b>Intangible assets:</b>			
Trademarks	\$ 2,064,000	\$ (433,125)	\$ 1,630,875
Patents	9,294,000	(2,976,622)	6,317,378
Non-Compete agreement	1,011,000	(600,621)	410,379
Total	<u>\$ 12,369,000</u>	<u>\$ (4,010,368)</u>	<u>\$ 8,358,632</u>

4. ACQUISITIONS (CONTINUED)

	June 30, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
<b>Intangible assets:</b>			
Trademarks	\$ 2,064,000	\$ (328,125)	\$ 1,735,875
Patents	9,294,000	(2,047,222)	7,246,778
Non-Compete agreement	1,011,000	(398,421)	612,579
<b>Total</b>	<b>\$ 12,369,000</b>	<b>\$ (2,773,768)</b>	<b>\$ 9,595,232</b>

At September 30 and June 30, 2006, the expected amortization of the intangible assets is as follows: \$1,240,000 per year in fiscal year 2007 through fiscal year 2008, \$1,030,000 per year in fiscal year 2009 through fiscal year 2012, \$740,000 in fiscal year 2013 and \$22,000 in fiscal year 2014. The weighted average useful life of these intangible assets is 9.55 years at June 30, 2006.

5. PROPERTY AND EQUIPMENT

Property and equipment, at cost, consist of the following:

	Useful Lives	June 30		September 30
		2006	2005	2006
(unaudited)				
Computer equipment and purchased software	3 years	\$ 3,063,618	\$ 2,536,990	\$ 3,156,685
Vending machines and related components	7 years	4,427	4,427	4,427
Control systems	3 years	79,567	479,530	8,503
Furniture and equipment	5-7 years	738,746	816,537	739,302
Leasehold improvements	Lease term	126,007	74,576	126,007
Vehicles	5 years	29,066	29,066	29,066
		4,041,431	3,941,126	4,063,990
Less accumulated depreciation		(2,922,127)	(3,256,199)	(2,968,885)
		<b>\$ 1,119,304</b>	<b>\$ 684,927</b>	<b>\$ 1,095,105</b>

Assets under capital lease totaled approximately \$0 (unaudited), \$0 and \$6,000 as of September 30 and June 30, 2006 and 2005, respectively. Capital lease amortization of approximately \$2,000, \$2,000, \$20,000, \$0 (unaudited) and \$1,000 (unaudited), is included in depreciation expense for the years ended June 30, 2006, 2005 and 2004, and for the three months ended September 30, 2006 and 2005, respectively.

## 6. ACCRUED EXPENSES

Accrued expenses consist of the following:

	June 30		September 30
	2006	2005	2006
Accrued compensation and related			(unaudited)
sales commissions	\$ 384,256	\$ 404,485	\$ 423,296
Accrued interest	381,240	445,495	392,598
Accrued professional fees	162,051	151,220	92,051
Accrued taxes and filing fees	100,573	97,860	108,464
Accrued consulting fees	--	122,500	--
Advanced customer billings	109,007	65,385	75,349
Accrued loss contingency	270,000	--	270,000
Accrued other	605,811	192,407	687,648
	<u>\$ 2,012,938</u>	<u>\$ 1,479,352</u>	<u>\$ 2,049,406</u>

## 7. RELATED PARTY TRANSACTIONS

During the years ended June 30, 2006, 2005, and 2004 and the three months ended September 30, 2006 and 2005, the Company incurred approximately \$258,000, \$284,000, \$391,000, \$118,000 (unaudited), and \$54,000 (unaudited), respectively, in connection with legal services provided by a member of the Company's Board of Directors. At June 30, 2006 and 2005 and September 30, 2006, approximately \$28,000, \$25,000 and \$35,000 (unaudited), respectively, of the Company's accounts payable and accrued expenses were due to this Board member. During the year ended June 30, 2005, the Company incurred approximately \$72,600 in connection with consulting services provided by another member of the Company's Board of Directors. At September 30 and June 30, 2006 and June 30, 2005, approximately \$0 (unaudited), \$0 and \$73,000, respectively, of the Company's accrued expenses were due to this Board member. During the years ended June 30, 2006, 2005 and 2004, certain Board members and executives participated in various debt or equity offerings of the Company for total investments of approximately \$53,000, \$245,000, and \$266,000, respectively. There was no participation by Board members in debt or equity offerings during the three months ended September 30, 2006 and 2005. As of September 30 (unaudited) and June 30, 2006 and June 30, 2005, Mr. Illes, an accredited investor, held \$1,000,000 of Senior Notes.

## 8. LONG-TERM DEBT

Long-term debt consists of the following:

	June 30		September 30
	2006	2005	2006
			(unaudited)
Software licensing and other	\$ 123,964	\$ 186,768	\$ 95,756
Capital lease obligations	--	1,057	--
	123,964	187,825	95,756
Less current portion	89,917	100,646	67,369
	<u>\$ 34,047</u>	<u>\$ 87,179</u>	<u>\$ 28,387</u>

During fiscal year 2005, the Company entered into a loan agreement in connection with software licensing for approximately \$170,000, due in eight equal quarterly payments of \$21,229 through March 2007 at an interest rate of 5.32% .

9. INCOME TAXES

At June 30, 2006 and 2005, the Company had net operating loss carryforwards of approximately \$111,024,000 and \$98,428,000, respectively, to offset future taxable income expiring through approximately 2026. In addition, the Company had a capital loss carryforward of approximately \$1,360,000 and \$1,264,000 as of June 30, 2006 and 2005, respectively, that expires in 2011. At June 30, 2006 and 2005, the Company recorded net deferred tax assets of approximately \$43,882,000 and \$39,143,000, respectively, which was reduced by a valuation allowance of the same amount as the realization of the deferred tax asset is not likely, principally due to the lack of earnings history.

The timing and extent to which the Company can utilize future tax deductions in any year may be limited by provisions of the Internal Revenue Code regarding changes in ownership of corporations. Stitch had net operating loss carryforwards of approximately \$11,800,000 at the acquisition date. Such net operating loss carryforwards are limited under the same provisions as to the amount available to offset future taxable income and to the extent used in any given year, will result in decreases to goodwill as opposed to income tax expense.

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	
	2006	2005
<b>Deferred tax assets:</b>		
<b>Net operating loss and capital loss carryforwards</b>		
	\$ 41,833,000	\$ 37,508,000
Deferred research and development costs	234,000	373,000
Software development costs	1,081,000	1,297,000
Other	1,430,000	780,000
	44,578,000	39,958,000
<b>Deferred tax liabilities:</b>		
<b>Intangibles</b>		
	(696,000)	(815,000)
	43,882,000	39,143,000
<b>Valuation allowance</b>	<b>(43,882,000)</b>	<b>(39,143,000)</b>
<b>Deferred tax assets, net</b>	<b>\$ --</b>	<b>\$ --</b>

## 10. SENIOR NOTES

The Company has issued six series of Senior Notes each with an annual interest rate of 12% and are convertible into shares of the Company's Common Stock for which there were outstanding obligations as of September 30, 2006 or June 30, 2006, 2005 or 2004. These Senior Notes were scheduled to mature on December 31, 2004 ("2004 Senior Notes"), December 31, 2005 ("2005 Senior Notes"), December 31, 2006, December 31, 2007, December 31, 2008, and December 31, 2009. The Company has also issued three series of Senior Notes each with an annual interest rate of 10% and are convertible into shares of the Company's Common Stock for which there were outstanding obligations as of September 30, 2006, June 30, 2006 or June 30, 2005. These Senior Notes were scheduled to mature on June 30, 2007, December 31, 2008, and December 31, 2010.

The 2004 Senior Notes were issued pursuant to a private placement offering authorized during the year ended June 30, 2002. The 2004 Senior Notes were convertible into shares of Common Stock at \$40 per share at any time through December 31, 2004. Certain shareholders of the Company who held warrants to purchase shares of Common Stock exercisable at \$50 per share were offered the opportunity to cancel those warrants and receive an equivalent number of new warrants exercisable at \$10 per share if they invested in the 2004 Senior Note offering. The fair value of the new warrants issued and the intrinsic value of the beneficial conversion feature associated with the 2004 Senior Notes created debt discount that was allocated to equity and was amortized to interest expense through December 31, 2004. During January 2005, the Company repaid \$131,152 of these Senior Notes and agreed with the holders of the remaining \$320,000 of these notes to extend the maturity date to March 31, 2005. In exchange for extending the maturity date, the Company authorized a reduction of the conversion price to \$10 resulting in the recording of \$32,000 as debt discount related to the intrinsic value of this beneficial conversion feature, which was amortized through March 31, 2005. The maturity date of these notes was further extended to June 30, 2009 in March 2006, with no other terms being modified.

The 2005 Senior Notes were issued pursuant to a private placement offering authorized during the year ended June 30, 2002 that included the issuance of 200 shares of Common Stock for each \$10,000 of face amount of notes issued. The 2005 Senior Notes were convertible into shares of Common Stock at \$20 per share at any time through December 31, 2005. The fair value of the Common Stock issued and the intrinsic value of beneficial conversion feature associated with the 2005 Senior Notes created debt discount that was allocated to equity and was amortized to interest expense through December 31, 2005. During the years ended June 30, 2006, 2005 and 2004, \$130,000, \$21,000, and \$514,359, respectively, of the 2005 Senior Notes were converted into 6,500, 1,050, and 25,717, shares of Common Stock, respectively. On January 1, 2006, the Company repaid all of the outstanding 2005 Senior Notes for a total repayment of \$910,262.

In March 2003, the Company granted to the holders of Senior Notes due December 31, 2003 ("2003 Senior Notes") and the 2004 Senior Notes the right to extend the maturity date of these Senior Notes to December 31, 2006 ("2006 Senior Notes") and December 31, 2007 ("2007 Senior Notes"), respectively, in exchange for reducing the conversion rates from \$125 to \$20 per share for the 2003 Senior Notes and from \$40 to \$20 per share for the 2004 Senior Notes. This offer expired on December 31, 2003. During the years ended June 30, 2004 and 2003, Senior Note holders agreed to exchange an aggregate of \$2,303,953 and \$6,911,397, respectively, of 2003 Senior Notes and 2004 Senior Notes for new notes maturing in 2006 and 2007. The exchange of the 2003 Senior Notes and 2004 Senior Notes to the 2006 Senior Notes and 2007 Senior Notes was deemed a significant modification of the terms of the Senior Notes and, accordingly, the exchanged 2003 Senior Notes and 2004 Senior Notes have been extinguished. The unamortized debt discount and other issuance costs remaining on the 2003 Senior Notes and 2004 Senior Notes exchanged and extinguished were expensed (\$318,915 for the year ended June 30, 2004) and have been reported as a loss on debt modification in the Consolidated Statements of Operations. Included in the loss on debt modification for the year ended June 30, 2004 is \$277,279 that occurred during the three months ended September 30, 2003. During fiscal year 2003 and 2004, the Company's share price was often greater than the conversion price at times when Senior Note holders exchanged their 2003 and 2004 Senior Notes for 2006 and 2007 Senior Notes. The intrinsic value of this beneficial conversion feature created debt discount that was allocated to equity and is being amortized to interest expense through December 31, 2006 and 2007, respectively.

10. SENIOR NOTES (CONTINUED)

During the year ended June 30, 2006 and 2004, \$10,000 and \$1,478,000, respectively, of the 2006 Senior Notes were converted into 500 and 73,900 shares of Common Stock, respectively. During the years ended June 30, 2006, 2005 and 2004, \$10,000, \$34,381, and \$848,619, respectively, of the 2007 Senior Notes were converted into 500, 1,719 and 42,430 shares of Common Stock, respectively. During May 2006, the Company repaid all of the 2006 Senior Notes for a total principal repayment of \$1,683,500.

On November 3, 2004, the Company authorized the issuance of up to \$2,500,000 of Senior Notes convertible into shares of Common Stock at \$10 per share and maturing on June 30, 2007 (2007-B Senior Notes"). Interest is payable quarterly at a rate of 10% per annum. Participation in the Senior Note offering was offered to the holders of certain warrants issued in conjunction with the payment of interest on Senior Notes (see "Additional Interest Warrants" in Note 13), holders of the warrants issued in conjunction with the 2004-A Private Placement Offering, and to an accredited investor and current warrant holder. Due to the limited number of authorized shares available for issuance, the terms of the offering provided that all of such warrant holder's warrants would be cancelled if they participated in the offering. Through the last day of the offering, the Company received \$1,550,789 in gross proceeds from sales of the 2007-B Senior Notes and 56,370 shares underlying the warrants were cancelled. As the Company's share price on the day of issuance of each of these Senior Notes was greater than the conversion price of \$10, the Company recorded the intrinsic value of this beneficial conversion feature totaling \$518,645 as additional debt discount, which is being amortized to interest expense through the maturity date of these Senior Notes. During the years ended June 30, 2006 and 2005 and the three months ended September 30, 2006, \$56,136, \$460,827 and \$500 (unaudited), respectively, of the 2007-B Senior Notes were converted into 5,613, 46,082 and 50 (unaudited), respectively, shares of Common Stock.

On February 23, 2005, the Company authorized the issuance of up to \$1,755,000 of Senior Notes, due April 30, 2005 to accredited investors (the "2005-B Senior Notes") with interest payable at a rate of 10% per annum. In connection with this offering, the Company paid a due diligence fee of \$27,000 to an accredited investor. The Company received \$1,755,000 in gross proceeds from the 2005-B Senior Note offering. On March 22, 2005, the Company authorized an offer whereby the holders of the 2005-B Senior Notes had the right through April 30, 2005 to exchange their 2005-B Senior Notes for Senior Notes convertible into shares of Common Stock at \$10 per share maturing on December 31, 2010 ("2010 Senior Notes"). Interest on the 2010 Senior Notes is payable quarterly at 10% per annum. During March 2005, all of the 2005-B Senior Notes were exchanged for 2010 Senior Notes. As the Company's share price on the day of issuance of each of these Senior Notes was greater than the conversion price of \$10, the Company recorded the intrinsic value of this beneficial conversion feature totaling \$1,394,200 as additional debt discount, which is being amortized to interest expense through the maturity date of these Senior Notes. During the years ended June 30, 2006 and 2005, \$98,000 and \$415,000, respectively, of the 2010 Senior Notes were converted into 9,800 and 41,500 shares, respectively, of Common Stock. During the three months ended September 30, 2006, the Company repaid the face amount of \$100,000 (unaudited) of the 2010 Senior Notes with a payment of \$80,000 and recognized a discount on repayment of \$20,000.

On March 22, 2005, the Company authorized an offer to the holders of the Senior Notes whereby those holders could elect to extend the maturity date of their Senior Notes (the "Senior Note Extension Offer"). Holders of 2005 Senior Notes had the right to extend their maturity to December 31, 2008 ("2008 Senior Notes") and holders of 2006 Senior Notes had the right to elect to extend their maturity to December 31, 2009 ("2009 Senior Notes"). Principal on the Senior Notes extended was not be prepaid prior to April 1, 2006. During the year ended June 30, 2005, these Senior Note holders agreed to exchange an aggregate of \$1,920,651 and \$1,520,000, respectively, of 2005 Senior Notes and 2006 Senior Notes for new notes maturing in 2008 and 2009. The exchange of the 2005 Senior Notes and 2006 Senior Notes to the 2008 Senior Notes and 2009 Senior Notes was not deemed a significant modification of the terms of the Senior Notes and, accordingly, the unamortized debt discount and other issuance costs remaining on the 2005 Senior Notes and 2006 Senior Notes exchanged will be amortized to interest expense through the maturity date of the new notes. During the three months ended September 30, 2006, the Company repaid the face amount of \$11,550 (unaudited) of the 2008 Senior Notes with a payment of \$9,240 and recognized a discount on repayment of \$2,310.

10. SENIOR NOTES (CONTINUED)

During October 2005, the Company approved a non-dilutive private placement offering of up to \$2,333,333 of principal amount 10% Convertible Senior Notes due December 31, 2008 (the "2008-C Senior Notes") to the holders of the 2005-D Common Stock Warrants, which were received in connection with an offering that commenced on March 22, 2005 and ended on April 15, 2005 ("2005-D Private Placement Offering") in which accredited investors purchased Common Stock at \$15 per share. The 2008-C Senior Note offering terminated on November 30, 2005. The holders of the 2005-D Common Stock Warrants had the right to purchase the principal amount of the 2008-C Senior Notes equal to the number of 2005-D Common Stock Warrants multiplied by \$10. Upon the investment in the offering, the corresponding 2005-D Common Stock Warrants were cancelled, resulting in a non-dilutive offering. Interest on the 2008-C Senior Notes shall be paid on a quarterly basis in arrears at the rate of 10% per annum with the outstanding principal amount of the 2008-C Senior Notes together with all accrued and unpaid interest thereon to be paid in full no later than December 31, 2008. The 2008-C Senior Notes are convertible at any time into Common Stock at the rate of \$10 per share. As the Company's share price on the day of issuance of each of these Senior Notes was greater than the conversion price of \$10, the Company recorded the intrinsic value of this beneficial conversion feature totaling \$230,864 as additional debt discount, which is being amortized to interest expense through the maturity date of these Senior Notes. For each \$10,000 investment in the 2008-C Senior Notes, the subscriber received a special purchase right to purchase up to 1,000 shares of Common Stock at \$20 per share at any time on or before December 31, 2008. The Company issued \$544,944 of the 2008-C Senior Notes during the six months ended December 31, 2005 and issued special purchase rights to acquire up to 54,494 shares of Common Stock at \$20 per share. During January 2006, the holder of each special purchase right agreed to exchange the purchase rights for warrants to purchase shares of Common Stock at \$20 at anytime prior to December 31, 2008. The fair value of the purchase rights issued in conjunction with the 2008-C Senior Notes created debt discount totaled \$184,542, which is being amortized to interest expense through the maturity date of these Senior Notes. The fair value was estimated using the Black-Scholes model with the following assumptions: dividend yield of 0%, expected stock price volatility of 0.868, risk-free interest rate of 4.0%, and an expected life of three years. During the year ended June 30, 2006, \$363,333 of the 2008-C Senior Notes were converted into 36,333 shares of Common Stock.

During October 2005, the Company approved a non-dilutive private placement offering of up to \$1,000,000 of Notes ("Bridge Notes") due January 6, 2006 with interest payable on the due date at a rate of 10% per annum. The offering terminated on November 30, 2005. The Company issued \$770,000 of the Bridge Notes. As all of the aforementioned 2008-C Senior Notes were not subscribed on the due date of the Bridge Notes, the Bridge Notes were automatically exchanged on January 6, 2006, in accordance with the original terms of Bridge Notes, for a like principal amount of new Convertible Senior Notes due December 31, 2010 ("2010-B Senior Notes"). Interest on the 2010-B Senior Notes is payable quarterly at 10% per annum and is convertible into Common Shares at \$10 per share. As the Company's share price on the day of issuance of each of these Senior Notes was greater than the conversion price of \$10, the Company recorded the intrinsic value of this beneficial conversion feature totaling \$321,399 as additional debt discount, which is being amortized to interest expense through the maturity date of these Senior Notes. In addition, for each \$10,000 of 2010-B Senior Notes issued in exchange for the Bridge Notes, the Company also issued special purchase rights that enable the holder to purchase up to 1,000 shares of Common Stock at \$20 per share through December 31, 2008. The Company issued \$770,000 of the 2010-B Senior Notes and issued special purchase rights to acquire up to 77,000 shares of Common Stock at \$20 per share. During January 2006, the holder of each special purchase right agreed to exchange the purchase rights for warrants to purchase shares of Common Stock at \$20 at anytime prior to December 31, 2008. The fair value of the purchase rights issued in conjunction with the 2010-B Senior Notes created debt discount totaled \$244,399, which is being amortized to interest expense through the maturity date of these Senior Notes. The fair value was estimated using the Black-Scholes model with the following assumptions: dividend yield of 0%, expected stock price volatility of 0.844, risk-free interest rate of 4.0%, and an expected life of three years.



USA Technologies, Inc.  
Notes to Consolidated Financial Statements

10. SENIOR NOTES (CONTINUED)

Through December 31, 2003, the holders of the Senior Notes had the right to purchase shares of the Company's Common Stock at \$20 per share using quarterly interest payments that were due in lieu of a cash payment of the interest. Additionally, for each share purchased, the note holder was entitled to receive a warrant to purchase one share of the Company's Common Stock at \$20 per share exercisable at any time through June 30, 2004 (extended to August 30, 2004). For the year ended June 30, 2004, 10,612 shares of Common Stock were issued for payment of interest due of \$212,238. The fair value of the warrants issued and the beneficial conversion feature related to the \$20 per share rate used to convert the interest to shares of Common Stock totaled \$266,258 for the year ended June 30, 2004 and have been recorded as additional interest expense. There were no shares of Common Stock issued for payment of interest on the Senior Notes during the years ended June 30, 2005 and 2006.

A summary of the activity for the Senior Notes for the years ended June 30, 2006 and 2005 and the three months ended September 30, 2006 follows:

	Senior Notes Maturing December 31,							
	2003 (2003 Senior Notes)	2004 (2004 Senior Notes)	2005 (2005 Senior Notes)	2006 (2006 Senior Notes)	2007 (2007 Senior Notes)	2008 (2008 & 2008-C Senior Notes)	2009 (2009 Senior Notes)	2010 (2010 & 2010-B Senior Notes)
<b>Face amount of Senior Notes</b>								
Balance, June 30, 2004	\$ --	\$ 451,152	\$ 3,011,791	\$ 3,213,500	\$ 3,019,397	\$ --	\$ --	\$ --
Issued for cash	--	--	--	--	--	--	--	--
Repayment	--	(131,152)	(12,735)	--	--	--	--	--
<b>2004 Senior Notes exchanged for June 30, 2006 Senior Notes</b>								
	--	(320,000)	--	--	--	--	--	--
<b>2005 and 2006 Senior Notes exchanged for 2008 and 2009 Senior Notes</b>								
	--	--	(1,920,651)	(1,520,000)	--	1,920,651	1,520,000	--
<b>2005-B Senior Notes issued for cash and subsequently exchanged for 2010 Senior Notes</b>								
	--	--	--	--	--	--	--	1,755,000
Conversions to Common Stock	--	--	(21,000)	--	(34,381)	--	--	(415,000)
Balance, June 30, 2005	\$ --	\$ --	\$ 1,057,405	\$ 1,693,500	\$ 2,985,016	\$ 1,920,651	\$ 1,520,000	\$ 1,340,000
<b>2008-C Issued for cash</b>								
	--	--	--	--	--	544,944	--	--
<b>Bridge Notes converted into 2010-B Senior Notes</b>								
	--	--	--	--	--	--	--	770,000
Repayment	--	--	(927,405)	(1,683,500)	(12,500)	(5,343)	--	--
Conversions to Common Stock	--	--	(130,000)	(10,000)	(10,000)	(363,333)	--	(98,000)
Balance, June 30, 2006	\$ --	\$ --	\$ --	\$ --	\$ 2,962,516	\$ 2,096,919	\$ 1,520,000	\$ 2,012,000
<b>Repayment (unaudited)</b>								
	--	--	--	--	--	(9,240)	--	(80,000)
<b>Discount on note repayment (unaudited)</b>								
	--	--	--	--	--	(2,310)	--	(20,000)
Balance, September 30, 2006 (unaudited)	\$ --	\$ --	\$ --	\$ --	\$ 2,962,516	\$ 2,085,369	\$ 1,520,000	\$ 1,912,000

	Senior Notes Maturing June 30	
	2007 (2007-B Senior Notes)	2009
<b>Face amount of Senior Notes</b>		
Balance, June 30, 2004	\$ --	\$ --
Issued for cash	--	1,550,790
<b>2004 Senior Notes exchanged for June 30, 2006 Senior Notes</b>		
	320,000	--
Conversions to Common Stock	--	(460,827)
Balance, June 30, 2005	\$ 320,000	\$ 1,089,962
Repayment	--	(50,000)
Conversions to Common Stock	--	(56,136)
Balance, June 30, 2006	\$ 320,000	\$ 983,826
Conversions to Common Stock (unaudited)	--	(500)
Balance, September 30, 2006 (unaudited)	\$ 320,000	\$ 983,326



USA Technologies, Inc.  
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10. SENIOR NOTES (CONTINUED)

	Senior Notes Maturing December 31,							
	2003 (2003 Senior Notes)	2004 (2004 Senior Notes)	2005 (2005 Senior Notes)	2006 (2006 Senior Notes)	2007 (2007 Senior Notes)	2008 (2008 & 2008-C Senior Notes)	2009 (2009 Senior Notes)	2010 (2010 & 2010-B Senior Notes)
Debt discount and other issuance costs								
Unamortized costs at								
June 30, 2003	\$ (80,233)	\$ (453,930)	\$ (2,153,223)	\$ (1,104,169)	\$ (596,852)	\$ --	\$ --	\$ --
Debt discount from issuances	--	--	--	(1,155,475)	(825,532)	--	--	--
Amortization and write-off of unamortized costs upon conversions to Common Stock	32,803	133,180	1,052,231	1,329,255	827,064	--	--	--
Loss on modification for exchanges of 2003 and 2004 Senior Notes for 2006 and 2007 Senior Notes	47,430	271,485	--	--	--	--	--	--
Unamortized costs at								
June 30, 2004	--	(49,265)	(1,100,992)	(930,389)	(595,320)	--	--	--
Debt discount from issuance	--	--	358,659	308,052	--	(358,659)	(308,052)	(1,394,200)
Amortization and write off of unamortized costs upon conversions to Common Stock	--	49,265	617,089	328,148	174,933	23,911	16,213	376,778
Unamortized costs at								
June 30, 2005	\$ --	\$ --	\$ (125,244)	\$ (294,189)	\$ (420,387)	\$ (334,748)	\$ (291,839)	\$ (1,017,422)
Debt discount from issuance	--	--	--	--	--	(415,406)	--	(565,798)
Amortization and write off of unamortized costs upon conversions to Common Stock	--	--	125,244	294,189	170,061	402,128	64,853	302,526
Unamortized costs at								
June 30, 2006	\$ --	\$ --	\$ --	\$ --	\$ (250,326)	\$ (348,026)	\$ (226,986)	\$ (1,280,694)
Amortization (unaudited)	--	--	--	--	41,721	36,097	16,213	129,819
Unamortized costs at								
September 30, 2006 (unaudited)	\$ --	\$ --	\$ --	\$ --	\$ (208,605)	\$ (311,930)	\$ (210,773)	\$ (1,150,876)
Senior Notes reflected in the Consolidated Balance Sheet:								
June 30, 2005								
Face amount	\$ --	\$ --	\$ 1,057,405	\$ 1,693,500	\$ 2,985,016	\$ 1,920,651	\$ 1,520,000	\$ 1,340,000
Unamortized costs	--	--	(125,244)	(294,189)	(420,387)	(334,748)	(291,839)	(1,017,422)
	\$ --	\$ --	\$ 932,161	\$ 1,399,311	\$ 2,564,629	\$ 1,585,903	\$ 1,228,161	\$ 322,578
June 30, 2006								
Face amount	\$ --	\$ --	\$ --	\$ --	\$ 2,962,516	\$ 2,096,919	\$ 1,520,000	\$ 2,012,000
Unamortized costs	--	--	--	--	(250,326)	(348,026)	(226,986)	(1,280,694)
	\$ --	\$ --	\$ --	\$ --	\$ 2,712,190	\$ 1,748,893	\$ 1,293,014	\$ 731,306
September 30, 2006 (unaudited)								
Face amount	\$ --	\$ --	\$ --	\$ --	\$ 2,962,516	\$ 2,085,369	\$ 1,520,000	\$ 1,912,000
Unamortized costs	--	--	--	--	(208,605)	(311,930)	(210,773)	(1,150,876)
	\$ --	\$ --	\$ --	\$ --	\$ 2,753,911	\$ 1,773,439	\$ 1,309,227	\$ 761,124

10. SENIOR NOTES (CONTINUED)

	Senior Notes Maturing	
	June 30,	
	2009	2007 (2007-B Senior Notes)
Debt discount and other		
issuance costs		
Unamortized costs at		
June 30, 2004	\$ --	\$ --
Debt discount from issuance	--	(518,645)
Amortization and write off		
of unamortized costs upon		
conversions to Common		
Stock	--	225,415
Unamortized costs at		
June 30, 2005	\$ --	\$ (293,230)
Debt discount from issuance	--	--
Amortization and write off		
of unamortized costs upon		
conversions to Common		
Stock	--	160,890
Unamortized costs at		
June 30, 2006	\$ --	\$ (132,340)
Amortization and write off		
of unamortized costs upon		
conversions to Common		
Stock (unaudited)	--	33,135
Unamortized costs at		
September 30, 2006 (unaudited)	\$ --	\$ (99,205)

Senior Notes reflected in the  
Consolidated Balance Sheet:

June 30, 2005		
Face amount	\$ 320,000	\$ 1,089,962
Unamortized costs	--	\$ (293,230)
	\$ 320,000	\$ 796,732
June 30, 2006		
Face amount	\$ 320,000	\$ 983,826
Unamortized costs	--	\$ (132,340)
	\$ 320,000	\$ 851,486
September 30, 2006 (unaudited)		
Face amount	\$ 320,000	\$ 983,326
Unamortized costs	--	\$ (99,205)
	\$ 320,000	\$ 884,121

10. SENIOR NOTES (CONTINUED)

Aggregate maturities of Senior Notes as of September 30, 2006 are as follows (unaudited):

2007	\$3,941,342
2008	2,085,369
2009	1,840,000
2010	1,912,000
	<u>\$ 9,783,211</u>
Less discount	1,981,387
	<u>\$ 7,801,824</u>

Aggregate maturities of Senior Notes as of June 30, 2006 are as follows:

2007	\$3,946,342
2008	2,096,919
2009	1,840,000
2010	2,012,000
	<u>\$ 9,895,261</u>
Less discount	2,238,372
	<u>\$ 7,656,889</u>

11. PREFERRED STOCK

The authorized Preferred Stock 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 one-hundredth of a vote and is convertible at any time into one-hundredth of a share of Common Stock. Each share of Common Stock entitles the holder to one voting right. Series A Preferred Stock provides for an annual cumulative dividend of \$1.50 per share, payable when, as and if declared by the Board of Directors, to the shareholders of record in equal parts on 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.

Cumulative unpaid dividends at June 30, 2006 and 2005 and September 30, 2006 amounted to \$8,226,261, 7,461,293 and \$8,602,418 (unaudited), respectively. Cumulative unpaid dividends are convertible into common shares at \$1,000 per common share at the option of the shareholder. During the years ended June 30, 2006 and 2004 and the three months ended September 30, 2006, certain holders of the Preferred Stock converted 1,200, 1,750 and 1,150 (unaudited), respectively, into 12, 17 and 11 (unaudited) shares of Common Stock, respectively. Certain of these shareholders also converted cumulative preferred dividends of \$18,320, \$22,440 and \$15,000 (unaudited), respectively, into 18, 22 and 15 (unaudited) shares of Common Stock during the year ended June 30, 2006 and 2004 and the three month period ended September 30, 2006, respectively. There were no conversions of preferred stock or cumulative preferred dividends during the year ended June 30, 2005. 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, 2004, 2005, 2006 or September 30, 2006. 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.

## 12. COMMON STOCK

On February 7, 2006, our shareholders approved a 1-for-100 reverse stock split of our Common Stock (see Note 1).

The Company's Board of Directors has authorized various Common Stock private placement offerings. Activity for these offerings during the years ended June 30, 2006, 2005 and 2004 and the three months ended September 30, 2006:

- o On January 9, 2006, the Company entered into a Stock Purchase Agreement with Rationalwave Onshore Equity Fund, LP ("Rationalwave"). Under this agreement, the Company sold to Rationalwave 40,000 shares of Common Stock for \$10 per share for an aggregate of \$400,000.
- o On December 13, 2005, the Company entered into a Stock Purchase Agreement with Wellington Management Company, LLP, a large Boston-based institutional investor, on behalf of certain of its clients ("Wellington"). Under this agreement, the Company sold to Wellington 400,000 shares of Common Stock for \$10 per share for an aggregate of \$4,000,000.
- o On March 22, 2005, the Company authorized the issuance of up to 233,333 shares of Common Stock at \$15 per share to accredited investors through April 15, 2005 (the "2005-D Private Placement Offering"). For shares purchased under the offering, the investors also received warrants to purchase an equal number of shares of Common Stock exercisable at \$15 per share at any time prior to December 31, 2005. The Company issued 233,333 shares of Common Stock and 233,333 Common Stock warrants under the 2005-D Private Placement Offering, for total gross proceeds of \$3,500,000. Included in this amount are subscriptions receivable of \$35,723 and \$233,850 at June 30, 2005, of which \$35,723 was received in July 2005. The Company incurred \$73,103 of stock issuance costs in connection with the 2005-D Private Placement Offering.
- o A Common Stock purchase agreement with an accredited investor, Steve Illes, was initially executed in June 2004 and then replaced in August 2004 with a new agreement (the "Common Stock Agreement"). Pursuant to the Common Stock Agreement, the investor agreed to purchase shares of the Company's Common Stock, provided that the aggregate purchase price did not exceed \$7,500,000. Under the Common Stock Agreement, the Company had the right at any time to require Mr. Illes to purchase Common Stock from the Company at the lower of: (i) \$30 per share; or (ii) 90% of the closing bid price per share on the date prior to the date of the delivery by the Company to the investor of notice of his obligation to purchase. The Company could require Mr. Illes to purchase shares under the Common Stock Agreement only if the shares had been registered by the Company for resale under the Act. Additionally, the shares were only available for purchase for a period of one year from the date the shares were registered under the Act. During any calendar month, Mr. Illes could not be required by the Company to purchase Common Stock for an aggregate purchase price in excess of \$700,000. The Company registered 350,000 shares that were effective August 13, 2004. The Company agreed to pay Mr. Illes a due diligence fee of \$45,000 in connection with this transaction. During the year ended June 30, 2005, the Company issued 349,504 shares of Common Stock under the Common Stock Agreement for total gross proceeds of \$3,560,620. In addition to the due diligence fee, the Company incurred \$152,624 of other stock issuance costs in connection with the Common Stock Agreement during the year ended June 30, 2005.

## 12. COMMON STOCK (CONTINUED)

On April 4, 2005, the Company and Mr. Illes entered into a new Common Stock Purchase Agreement (“2005 Common Stock Agreement”). Pursuant to the 2005 Common Stock Agreement, Mr. Illes agreed to purchase shares of the Company’s Common Stock, provided that the aggregate purchase price did not exceed \$10,000,000. Under the 2005 Common Stock Agreement, the Company had the right at any time to require Mr. Illes to purchase Common Stock from the Company at the lower of: (i) \$30 per share; or (ii) 90% of the closing bid price per share on the date prior to the date of the delivery by the Company to the investor of notice of his obligation to purchase. During any calendar month, Mr. Illes could not be required by the Company to purchase Common Stock for an aggregate purchase price in excess of \$800,000. The Company could require the investor to purchase shares under the Common Stock Agreement only if the shares had been registered by the Company for resale under the Act. The Company filed a registration statement related to this agreement that included 205,000 shares of Common Stock and was effective May 13, 2005 and a registration statement that included 360,000 shares of Common Stock and was effective February 14, 2006. The Company issued 5,000 shares of Common Stock (\$90,000) to the investor as a due diligence/commitment fee in connection with this agreement. In addition to the due diligence fee, the Company incurred \$48,542 of other stock issuance costs in connection with the 2005 Common Stock Agreement during the year ended June 30, 2005. During the year ended June 30, 2006 and 2005, the Company issued 529,999 and 30,000 shares, respectively, of Common Stock under the 2005 Common Stock Agreement for total gross proceeds of \$4,443,066 and \$420,000, respectively.

On February 17, 2006, the Company entered into a Common Stock Purchase Agreement (the “2006 Common Stock Agreement”) with Mr. Illes, an accredited investor. Mr. Illes agreed to purchase shares of the Company’s Common Stock with an aggregate purchase price not to exceed \$15,000,000. Under the 2006 Common Stock Agreement, the Company has the right at any time to require Mr. Illes to purchase Common Stock from the Company at the lower of: (i) \$30.00 per share; or (ii) 90% of the closing bid price per share on the date prior to the date of the delivery by the Company to Mr. Illes of notice of his obligation to purchase. The Company can require Mr. Illes to purchase shares only if the shares have been registered by the Company for resale under the Act. The agreement also states that no additional shares shall be registered under the 2005 Common Stock Agreement. During any calendar month, Mr. Illes cannot be required by the Company to purchase Common Stock for an aggregate purchase price in excess of \$800,000. The Company has the right in the future, if necessary, to register additional shares in order to ensure that a sufficient number of shares are available for purchase by Mr. Illes. The 2006 Common Stock Agreement terminates June 30, 2009. The Company filed a registration statement related to the 2006 Common Stock Agreement that included 1,500,000 shares of Common Stock and was effective April 7, 2006. During the year ended June 30, 2006 and the three months ended September 30, 2006, the Company issued 784,429 and 285,818 (unaudited) shares, respectively, of Common Stock under the 2006 Common Stock Agreement for total gross proceeds of \$4,983,774 and \$1,803,500 (unaudited), respectively.

On September 25, 2006, the Company entered into a Common Stock Purchase Agreement (the “2006-B Common Stock Agreement”) with Steve Illes. Mr. Illes agreed to purchase shares of the Company’s Common Stock with an aggregate purchase price not to exceed \$15,000,000. Under the 2006-B Common Stock Agreement, the Company has the right at any time to require Mr. Illes to purchase Common Stock from the Company at the lower of: (i) \$30.00 per share; or (ii) 90% of the closing bid price per share on the date prior to the date of the delivery by the Company to Mr. Illes of notice of his obligation to purchase. The Company can require Mr. Illes to purchase shares only if the shares have been registered by the Company for resale by Mr. Illes under the Securities Act of 1933, as amended. The agreement also states that no additional shares shall be registered under the 2006 Common Stock Agreement. During any calendar month, Mr. Illes cannot be required by the Company to purchase Common Stock for an aggregate purchase price in excess of \$800,000. The 2006-B Common Stock Agreement terminates August 30, 2009. The initial number of shares of Common Stock subject to this agreement is 1,000,000. On October 20, 2006 the Company filed a registration statement under the 1933 Act that included these 1,000,000 shares of Common Stock. The Company has the right in the future, if necessary, to register additional shares for resale by Mr. Illes in order to ensure that a sufficient number of shares are available for purchase by Mr. Illes under the 2006-B Common Stock Agreement. The Company agreed to issue to Mr. Illes 20,000 shares of Common Stock as a due diligence fee in connection with this transaction, and to register these shares for resale by Mr. Illes under the 1933 Act. As of November 30, 2006, no shares have been purchased by Mr. Illes under the 2006-B Common Stock Agreement.

## 12. COMMON STOCK (CONTINUED)

o The 2004-A Private Placement Offering was authorized during fiscal year 2004 for the issuance of common stock at \$15 per share. During the year ended June 30, 2004, there were 282,908 shares issued generating net proceeds of \$4,207,080. Included in this amount are subscriptions receivable of \$300,000 at June 30, 2004, which were collected by the Company during July 2004. Participants in the offering were granted one warrant to purchase shares of Common Stock for every two shares of Common Stock purchased and were exercisable at \$20 per share through December 31, 2004.

o The 2003-A Private Placement Offering was authorized during fiscal year 2003 for the issuance of common stock at \$10 per share. During the year ended June 30, 2004, there were 43,770 shares issued generating net proceeds of \$432,754. The Company also issued 6,950 shares under this offering during the years ended June 30, 2004 for services rendered by consultants amounting to \$185,000.

o During the year ended June 30, 2004, 200,100 shares of Common Stock were issued to accredited investors at \$25 per share in four private placement offerings generating net proceeds of \$5,002,500.

On March 17, 2005, the Company's shareholders approved an increase in the number of authorized shares of Common Stock from 475,000,000 to 560,000,000. On December 13, 2005, the Company's shareholders approved an increase in the number of authorized shares of Common Stock from 560,000,000 to 640,000,000.

During the year ended June 30, 2006, warrants were exercised to purchase 36,800 shares of Common Stock at a share price of \$10, generating proceeds of \$368,000. During the year ended June 30, 2005, warrants were exercised to purchase 109,942 shares of Common Stock at a share price of \$10, generating net proceeds of \$1,094,658. During the year ended June 30, 2004, warrants and stock options were exercised to purchase 321,793 shares of Common Stock at share prices ranging from \$7 to \$20, generating proceeds of \$2,800,472.

In July 2003, the Company and the Company's Chief Executive Officer ("CEO") amended the terms of his Executive Employment Agreement (expiring June 2005). Under the terms of the previous Executive Employment Agreement, the CEO would have been granted seven percent (non-dilutive) of all the then issued and outstanding shares of the Company's Common Stock in the event a "USA Transaction" (as defined) occurs, which among other events includes a change in control of the Company. The amended terms of the Executive Employment Agreement, eliminates the seven percent (non-dilutive) right to receive Common Stock upon a "USA Transaction" and granted the CEO an aggregate of 140,000 shares of Common Stock (subject to adjustment for stock splits or combinations) in the event a "USA Transaction" occurs. In exchange for the amendment of these terms, the Company issued the CEO 105,000 shares of its Common Stock valued at \$4,620,000 or \$44 per share representing the quoted market price of the Company's Common Stock on the date the amendment was entered into and the shares were granted. In connection with this amendment, the CEO also entered into a lock-up agreement pursuant to which he cannot sell 25,000 of these shares for a one-year period and 80,000 of these shares for a two-year period. The CEO is not required to pay any additional consideration for these shares of Common Stock. At the time of a "USA Transaction", all of the 140,000 shares are automatically deemed to be issued and outstanding, and will be entitled to be treated as any other issued and outstanding shares of Common Stock. These shares are irrevocable and fully vested, have no expiration date, and are not affected by the termination of the CEO for any reason whatsoever.



12. COMMON STOCK (CONTINUED)

In addition to the shares issued to the CEO, there were 9,500, 8,005, 9,207 and 1,500 (unaudited) shares of Common Stock issued to certain employees and officers for services and for professional services during the years ended June 30, 2006, 2005, and 2004 and the three months ended September 30, 2006, respectively. The value of these shares was based upon the fair value of the Company's Common Stock on the dates the shares were granted and totaled \$79,195, \$107,670, \$237,040 and \$11,850 (unaudited) for the years ended June 30, 2006, 2005, and 2004 and the three months ended September 30, 2006, respectively.

During the year ended June 30, 2004, 5,000 shares of Common Stock were issued to an accredited investor as settlement resulting from a non-registration event as defined under the subscription agreement dated November 4, 2002.

In April 2004, the Company's Board of Directors established and authorized the 2004-A Stock Compensation Plan for use in compensating employees, directors and consultants through the issuance of shares of Common Stock of the Company. There were 5,000 shares authorized under the 2004-A Plan. As of June 30, 2005 and 2004, there were 5,000 and 5,000 shares, respectively, issued under the 2004-A Plan. On October 29, 2004, the Board of Directors approved the 2004-B Stock Compensation Plan to allow up to 5,000 shares of Common Stock to be available for issuance to future or current employees, directors or consultants of the Company. As of June 30, 2006 and 2005, there were 5,000 and 3,913 shares, respectively, issued under the 2004-B Plan. On June 13, 2006, the Board of Directors approved the 2006-A Stock Compensation Plan to allow up to 25,000 shares of Common Stock to be available for issuance to future or current employees, directors or consultants of the Company. As of September 30 and June 30, 2006, there were 9,913 (unaudited) and 8,413 shares, respectively, issued under the 2006-A Plan.

As of September 30, 2006, the Company had reserved shares of Common Stock for future issuance for the following (unaudited):

Exercise of Common Stock Options	178,558
Exercise of Common Stock Warrants	202,923
Conversions of Preferred Stock and cumulative	
Preferred Stock dividends	13,806
Conversions of Senior Notes	659,007
Issuance under 2006 Common Stock Agreement	429,753
Issuance under 2006-A Stock Compensation Plan	15,087
Issuance under Chief Executive Officer's employment	
agreement upon the occurrence of a USA Transaction	140,000
Total shares reserved for future issuance	<u>1,639,134</u>

As of June 30, 2006, the Company had reserved shares of Common Stock for future issuance for the following:

Exercise of Common Stock Options	178,933
Exercise of Common Stock Warrants	219,481
Conversions of Preferred Stock and cumulative	
Preferred Stock dividends	13,441
Conversions of Senior Notes	669,635
Issuance under 2006 Common Stock Agreement	715,571
Issuance under 2006-A Stock Compensation Plan	16,587
Issuance under Chief Executive Officer's employment	
agreement upon the occurrence of a USA Transaction	140,000
Total shares reserved for future issuance	<u>1,953,648</u>

12. COMMON STOCK (CONTINUED)

A summary of the status of the Company's nonvested common shares as of September 30 (unaudited) and June 30, 2006, and changes during the year ended June 30, 2006 and three months ended September 30, 2006 (unaudited), is presented below:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at July 1, 2006	--	\$ --
Granted	125,000	8.00
Vested	41,667	8.00
Forfeited	--	--
Nonvested at June 30, 2006		
and September 30, 2006	<u>83,333</u>	\$ 8.00

13. COMMON STOCK WARRANTS AND OPTIONS

Common Stock Warrant activity for the years ended June 30, 2006, 2005 and 2004 and the three months ended September 30, 2006 was as follows:

	Warrants
Outstanding at June 30, 2003	621,277
Issued	188,739
Exercised	(320,604)
Cancelled	(154,840)
Outstanding at June 30, 2004	334,571
Issued	233,333
Exercised	(109,942)
Cancelled	(136,642)
Outstanding at June 30, 2005	321,320
Issued	131,494
Exercised	(36,800)
Cancelled	(196,533)
Outstanding at June 30, 2006	219,481
Cancelled	(16,558)
Outstanding at September 30, 2006 (unaudited)	<u>202,923</u>

All Common Stock warrants outstanding as of September 30, 2006 and June 30, 2006 and 2005 were exercisable. The following table shows exercise prices and expiration dates for warrants outstanding as of September 30, 2006 (unaudited):

Warrants Outstanding	Exercise Price Per Share	Expiration Date
71,429	\$7	October 26, 2007
131,494	\$20	December 31, 2008
<u>202,923</u>		

13. COMMON STOCK WARRANTS AND OPTIONS (CONTINUED)

The following table shows exercise prices and expiration dates for warrants outstanding as of June 30, 2006:

WARRANTS OUTSTANDING	EXERCISE PRICE PER SHARE	EXPIRATION DATE
750	\$12.50	June 30, 2006
71,429	\$7	October 26, 2007
131,494	\$20	December 31, 2008
12,000	\$91	August 29, 2010
3,779	\$100	April 24, 2011
29	\$103	April 30, 2011
<u>219,481</u>		

The following table shows exercise prices and expiration dates for warrants outstanding as of June 30, 2005:

WARRANTS OUTSTANDING	EXERCISE PRICE PER SHARE	EXPIRATION DATE
233,333	\$15	December 31, 2005
750	\$12.50	June 30, 2006
71,429	\$7	October 26, 2007
12,000	\$91	August 29, 2010
3,779	\$100	April 24, 2011
29	\$103	April 30, 2011
<u>321,320</u>		

In conjunction with the 2008-C Senior Note offering (Note 10), the Company issued warrants to purchase 54,494 shares of Common Stock and are exercisable at \$20 per share at any time prior to December 31, 2008.

In conjunction with the 2010-B Senior Note offering (Note 10), the Company issued warrants to purchase 77,000 shares of Common Stock and are exercisable at \$20 per share at any time prior to December 31, 2008.

In conjunction with the 2005-D Private Placement Offering (Note 12), the Company issued warrants to purchase 233,333 shares of Common Stock and are exercisable at \$15 per share at any time prior to December 31, 2005. During October 2005, the Company approved a temporary reduction in the exercise price of the 2005-D Common Stock Warrants from \$15 to \$10 per share through November 30, 2005. The Company received \$368,000 and issued 36,800 shares of Common Stock as a result of the exercise of the 2005-D Common Stock Warrants at \$10 per share.

Prior to June 30, 2004, the Company issued warrants to purchase approximately 37,000 shares of Common Stock to holders of the Senior Notes who elected to receive quarterly interest on their Notes in shares of Common Stock, in lieu of a cash payment of interest ("Original Interest Warrants"). These warrants were exercisable at \$20 per share through August 30, 2004. In June 2004, the Company issued additional warrants to the Senior Note holders who elected to receive interest in shares of Common Stock ("Additional Interest Warrants"). One additional warrant was issued for each warrant previously issued with an exercise price of \$20 per share through December 31, 2004.

13. COMMON STOCK WARRANTS AND OPTIONS (CONTINUED)

The Company reduced the exercise price of the Original Interest Warrants to \$15 per share and extended their expiration through October 29, 2004. In addition, for each Original Interest Warrant exercised through October 4, 2004, the expiration date of one Additional Interest Warrant was extended to June 30, 2005 from December 31, 2004, and the exercise price was reduced to \$15 per share through June 30, 2005. The Company also reduced the exercise price of the Additional Interest Warrants to \$15 per share through November 30, 2004 and then retroactively to \$10 per share through December 31, 2004. Investors who had previously exercised Original Interest Warrants and Additional Interest Warrants at \$15 per share were refunded the equivalent of \$5 per share in recognition of the reduction of the exercise price to \$10 per share that occurred after the warrants were exercised. Such refunds amounted to \$40,971. During the year ended June 30, 2005, Original Interest Warrants and Additional Interest Warrants were exercised to purchase 8,074 shares of Common Stock. Such exercises generated net proceeds of approximately \$75,000, after considering the above-mentioned refund.

As of October 25, 2004, the Company reduced the exercise price of the Common Stock warrants issued as part of the 2004-A Private Placement Offering to \$10 per share, from \$20 per share, through November 30, 2004. On December 13, 2004, the exercise price of \$10 per share was retroactively extended to December 31, 2004. During the year ended June 30, 2005, the Company received \$765,833 upon the exercise of 76,583 of these warrants at an exercise price of \$10 per share.

The Company's Board of Directors has granted options to employees and Board members to purchase shares of Common Stock at prices that were at or above fair market value on the dates the options were granted. The option term and vesting schedule were established by the contracts under which the options were granted.

Common Stock Option activity during the years ended June 30, 2006, 2005 and 2004 and the three months ended September 30, 2006 (unaudited) was as follows:

	OPTIONS OUTSTANDING	EXERCISE PRICE PER SHARE	WEIGHTED-AVERAGE EXERCISE PRICE
Outstanding at June 30, 2003	29,075	\$16.50-\$250	\$35.32
Granted	3,000	\$30	\$30.00
Exercised	(2,239)	\$16.50	\$16.50
Expired	(10,861)	\$16.50-\$250	\$56.15
Outstanding at June 30, 2004	18,975	\$16.50-\$200	\$23.80
Granted	3,000	\$20	\$20.00
Cancelled	(1,876)	\$30	\$30.00
Outstanding at June 30, 2005	20,099	\$16.50-\$200	\$23.58
Granted	160,000	\$7.50-\$8	\$7.52
Expired	(1,166)	\$100-\$200	\$105.66
Outstanding at June 30, 2006	178,933	\$7.50-\$100	\$8.68
Expired	(375)	\$30	\$30.00
Outstanding at September 30, 2006	178,558	\$7.50-\$100	\$8.64
Exercisable at June 30, 2006	86,767	\$7.50-\$100	\$9.69
Exercisable at September 30, 2006	86,767	\$7.50-\$100	\$9.64

13. COMMON STOCK WARRANTS AND OPTIONS (CONTINUED)

The following table shows exercisable options, exercise prices, the weighted average remaining contractual life and the aggregate intrinsic value for options outstanding as of September 30, 2006 (unaudited).

OPTIONS OUTSTANDING	OPTIONS EXERCISABLE	EXERCISE PRICE PER SHARE	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)-		INTRINSIC VALUE-	
			OUTSTANDING	EXERCISABLE	OUTSTANDING	EXERCISABLE
154,000	69,334	\$7.50	5.51	4.67	\$ -	\$ -
6,000	-	\$8	6.22	0.00	\$ -	\$ -
14,658	14,658	\$16.50	0.62	0.62	\$ -	\$ -
3,000	1,875	\$20	1.70	1.32	\$ -	\$ -
750	750	\$30	0.21	0.21	\$ -	\$ -
150	150	\$100	0.71	0.71	\$ -	\$ -
178,558	86,767		5.04	3.87	\$ -	\$ -

The following table shows exercisable options, exercise prices, the weighted average remaining contractual life and the aggregate intrinsic value for options outstanding as of June 30, 2006.

OPTIONS OUTSTANDING	OPTIONS EXERCISABLE	EXERCISE PRICE PER SHARE	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)-		INTRINSIC VALUE-	
			OUTSTANDING	EXERCISABLE	OUTSTANDING	EXERCISABLE
154,000	69,334	\$7.50	5.72	4.83	\$30,800	\$13,867
6,000	-	\$8	6.47	0.00	\$ -	\$ -
14,658	14,658	\$16.50	0.87	0.87	\$ -	\$ -
3,000	1,500	\$20	1.95	0.40	\$ -	\$ -
1,125	1,125	\$30	0.31	0.31	\$ -	\$ -
150	150	\$100	0.96	0.96	\$ -	\$ -
178,933	86,767		5.25	4.02	\$30,800	\$13,867

Total expected compensation expense related to the vesting of options outstanding as of June 30, 2006 is \$477,946 and is expected to be recognized over weighted-average period of 1.43 years. The intrinsic value of the non-vested options as of September 30 and June 30, 2006 was \$0 (unaudited) and \$16,933, respectively.

On April 21, 2006, the Board of Directors approved the grant of 12,000 Common Stock Options to each of the outside directors serving as of February 27, 2006 and 6,000 Common Stock Options to Mr. Passner, a new director as of April 12, 2006, all with an exercise price of \$7.50 per share and all exercisable at any time within five years following the date of vesting. The options granted to Mr. Sellers and Mr. Van Allen are fully vested. Of the options granted to Mr. Katz and Mr. Lurio, 6,000 vest immediately, 3,000 vest on April 1, 2007, and 3,000 vest on April 1, 2008. Of the options granted to Mr. Passner, 3,000 vest on April 1, 2007, and 3,000 vest on April 1, 2008.

In conjunction with the signing of employment agreements on May 11, 2006, the Company granted Mr. Jensen, Mr. Herbert, and Mr. DeMedio, 75,000, 18,000 and 7,000 Common Stock Options, all with an exercise price of \$7.50 per share and all exercisable at any time within five years following the date of vesting. The options vest as follows: one-third on May 11, 2006; one-third on June 30, 2007; and one-third on June 30, 2008.

In conjunction with the appointment of Stephen McHugh to the Board of Directors on June 20, 2006, the Company granted Mr. McHugh 6,000 Common Stock Options with an exercise price of \$8.00 per share. The options vest as follows: 3,000 on June 20, 2007 and 3,000 on June 20, 2008. The options are exercisable at any time within five years of vesting.

13. COMMON STOCK WARRANTS AND OPTIONS (CONTINUED)

The fair value of the stock options granted on April 21 and May 11, 2006 was \$4.83 and \$5.51, respectively, and was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions.

Dividend yield	0%
Expected stock price volatility	0.823
Risk-free interest rate	4.0%
Expected life, in years	5

The fair value of the stock options granted on June 20, 2006 was \$5.06 and was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions.

Dividend yield	0%
Expected stock price volatility	0.796
Risk-free interest rate	4.0%
Expected life, in years	5

During the year ended June 30, 2005, stock options were granted to one individual to purchase 3,000 shares of Common Stock of the Company at \$20 per share and vest through April 30, 2007. The fair value of the stock options granted, \$9.36, was estimated on the date of the grant using the Black-Scholes option-pricing model with the following assumptions.

Dividend yield	0%
Expected stock price volatility	0.922
Risk-free interest rate	4.0%
Expected life, in years	2

During the year ended June 30, 2004, stock options were granted to one individual to purchase 3,000 shares of Common Stock of the Company at \$30 per share. The fair value of the stock options granted, \$16.00, was estimated on the date of the grant using the Black-Scholes option-pricing model with the following assumptions.

Dividend yield	0%
Expected stock price volatility	0.971
Risk-free interest rate	4.0%
Expected life, in years	3

The weighted-average grant-date fair value of stock options granted was \$5.26, \$9.36 and \$16.00 during the years ended June 30, 2006, 2005 and 2004, respectively. The total fair value of options vested during the years ended June 30, 2006, 2005 and 2004 and the three months ended September 30, 2006 and 2005 was \$371,050, \$18,000, \$0, \$3,375 (unaudited) and \$3,375 (unaudited), respectively.

#### 14. TERMINATION OF KODAK VENDING PLACEMENT AGREEMENT

The Company's wholly owned subsidiary, Stitch, entered into a vending placement agreement whereby Stitch agreed to purchase film and cameras directly from Eastman Kodak Company and vending machines from a supplier. Stitch placed the vending machines at numerous locations throughout the United States under agreements negotiated with the location owners and derived revenues amounting to \$0, \$0 and \$358,484 for the years ended June 30, 2006, 2005 and 2004, respectively.

During 2003, Stitch alleged that the supplier and another party to the vending agreement breached the vending agreement and the supplier and the other party to the vending agreement alleged that Stitch had breached the vending agreement. Effective December 31, 2003, the parties finalized a settlement of this matter which resulted in the termination of the vending agreement. Under the settlement agreement, the Company received a payment from Kodak of approximately \$675,000. The agreement also provides for the Company to receive payments of \$300 per vending machine from the supplier of the vending machines, as the machines are pulled from service at the supplier's sole cost and expense. Upon receipt of the \$300 per machine, title to the vending machine transfers from Stitch to the supplier. Through December 30, 2004, the Company had received \$65,100 for these machines. The agreement also provided that the supplier cancel a \$124,000 obligation of Stitch for the purchase of vending machines.

This termination agreement resulted in a gain of \$429,204 during the year ended June 30, 2004 and is reflected as Other income in the June 30, 2004 Consolidated Statement of Operations. This gain is comprised of the payment from Kodak of approximately \$675,000 plus the cancellation of Stitch's obligation to the supplier of the vending machines of approximately \$124,000 less a write-down of the carrying value of vending machines of approximately \$367,000 and a net write-off of amounts due to and from Kodak of \$3,000. The remaining vending machines are reported as assets held for sale in the June 30, 2004, as it was determined that the plan of sale criteria in FAS 144 was met in the termination agreement, at which time depreciation of these assets ceased. During the year ended June 30, 2005, the Company wrote off the remaining value of the vending machines that had not been sold during the year as a loss on contract settlement totaling \$42,300.

#### 15. RETIREMENT PLAN

The Company's Savings and Retirement Plan (the "Plan") allows employees who have attained the age of 21 and have completed six months of service to make voluntary contributions up to a maximum of 15% of their annual compensation, as defined in the Plan. Through June 30, 2000, the Plan did not provide for any matching contribution by the Company, however, starting at the beginning of fiscal year 2001, the Company amended the Plan to include a Company matching contribution up to 10% of an employee's compensation. Effective January 1, 2003, the matching contribution changed to a dollar-for-dollar matching contribution on salary deferrals up to 3% of the employee's compensation then a fifty-cents on the dollar matching contribution on salary deferrals from 3% to 5%. The Company's contribution for the years ended June 30, 2006, 2005 and 2004 and three months ended September 30, 2006 and 2005 was approximately \$114,000, \$96,000, \$78,000, \$30,000 (unaudited) and \$34,000 (unaudited), respectively.

16. COMMITMENTS AND CONTINGENCIES

The Company conducts its operations from various facilities under operating leases. In March 2003, the Company entered into a lease for 12,864 square feet of space located in Malvern, Pennsylvania for its principal executive office and used for general administrative functions, sales activities, and product development. The lease term extends through December 31, 2008 and provides for escalating rent payments and a period of free rent prior to the commencement of the monthly lease payment in January 2004 of approximately \$25,000 per month. During April 2005, the Company entered into an amendment to the lease covering 4,385 additional square feet that is contiguous to its existing space. The lease term was extended to December 31, 2010, and the amendment provides for a period of free rent for the additional space with rent of approximately \$31,000 per month commencing in September 2005 with escalating rental payments thereafter.

The Company also leases 9,084 square feet of space, located in Malvern, Pennsylvania, on a month-to-month basis for a monthly payment of approximately \$8,000. During prior years, the facility was solely used to warehouse product. All product warehousing, shipping and customer support was transferred to this location from the executive office location during the first quarter of fiscal year 2005.

In connection with the acquisition of the energy conservation product line in July 2003 from Bayview Technology Group, LLC, the Company assumed leases for 6,384 square feet of space located in Denver, Colorado used for administrative functions, sales activities and product warehousing associated with our energy management products. The lease terms extended through June 30, 2005 and provided for escalating rent payments ending at \$8,200 per month. The lease provided for additional rent for a prorated share of operating costs for the entire facility.

In December 2004, the Company entered into a lease for 2,837 square feet of space located in Denver, Colorado to replace the above-mentioned lease used for administrative functions, sales activities and product warehousing associated with our energy management products. The lease terms extend through May 31, 2009 and provide for five months of free rent followed by rent payments of \$1,200 per month and escalating payments beginning on June 1, 2006. The lease provides for additional rent for a prorated share of operating costs for the entire facility.

Rent expense under operating leases was approximately \$489,000, \$447,000, \$450,000, \$139,000 (unaudited) and \$117,000 (unaudited) during the years ended June 30, 2006, 2005 and 2004 and the three months ended September 30, 2006 and 2005, respectively. Future minimum lease payments subsequent to June 30, 2006 under noncancellable operating leases are as follows:

	OPERATING LEASES
2007	\$ 438,000
2008	447,000
2009	452,000
2010	220,000
Total minimum lease payments	\$ 1,989,000

During the fourth quarter of fiscal year 2006, the Company committed to purchase approximately \$1,334,000 of inventory from a third party manufacturer through December 31, 2007. The Company expects to begin taking delivery of the inventory during the third quarter of fiscal year 2007 upon completion of manufacturing.



16. COMMITMENTS AND CONTINGENCIES (CONTINUED)

On May 11, 2006, the Company and Mr. Jensen entered into an Amended and Restated Employment Agreement pursuant to which the term of Mr. Jensen's employment with the Company was extended to June 30, 2009. Effective May 11, 2006, Mr. Jensen's base salary was increased to \$325,000 per annum. Mr. Jensen's base salary had not been increased since January 1, 2004. 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. Mr. Jensen was granted the right (exercisable at any time prior to the 60th day following the commencement of each fiscal year) to elect to have one-half of his base salary for each of the fiscal years ending June 30, 2007, June 30, 2008, and June 30, 2009 paid in shares of Common Stock rather than cash. Mr. Jensen has elected to receive shares in lieu of cash for one-half of his base salary for the fiscal year ending June 30, 2007. As a result of such election, 22,080 shares will be issued to him which will vest as follows: 5,520 on July 1, 2006; 5,520 on October 1, 2006; 5,520 on January 1, 2007; and 5,520 on April 1, 2007. Mr. Jensen was also granted 75,000 shares of Common Stock and an additional amount of options to purchase up to 75,000 shares of Common Stock at \$7.50 per share. The 75,000 shares of Common Stock vest as follows: 25,000 on June 1, 2006; 25,000 on January 1, 2007; and 25,000 on June 1, 2007. The options vest as follows: 25,000 on May 11, 2006; 25,000 on June 30, 2007; and 25,000 on June 30, 2008. The options may be exercised at any time within 5 years of vesting. The Company recorded a non-cash compensation charge of \$264,000 and \$172,127 related to the grant of restricted Common Stock and Common Stock Options, respectively, during the fiscal year ended June 30, 2006. See note 13 for additional option disclosures. All of the shares granted to or to be issued to Mr. Jensen under his employment agreement, and the shares underlying the options granted to Mr. Jensen, are not and will not be registered under the Securities Act of 1933, as amended, and constitute restricted securities as such term is defined in Rule 144 promulgated under the 1933 Act. In October 2006, the Company granted to Mr. Jensen piggyback registration rights under the Act for the shares described above for a period of five years following the vesting of any of such shares and for the shares underlying any of the options described above for a period of five years following the vesting of any such options.

As previously provided in his employment agreement, upon the occurrence of a "USA Transaction" (as defined below), the Company will issue to Mr. Jensen 140,000 shares of Common Stock subject to adjustment for stock splits or combinations ("Jensen Shares"). Mr. Jensen is not required to pay any additional consideration for the Jensen Shares. At the time of any USA Transaction, all of the Jensen Shares 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 Jensen Shares are irrevocable and fully vested, have no expiration date, 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.

16. COMMITMENTS AND CONTINGENCIES (CONTINUED)

On May 11, 2006, the Company and Mr. Herbert entered into an Amended and Restated Employment Agreement pursuant to which the term of Mr. Herbert's employment with the Company was extended to June 30, 2009. Effective May 11, 2006, Mr. Herbert's base salary was increased to \$285,000 per annum. Mr. Herbert's base salary had not been increased since January 1, 2004. 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. In the event that a USA Transaction (as defined in Mr. Jensen's employment agreement) shall occur, then Mr. Herbert has the right to terminate his agreement upon 30 days notice to USA. Mr. Herbert was granted the right to elect to have one-half of his base salary for each of the fiscal years ending June 30, 2007, June 30, 2008, and June 30, 2009 paid in shares of Common Stock rather than cash. Mr. Herbert was also granted 50,000 shares of Common Stock and an additional amount of options to purchase up to 18,000 shares of Common Stock at \$7.50 per share. The 50,000 shares of Common Stock vest as follows: 16,667 on June 1, 2006; 16,667 on January 1, 2007; and 16,666 on June 1, 2007. The options vest as follows: 6,000 on May 11, 2006; 6,000 on June 30, 2007; and 6,000 on June 30, 2008. The options may be exercised at any time within 5 years of vesting. The Company recorded a non-cash compensation charge of \$176,003 and \$41,310 related to the grant of restricted Common Stock and Common Stock Options, respectively, during the fiscal year ended June 30, 2006. See note 13 for additional option disclosures. All of the shares granted to or to be issued to Mr. Herbert under his employment agreement, and the shares underlying the options granted to Mr. Herbert, are not and will not be registered under the Securities Act of 1933, as amended, and constitute restricted securities as such term is defined in Rule 144 promulgated under the 1933 Act. In October 2006, the Company granted to Mr. Herbert piggyback registration rights under the Act for the shares described above for a period of five years following the vesting of any of such shares and for the shares underlying any of the options described above for a period of five years following the vesting of any such options.

On May 11, 2006, the Company and Mr. DeMedio entered into an amendment to his Employment Agreement pursuant to which the term of Mr. DeMedio's employment with the Company was extended to June 30, 2008. Effective May 11, 2006, Mr. DeMedio's base salary was increased to \$165,000 per annum. Mr. DeMedio was granted the right to elect to have one-half of his base salary for each of the fiscal years ending June 30, 2007, and June 30, 2008 paid in shares of Common Stock rather than cash. Mr. DeMedio was also granted options to purchase up to 7,000 shares of Common Stock at \$7.50 per share. The options vest as follows: 2,334 on May 11, 2006; 2,333 on June 30, 2007; and 2,333 on June 30, 2008. The options may be exercised at any time within 5 years of vesting. The Company recorded a non-cash compensation charge of \$16,068 related to the grant of restricted Common Stock Options during the fiscal year ended June 30, 2006. See note 13 for additional option disclosures. All of the shares underlying the options granted to Mr. DeMedio under his employment agreement are not and will not be registered under the Securities Act of 1933, as amended, and constitute restricted securities as such term is defined in Rule 144 promulgated under the 1933 Act. In October 2006, the Company granted to Mr. DeMedio piggyback registration rights under the Act for the shares underlying any of the options described above for a period of five years following the vesting of any such options.

Various legal actions and claims occurring in the normal course of business are pending or may be instituted or asserted in the future against the Company. The Company does not believe that the resolution of these matters will have a material effect on the financial position or results of operations of the Company.

In February 2005, a Complaint was filed against the Company by Swartz Private Equity, LLC ("Swartz") alleging that the Company breached various agreements entered into with Swartz in August and September 2000 in connection with the so-called equity line of credit provided by Swartz to the Company. The Complaint requested money damages of \$4,350,381 representing the alleged value of the warrants held by or claimed to be due to Swartz, money damages of \$196,953 representing a termination fee allegedly due in connection with the termination of the agreements, and unspecified money damages relating to the alleged breach of the rights of first refusal.

## 16. COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Company's response to the Complaint denied any liability to Swartz and asserted various counterclaims against Swartz that seek money damages and other affirmative relief against Swartz. The Company's response, among other things, stated that the entire transaction was void and unenforceable because Swartz had failed to register as a broker-dealer under applicable Federal and state securities laws as required in order for Swartz to be engaged in the business of providing equity line products.

On September 20, 2006, the parties agreed to fully settle this litigation. In this regard, the Company agreed to issue to Swartz 33,184 shares of our Common Stock. We also agreed to honor the cashless exercise of warrants by Swartz in 2003 for 6,816 shares of Common Stock. We had previously disputed that Swartz had validly exercised those warrants. We have granted to Swartz certain registration rights in connection with the 33,184 shares. The settlement agreement and release implementing the settlement was signed by the parties on October 12, 2006. The Company had recorded a liability of \$270,000 as of June 30 and September 30, 2006 to accrue for the value of the 40,000 shares of Common Stock that were issued in October under the settlement agreement.

## 17. SUBSEQUENT EVENTS (UNAUDITED)

From October 1, 2006 through November 30, 2006, the Company issued an additional 429,753 shares of Common Stock under the 2006 Common Stock Agreement for total gross proceeds of \$1,991,151.

From December 20, 2006 through January 5, 2007, the Company issued 778,761 shares of Common Stock under the 2006-B Common Stock Agreement for total gross proceeds of \$4,280,743.

During October 2006, the Company entered into a loan agreement with a financial institution bearing interest at 18% and secured by \$470,000 of the Finance Receivables. The Company received \$470,000 in proceeds and agreed to make 12 monthly payments of \$25,000 followed by 18 monthly payments of \$15,000 from the proceeds received from the finance receivables.

On December 15, 2006, the Company entered into stock purchase agreements (the "Agreements") with certain investors ("Buyers"). Pursuant to the Agreements, the Company agreed to sell to the Buyers 1,400,000 shares of the Company's Common Stock (the "Shares") at a price of \$6.00 per share, for gross proceeds of \$8,400,000. The Company also agreed to issue to the Buyers warrants to purchase up to 700,000 common shares at an exercise price of \$6.40 per share exercisable at any time through December 31, 2011 (the "Warrants"). The closing under the Agreements occurred on December 20, 2006. William Blair & Co., LLC ("Blair") acted as the exclusive placement agent for the private placement. As compensation for its services, Blair received from the Company a fee equal to eight percent (8%) of the total consideration received by the Company as a result of the offering (other than consideration received from Buyers who were existing investors in the Company). The fee was comprised of 7% in cash, or \$520,800, and 1% in the form of five-year warrants for the purchase of the Company's Common Stock at 110% of the purchase price paid by the Buyers or \$6.60 per share. Pursuant to the Agreements, the Company agreed to file a registration statement with the Securities and Exchange Commission ("SEC") covering the resale of the Shares and of the Shares underlying the Warrants within thirty days from the date of the Agreements. In the event that the registration statement to be filed by the Company is not declared effective by the SEC within ninety (90) days from the date of the Agreements, the Company is required to pay to the Buyers a cash payment equal to one percent (1%) of the aggregate subscription price paid by the Buyers for each month beyond such ninety (90) day period that the registration statement is not effective. The maximum aggregate penalty payable to the Buyers is twelve percent (12%) of the aggregate subscription price paid by the Buyers.

On December 31, 2006, and as permitted under the terms thereof, the Company prepaid a total of \$4,341,121 of Convertible Senior Notes. These Convertible Senior Notes consisted of all the \$983,327 principal amount of outstanding 10% Convertible Senior Notes due June 30, 2007, all the \$2,962,516 principal amount of outstanding 12% Convertible Senior Notes due December 31, 2007, and \$395,278 principal amount of 12% Convertible Senior Notes due December 31, 2008.

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## PART II INFORMATION NOT REQUIRED IN THE PROSPECTUS

### ITEM 13. 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	\$ 1,609.55
Printing and Engraving Expenses	\$ 3,390.45
Accounting Fees and Expenses	\$ 15,000.00
Legal Fees and Expenses	\$ 15,000.00
Total	\$ 35,000.00

### ITEM 14. 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. Our By-laws substantively provide that we will indemnify our 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. Our By-laws eliminate the personal liability of the directors to the fullest extent permitted by Section 1713 of the BCL.

### ITEM 15. 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 USA without registration under the Securities Act of 1933, as amended ("Act"):

**PRIVATE PLACEMENTS**

From February through June 2004, the Company sold 282,908 shares of Common Stock to 34 accredited investors at \$15 per share for an aggregate of \$4,243,625. During June 2004, the Company granted to each investor in the offering a warrant to purchase one-half of a share for each share subscribed for by such investor in the offering. The Company issued warrants to purchase a total of 141,454 shares. The warrants were originally exercisable at \$20 per share at any time through December 31, 2004. The exercise price was subsequently reduced to \$10 per share. We have agreed to register the shares and the shares underlying the warrants under the Act for resale for a period of two years. The offer and sales of the shares was exempt from registration

under Rule 506 promulgated under Section 4(2) of the Act. All of the investors were either pre-existing security holders or business associates. The offer and sale thereof did not involve any general advertising or solicitation and the securities contained appropriate restrictive legends under the Act.

In June 2004, we issued warrants to purchase up to 37,164 shares of Common Stock to the holders of our senior notes who elected to receive warrants in lieu of the cash interest payment due for the quarters ended June 30, 2002, September 30, 2002, December 31, 2002, March 31, 2003, June 30, 2003, September 30, 2003 and December 31, 2003. The warrants are exercisable at \$20 per share at any time through December 31, 2004 and were later reduced in price to \$10 per share. We have agreed to register the shares underlying the warrants under the Act for resale for a period of 2 years. The securities were offered and sold under the exemption from registration set forth in Rule 506 promulgated under the Act. All of the noteholders are accredited investors and existing security holders of USA, and there was no general solicitation or advertising.

On June 18, 2004, we entered into a Common Stock Purchase Agreement with Steve Illes. During the one year period following the effectiveness of a registration statement covering the shares, Mr. Illes has agreed to purchase from USA shares of Common Stock, provided that the aggregate purchase price can not exceed \$7,500,000. Under the Agreement, Mr. Illes is permitted to purchase Common Stock from USA at any time at the price per share of \$30. In addition, USA has the right at any time to require Mr. Illes to purchase Common Stock from USA at the lower of: (i) \$30; or (ii) 90% of the closing bid price per share on the date prior to the date of the delivery by USA to Mr. Illes of notice of his obligation to purchase. USA can require Mr. Illes to purchase shares under the Agreement only if the shares have been registered by the Company for resale by Mr. Illes under the Act. During any calendar month, Mr. Illes is not permitted to purchase and can not be required by USA to purchase Common Stock for an aggregate purchase price in excess of \$700,000. We have agreed to register for resale the shares purchased by Mr. Illes under the Agreement for a period of one year from the date of the effectiveness of the initial registration statement covering the shares to be purchased by Mr. Illes. We have agreed to pay to Mr. Illes a due diligence fee of \$45,000. The securities were offered and sold to Mr. Illes under the exemption from registration set forth under Rule 506 promulgated under the Act. Mr. Illes is an existing shareholder and an accredited investor, and there was no general solicitation or advertising.

In July 2004, the Staff of the Securities and Exchange Commission indicated that because of the discretion given to Mr. Illes under the Agreement to purchase the shares at any time for \$30 per share, it was not appropriate to register the shares unless this discretion was eliminated. On August 6, 2004 the Company and Mr. Illes entered into a subsequent agreement which superceded the prior agreement and gave the Company the right to require Mr. Illes to purchase the shares but did not give Mr. Illes any discretion to purchase shares. During the one year period following the date of effectiveness of a registration statement covering the shares, Mr. Illes has agreed to purchase from USA shares of Common Stock, provided that the aggregate purchase price can not exceed \$7,500,000. Under the Agreement, USA has the right at any time to require Mr. Illes to purchase Common Stock from USA at the lower of: (i) \$30; or (ii) 90% of the closing bid price per share

on the date prior to the date of the delivery by USA to Mr. Illes of notice of his obligation to purchase. USA can require Mr. Illes to purchase shares under the Agreement only if the shares have been registered by the Company for resale by Mr. Illes under the Act. During any calendar month, Mr. Illes is not permitted to purchase and can not be required by USA to purchase Common Stock for an aggregate purchase price in excess of \$700,000.

From November 3, 2004 through February 14, 2005, the Company sold \$1,550,789 of senior notes convertible into Common Shares at \$10 per share and maturing on June 30, 2007. Interest is payable quarterly at a rate of 10% per annum. The securities were offered and sold under the exemption from registration set forth in Rule 506 promulgated under Section 4(2) of the Act. All of the purchasers of the notes were accredited investors, were either pre-existing security holders or business associates and there was no general solicitation or advertising. We have agreed to use our best efforts to have the shares underlying the senior notes registered for resale under the Act through June 30, 2007.

In March 2005, the Company exchanged \$1,755,000 of principal amount 2005-B 10% Senior Notes for a like principal amount of 2005-C 10% Convertible Senior Notes ("2010 Senior Notes"). The 2010 Senior Notes are convertible into Common Shares at \$10 per share and due December 31, 2010. There are an aggregate of 175,500 shares underlying these senior notes. Interest is payable quarterly at a rate of 10% per annum. We have agreed to register the shares underlying the 2010 Senior Notes under the Act for resale through April 30, 2006. The exchange of the shares was exempt from registration under Section 3(a)(9) of the Act. All of the investors receiving 2010 Senior Notes are existing security holders. No commission or remuneration was paid or given directly or indirectly for soliciting the exchange.

During March and April 2005, the Company sold 233,333 shares of Common Stock at \$15 per share for an aggregate of \$3,500,000 ("2005-D Private Placement Offering"). For each share purchased, the Company granted a warrant to purchase one share of Common Stock exercisable at \$15 per share at anytime prior to December 31, 2005. The Company issued warrants to purchase a total of 233,333 shares. To date, none of the warrants have been exercised. We have agreed to register the shares and the shares underlying the warrants under the Act for resale through December 31, 2006. The offer and sales of the shares was exempt from registration under Rule 506 promulgated under Section 4(2) of the Act. All of the investors were accredited investors and either pre-existing security holders or business associates. The offer and sale thereof did not involve any general advertising or solicitation and the securities contained appropriate restrictive legends under the Act.

On April 4, 2005, the Company and Steve Illes entered into a new Common Stock Purchase Agreement ("2005 Common Stock Agreement"). Pursuant to the 2005 Common Stock Agreement, Mr. Illes agreed to purchase shares of the Company's Common Stock, provided that the aggregate purchase price does not exceed \$10,000,000. Under the 2005 Common Stock Agreement, the Company has the right at any time to require Mr. Illes to purchase Common Stock from the Company at the lower of: (i) \$30 per share; or (ii) 90% of the closing bid price per share on the date prior to the date of the delivery by the Company to Mr. Illes of notice of his obligation to purchase. The Company can require Mr. Illes to purchase shares under the Common Stock Agreement only if the shares have been registered by the Company for resale under the Act. During any

calendar month, Mr. Illes cannot be required by the Company to purchase Common Stock for an aggregate purchase price in excess of \$800,000. The Company issued 5,000 shares of Common Stock to Mr. Illes as a due diligence/commitment fee in connection with the 2005 Common Stock Agreement. The 2005 Common Stock Agreement terminates August 11, 2007. We have agreed to register for resale the shares purchased by Mr. Illes under the agreement until May 13, 2007. The securities offered and to be sold to Mr. Illes are exempt from registration as set forth under Rule 506 promulgated under the Act. Mr. Illes is an existing shareholder and an accredited investor, and there was no general solicitation or advertising.

During October and November 2005, the Company sold \$544,945 principal amount of 2005-G Convertible Senior Notes due December 31, 2008 to six investors. These notes earn interest at 10% per annum, payable quarterly, and are convertible into Common Shares at \$10 per share at any time prior to maturity. The offering was made to the holders of the 2005-D Common Stock Warrants. The 2005-D Warrants were exercisable at \$10 per share through November 30, 2005, and at \$15 through December 31, 2005. Each holder of the 2005-D Common Stock Warrants was entitled to purchase the principal amount of the 2005-G Senior Notes equal to the number of 2005-D Warrants held multiplied by \$10. Upon any investment in the offering, the corresponding number of 2005-D Warrants were cancelled. There are 54,494 shares underlying these 2005-G senior notes. For each \$10,000 of senior notes purchased, the investor also received a purchase right to purchase up to 1,000 shares at \$20 per share at anytime prior to December 31, 2008. The purchase rights could only be exercised if the shares issuable upon the exercise of the purchase rights are made available through the prepayment by the Company of outstanding convertible senior notes that are convertible at \$20 per share. The Company issued purchase rights to acquire 54,494 shares. During January 2006, the holder of each purchase right agreed to exchange the purchase rights for warrants to purchase shares at \$20 at anytime prior to December 31, 2008. Pursuant thereto, warrants were issued for an aggregate of 54,494 shares. We have agreed to register the shares underlying the 2005-G Senior Notes and the shares underlying the warrants under the Act for resale, and to keep the registration statement current and effective through November 30, 2006. The offer and sale of the 2005-G Senior Notes and purchase rights was exempt from registration under Rule 506 promulgated under Section 4(2) of the Act. All of the investors were accredited investors. The offer and sale thereof did not involve any general advertising or solicitation and the securities contained appropriate restrictive legends under the Act. The issuance by us of the warrants was exempt from registration under Section 3(a)(9) of the Act. All of the investors were existing holders of the purchase rights. No commission or remuneration was paid or given directly or indirectly for soliciting the exchange.

On December 13, 2005, the Company entered into a Stock Purchase Agreement with Wellington Management Company, LLP, a large Boston-based institutional investor, on behalf of certain of its clients ("Wellington"). Pursuant thereto, the Company sold to Wellington 400,000 shares of Common Stock for \$10 per share for an aggregate of \$4,000,000. The offer and sale of the shares was exempt from registration under Rule 506 promulgated under Section 4(2) of the Act. As investment manager, Wellington has shared dispositive and shared voting power over the shares. All of these clients are accredited investors. We have agreed to register the shares for resale under the Act for a period of one year. The Stock Purchase Agreement provides that if the

registration statement is not declared effective by the SEC within 60 days from the date of the Stock Purchase Agreement, then the Company will pay to Wellington as liquidated damages two percent of the purchase price for the shares for each month beyond 60 days that the registration statement is not effective. As a condition of its investment, Wellington required the Company to approve and call a special meeting of its shareholders to consider approval of a 1-to-100 reverse stock split of its Common Stock.

In October and November, 2005, the Company offered for sale up to \$1,000,000 of principal amount of 10% Bridge Notes due January 6, 2006. Interest accrued on the Bridge Notes at the rate of 10% per annum from and after the date of issuance with all accrued and unpaid interest paid on January 6, 2006. The Company sold \$770,000 Bridge Notes to 8 investors. On January 6, 2006, the Bridge Notes were automatically exchanged for a like principal amount of new 2006-A Convertible Senior Notes due December 31, 2010. The 2006-A Notes bear interest at 10% and are convertible at any time prior to maturity at \$10 per share. For each \$10,000 of 2006-A Convertible Senior Notes received in exchange for the Bridge Notes, the Company also issued purchase rights enabling the holder to purchase up to 1,000 shares of Common Stock at \$20 per share at anytime prior to December 31, 2008. The purchase rights could only be exercised if the shares issuable upon the exercise of the purchase rights are made available through the prepayment by the Company of outstanding convertible senior notes that are convertible at \$20 per share. The Company issued purchase rights to acquire 77,000 shares. During January 2006, the holder of each purchase right agreed to exchange the purchase right for a warrant to purchase one share at \$20 at anytime prior to December 31, 2008. Pursuant thereto, warrants were issued for an aggregate of 77,700 shares. The offer and sale of the Bridge Notes was exempt from registration under Rule 506 promulgated under Section 4(2) of the Act. All of the investors were accredited investors. The offer and sale thereof did not involve any general advertising or solicitation and the securities contained appropriate restrictive legends under the Act. The issuance by us of the 2006-A Senior Notes and purchase rights in exchange for the Bridge Notes, and the warrants in exchange for the purchase rights was exempt from registration under Section 3(a)(9) of the Act. All investors were existing security holders of the Company. No commission or remuneration was paid or given directly or indirectly for soliciting the exchange. We have agreed to register the shares underlying the 2006-A Senior Notes and the shares underlying the warrants under the Act for resale, and to keep the registration statement current and effective through November 30, 2006.

On January 9, 2006, the Company entered into a Stock Purchase Agreement with Rationalwave On Shore Equity Fund, L.P. ("Rationalwave"), an accredited investor. Pursuant thereto, the Company sold to Rationalwave 40,000 shares of Common Stock for \$10 per share for an aggregate of \$400,000. The offer and sale of the shares was exempt from registration under Rule 506 promulgated under Section 4(2) of the Act. We have agreed to register the shares for resale under the Act through January 9, 2007.

On February 17, 2006, the Company and Steve Illes entered into a Common Stock Purchase Agreement ("2006 Common Stock Agreement"). Pursuant to the 2006 Common Stock Agreement, Mr. Illes agreed to purchase shares of the Company's Common Stock, provided that the aggregate purchase price does not exceed \$20,000,000. Under the 2006 Common Stock Agreement, the Company has the right at any time to require Mr. Illes to purchase Common Stock from the Company at



the lower of: (i) \$30.00 per share; or (ii) 90% of the closing bid price per share on the date prior to the date of the delivery by the Company to Mr. Illes of notice of his obligation to purchase. The Company can require Mr. Illes to purchase shares under the Common Stock Agreement only if the shares have been registered by the Company for resale under the Act. During any calendar month, Mr. Illes cannot be required by the Company to purchase Common Stock for an aggregate purchase price in excess of \$800,000. The 2006 Common Stock Agreement terminates June 30, 2009. We have agreed to register for resale the shares purchased by Mr. Illes under the agreement for a two year period. The securities offered and to be sold to Mr. Illes are exempt from registration as set forth under Rule 506 promulgated under the Act. Mr. Illes is an existing shareholder and an accredited investor, and there was no general solicitation or advertising. The 2006 Common Stock Agreement replaces the April 2005 stock purchase agreement between Mr. Illes and the Company, and provides that no further shares may be registered under that agreement.

Pursuant to the Employment Agreement dated May 11, 2006 between Mr. Jensen and the Company, the Company agreed to issue to Mr. Jensen an aggregate of 75,000 shares of Common Stock. These shares vest as follows: 25,000 on June 1, 2006; 25,000 on January 1, 2007; and 25,000 on June 1, 2007. Pursuant to his Employment Agreement, Mr. Jensen also elected to have fifty percent of his base salary for the fiscal year ending June 30, 2007 paid through the issuance to him of 22,080 shares of Common Stock in lieu of cash. These shares vest as follows: 5,520 shares on July 1, 2006; 5,520 shares on October 1, 2006; 5,520 shares on January 1, 2007; and 5,520 shares on April 1, 2007. The offer and sale of the shares to Mr. Jensen were exempt from registration under Section 4(2) of the Act.

Pursuant to the Employment Agreement dated May 11, 2006 between Mr. Herbert and the Company, the Company agreed to issue to Mr. Herbert an aggregate of 50,000 shares of Common Stock. These shares vest as follows: 16,667 on June 1, 2006; 16,667 on January 1, 2007; and 16,666 on June 1, 2007. The offer and sale of the shares to Mr. Herbert were exempt from registration under Section 4(2) of the Act.

On September 25, 2006, the Company and Steve Illes entered into the 2006-B Common Stock Purchase Agreement ("2006-B Common Stock Agreement"). Pursuant to the 2006-B Common Stock Agreement, Mr. Illes agreed to purchase shares of the Company's Common Stock, provided that the aggregate purchase price does not exceed \$15,000,000. Under the 2006-B Common Stock Agreement, the Company has the right at any time to require Mr. Illes to purchase Common Stock from the Company at the lower of: (i) \$30.00 per share; or (ii) 90% of the closing bid price per share on the date prior to the date of the delivery by the Company to Mr. Illes of notice of his obligation to purchase. The Company can require Mr. Illes to purchase shares under the 2006-B Common Stock Agreement only if the shares have been registered by the Company for resale under the Act. During any calendar month, Mr. Illes cannot be required by the Company to purchase Common Stock for an aggregate purchase price in excess of \$800,000. The 2006-B Common Stock Agreement terminates August 30, 2009. We have agreed to register for resale the shares purchased by Mr. Illes under the agreement for a two year period. The securities offered and to be sold to Mr. Illes are exempt from registration as set forth under Rule 506 promulgated under the Act. Mr. Illes is an existing shareholder and an accredited investor, and there was no general solicitation or advertising. The 2006-B Common Stock Purchase Agreement replaces the February 2006 stock

purchase agreement between Mr. Illes and the Company, and provides that no further shares may be registered under that agreement.

In September 2006, the Company agreed to settle a legal action brought against the Company by Erica Bender, a former employee. As part of the settlement, the Company issued to her 2,536 shares valued at \$7.10 per share. The offer and sale of the shares to Bender were exempt from registration under Section 4(2) of the Act.

In September 2006, the Company settled its pending litigation with Swartz Private Equity, LLC. In full settlement of the litigation, the Company issued to Swartz an aggregate of 40,000 shares of Common Stock. Of these shares, 6,816 shares were attributable to the cashless exercise by Swartz in May and June 2003 of warrants, and the balance of 33,184 shares are newly issued shares. Under the settlement agreement, the Company has agreed to register for resale the 33,184 shares through October 12, 2007. The issuance of the shares to Swartz by the Company was exempt from registration under Rule 506 promulgated under Section 4(2) of the Act.

During December 2006, the Company sold 1,400,000 shares of Common Stock for \$6.00 per share for an aggregate of \$8,400,000 to 78 investors. For each share purchased in the offering, the investor received a warrant to purchase one-half of a share. Pursuant to the offering, warrants to purchase an aggregate of 700,017 shares were issued. The warrants are exercisable at any time through December 31, 2011 at \$6.40 per share. The offer and sale of the shares and the warrants was exempt from registration under Rule 506 promulgated under Section 4(2) of the Act. All of these investors are accredited investors. We have agreed to register the shares and the shares underlying the warrants for resale under the Act through December 14, 2007. The Stock Purchase Agreements entered into with the investors provide that if the registration statement is not declared effective by the SEC within 90 days from the date of the Stock Purchase Agreements, or by March 14, 2007, then the Company will pay to the investors as liquidated damages one percent of the purchase price for the shares for each month beyond 90 days that the registration statement is not effective with the maximum damages not to exceed 12% of the purchase price for the shares.

In connection with the above private placement offering, William Blair & Company, LLC, acted as exclusive placement agent. As compensation for its services, Blair received cash compensation of \$529,200 and warrants to purchase up to 11,454 shares at \$6.60 per share at any time through December 31, 2011. Blair also received expense reimbursement from us of \$12,576.08. We have agreed to register the shares underlying the warrants for resale under the Act through December 14, 2007. The offer and sale of the warrants was exempt from registration under Section 4(2) of the Act. The investor is an accredited investor. The offer and sale thereof did not involve any general advertising or solicitation and the securities contained appropriate restrictive legends under the Act.

#### **STOCK OPTIONS**

On April 28, 2004 the Company issued to Mary West Young options to purchase 300,000 shares of Common Stock for \$.30 per share which vest ratably over a two year period.

On April 12, 2005 the Company issued to David DeMedio options to purchase 300,000 shares of Common Stock for \$.20 per share which vest ratably over a two year period.

On April 21, 2006, the Board of Directors approved the grant of 12,000 Common Stock Options to each of the outside directors serving as of February 27, 2006 and 6,000 Common Stock Options to Mr. Passner, a new director as of April 12, 2006, all with an exercise price of \$7.50 per share and all exercisable at any time within five years following the date of vesting. The options granted to Mr. Sellers and Mr. Van Allen are fully vested. Of the options granted to Mr. Katz and Mr. Lurio, 6,000 vest immediately, 3,000 vest on April 1, 2007, and 3,000 vest on April 1, 2008. Of the options granted to Mr. Passner, 3,000 vest on April 1, 2007, and 3,000 vest on April 1, 2008.

In conjunction with the signing of employment agreements on May 11, 2006, the Company granted Mr. Jensen, Mr. Herbert, and Mr. DeMedio, 75,000, 18,000 and 7,000 Common Stock Options, all with an exercise price of \$7.50 per share and all exercisable at any time within five years following the date of vesting. The options vest as follows: one-third on May 11, 2006; one-third on June 30, 2007; and one-third on June 30, 2008.

In conjunction with the appointment of Stephen McHugh to the Board of Directors on June 20, 2006, the Company granted Mr. McHugh 6,000 Common Stock Options with an exercise price of \$8.00 per share. The options vest as follows: 3,000 on June 20, 2007 and 3,000 on June 20, 2008. The options are exercisable at any time within five years of vesting.

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 of USA, each of such issuances were separate transactions not part of any plan, and none of the issuances involved any general solicitation or advertising.

**ITEM 16. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.****EXHIBITS**

Exhibit Number	Description
2.1	Asset Purchase Agreement dated July 11, 2003 by and between USA and Bayview Technology Group LLC (Incorporated by reference to Exhibit 2.1 to Form 8-K filed July 14, 2003)
3.1	Amended and Restated Articles of Incorporation of USA filed January 26, 2004 (Incorporated by reference to Exhibit 3.1.19 to Form 10-QSB filed on February 12, 2004).
3.1.1	First Amendment to Amended and Restated Articles of Incorporation of USA filed on March 17, 2005 (Incorporated by reference to Exhibit 3.1.1 to Form S-1 Registration Statement No. 333-124078).
3.1.2	Second Amendment to Amended and Restated Articles of Incorporation of USA filed on December 13, 2005 (Incorporated by reference to Exhibit 3.1.2 to Form S-1 Registration Statement No. 333-130992).
3.2	By-Laws of USA (Incorporated by reference to Exhibit 3.2 to Form SB-2 Registration Statement No. 33-70992).
4.1	Form of 2004 Senior Note (Incorporated by reference to Exhibit 4.24 to Form SB-2 Registration Statement No. 333-101032).
4.2	Form of 2005 Senior Note (Incorporated by reference to Exhibit 4.25 to Form SB-2 Registration Statement No. 333-101032).
4.3	Addendum to 2006 Senior Note. (Incorporated by reference to Exhibit 4.30 to Form 10-KSB filed on September 28, 2004).
4.4	Addendum to 2007 Senior Note. (Incorporated by reference to Exhibit 4.30 to Form 10-KSB filed on September 28, 2003).
4.5	Common Stock Purchase Agreement between the Company and Steve Illes dated April 4, 2005 (Incorporated by reference to Exhibit 4.13.1 to Form S-1 Registration Statement No. 333-124078).
4.6	Form of 2004-B Note (Incorporated by reference to Exhibit 4.28 to Form S-1 Registration Statement No. 333-119951).
4.7	Form of 2005-C Note (Incorporated by reference to Exhibit 4.15 to Form S-1 Registration Statement No. 333-124078).
4.8	Stock Purchase Agreement dated December 13, 2005 by and between the Company and certain clients of Wellington Management Company, LLC (Incorporated by reference to Exhibit 4.1 to Form 8-K filed December 19, 2005).
4.9	Stock Purchase Agreement dated January 9, 2006, by and between the Company and Rationalwave On Shore Equity Fund, L.P. (Incorporated by reference to Exhibit 4.19 to Form S-1 Registration Statement No. 333-130992).
4.10	Form of 2006-A 10% Convertible Senior Note due December 31, 2010 (Incorporated by reference to Exhibit 4.20 to Form S-1 Registration Statement No. 333-130992).
4.11	Form of 2006-A Warrant (Incorporated by reference to Exhibit 4.21 to Form S-1 Registration Statement No. 333-130992).

- 4.12 Form of 2005-G Warrant (Incorporated by reference to Exhibit 4.22 to Form S-1 Registration Statement No. 333-130992).
- 4.13 Common Stock Purchase Agreement between the Company and Steve Illes dated February 17, 2006 (Incorporated by reference to Exhibit 4.23 to Form S-1 Statement No. 333-132019).
- 4.14 2006-B Common Stock Purchase Agreement between the Company and Steve Illes dated September 25, 2006 (Incorporated by reference to Exhibit 4.14 to Form 10-K filed September 28, 2006).
- 4.15 Settlement Agreement And Mutual Release between Erika Bender and USA Technologies, Inc. dated September 22, 2006 (Incorporated by reference to Exhibit 4.15 to Form S-1 Registration Statement No. 333-138116).
- 4.16 Settlement Agreement dated October 12, 2006 between Swartz Private Equity, LLC and USA Technologies, Inc (Incorporated by reference to Exhibit 4.16 to Form S-1 Registration Statement No. 333-138116).
- 4.17 Common Stock Purchase Agreement between the Company and Cortina Asset Management LLC dated December 15, 2006.
- 4.18 Common Stock Purchase Agreement between the Company and Wellington Management Company, LLP, acting on behalf of Public Sector Pension Investment Board, dated December 15, 2006.
- 4.19 Common Stock Purchase Agreement between the Company and Wellington Management Company, LLP, acting on behalf of New York Nurses Association Pension Plan, dated December 15, 2006.
- 4.20 Common Stock Purchase Agreement between the Company and Wellington Management Company, LLP, acting on behalf of The Government of Singapore Investment Corporation Pte Ltd, dated December 15, 2006.
- 4.21 Common Stock Purchase Agreement between the Company and SF Capital Partners Ltd. dated December 15, 2006.
- 4.22 Common Stock Purchase Agreement between the Company and United Capital Management, Inc. dated December 15, 2006.
- 4.23 Common Stock Purchase Agreement between the Company and Harbour Holdings Ltd. dated December 15, 2006.
- 4.24 Common Stock Purchase Agreement between the Company and Skylands Special Investment LLC dated December 15, 2006.
- 4.25 Common Stock Purchase Agreement between the Company and Skylands Quest LLC dated December 15, 2006.
- 4.26 Common Stock Purchase Agreement between the Company and Skylands Special Investment II LLC dated December 15, 2006.
- 4.27 Form of 2006-BP Common Stock Purchase Warrant.

- 4.28 Common Stock Purchase Warrant issued to William Blair & Co., LLC, dated January 4, 2007.
- 5.1 Opinion of Lurio & Associates, P.C.
- 10.1 Amended And Restated Employment and Non-Competition Agreement between USA and Stephen P. Herbert dated May 11, 2006 (Incorporated by reference to Exhibit 10.2 to Form 10-Q filed on May 15, 2006).
- 10.2 Amended And Restated Employment and Non-competition Agreement between USA and George R. Jensen, Jr. dated May 11, 2006 (Incorporated by reference to Exhibit 10.1 to Form 10-Q filed on May 15, 2006).
- 10.3 Agreement and Plan of Merger dated April 10, 2002, by and among the Company, USA Acquisition, Inc., Stitch Networks Corporation, David H. Goodman, Pennsylvania Early Stage Partners, L.P., and Maytag Holdings, Inc. (Incorporated by reference to Exhibit 2.1 to Form 10-QSB for the quarter ended March 31, 2002).
- 10.4 Strategic Alliance Agreement between USA and ZiLOG Corporation dated October 15, 2002 (Incorporated by reference to Exhibit 10.39 to Form SB-2 Registration Statement No. 333-101032).
- 10.5 Vending Placement, Supply and Distribution Agreement between Stitch Networks Corporation, Eastman Kodak Company, Maytag Corporation and Dixie-Narco, Inc. dated December 2000 (Incorporated by reference to Exhibit 10.40 to Form SB-2 Registration Statement No. 333-101032).
- 10.6 Design and Manufacturing Agreement between USA and RadiSys dated June 27, 2000 (Incorporated by reference to Exhibit 10.41 to Form SB-2 Registration Statement No. 333-101032).
- 10.7 Termination Agreement dated December 31, 2003 by and between Eastman Kodak Company, Maytag Corporation, Dixie-Narco, Inc. and Stitch Networks Corporation. (Incorporated by reference to Exhibit 10.6 to Form 10-QSB filed on February 12, 2004).
- 10.8 Option Certificate (No. 198) dated April 28, 2004 in favor of Mary West Young. (Incorporated by reference to Exhibit 10.45 to Form SB-2 Registration Statement No. 333-116977)
- 10.9 Agreement of Lease between Pennswood Spring Mill Associates, as landlord, and the Company, as tenant, dated September 2002, and the Rider thereto (Incorporated by reference to Exhibit 10.21 to Form 10-KSB filed on September 28, 2004).
- 10.10 Agreement of Lease between Deerfield Corporate Center 1 Associates LP, as landlord, and the Company, as tenant, dated March 2003 (Incorporated by reference to Exhibit 10.22 to Form 10-KSB filed on September 28, 2004).
- 10.11 Amendment to Office Space Lease dated as of April 1, 2005 by and between the Company and Deerfield Corporate Center Associates, LP. (Incorporated by reference to Exhibit 10.19.1 to Form S-1 Registration Statement No. 333-124078)
- 10.12 Co-Marketing Agreement between Honeywell D.M.C. Services, LLC and the Company dated July 13, 2004 (Incorporated by reference to Exhibit 99.1 to Form 8-K filed on September 29, 2004).

- 10.13 Employment and Non-Competition Agreement between USA and David M. DeMedio dated April 12, 2005 (Incorporated by reference to Exhibit 10.22 to Form S-1 Registration Statement No. 333-124078).
- 10.14 First Amendment to Employment and Non-Competition Agreement between USA and David M. DeMedio dated May 11, 2006 (Incorporated by reference to Exhibit 10.3 to Form 10-Q filed on May 15, 2006).
- 10.15 Option Certificate (No. 200) dated April 12, 2005 in favor of David M. DeMedio (Incorporated by reference to Exhibit 10.23 to Form S-1 Registration Statement No. 333-124078).
- 10.16 Agreement dated December 28, 2004 between USA Technologies and PepsiCo, Inc. (Incorporated by reference to Exhibit 10.01 of Form 8-K filed July 27, 2005)
- 10.17 Option Certificate (No. 201) dated May 11, 2006 in favor of George R. Jensen, Jr. (Incorporated by reference to Exhibit 10.21 to Form 10-K filed on September 28, 2006)
- 10.18 Option Certificate (No. 202) dated May 11, 2006 in favor of Stephen P. Herbert (Incorporated by reference to Exhibit 10.22 to Form 10-K filed on September 28, 2006)
- 10.19 Option Certificate (No. 203) dated May 11, 2006 in favor of David M. Demedio (Incorporated by reference to Exhibit 10.23 to Form 10-K filed on September 28, 2006)
- 10.20 Option Certificate (No. 204) dated April 21, 2006 in favor of William W. Sellers (Incorporated by reference to Exhibit 10.24 to Form 10-K filed on September 28, 2006)
- 10.21 Option Certificate (No. 205) dated April 21, 2006 in favor of William L. Van Alen, Jr. (Incorporated by reference to Exhibit 10.25 to Form 10-K filed on September 28, 2006)
- 10.22 Option Certificate (No. 206) dated April 21, 2006 in favor of Steven Katz (Incorporated by reference to Exhibit 10.26 to Form 10-K filed on September 28, 2006)
- 10.23 Option Certificate (No. 207) dated April 21, 2006 in favor of Douglas M. Lurio (Incorporated by reference to Exhibit 10.27 to Form 10-K filed on September 28, 2006)
- 10.24 Option Certificate (No. 208) dated April 21, 2006 in favor of Albert Passner (Incorporated by reference to Exhibit 10.28 to Form 10-K filed on September 28, 2006)
- 10.25 Option Certificate (No. 209) dated July 20, 2006 in favor of Stephen W. McHugh (Incorporated by reference to Exhibit 10.29 to Form 10-K filed on September 28, 2006)
- 10.26 USA Technologies, Inc. 2006-A Stock Compensation Plan (Incorporated by reference to Exhibit 10.1 to Form S-8 filed June 19, 2006).
- 10.27 Restricted Stock Issuance Agreement In Lieu of Cash Base Salary between George R. Jensen, Jr. and USA Technologies, Inc. dated June 28, 2006 (Incorporated by reference to Exhibit 10.31 to Form S-1 filed October 20, 2006).

- 10.28 Restricted Bonus Stock Issuance Agreement between George R. Jensen, Jr., and USA Technologies, Inc. dated June 28, 2006 (Incorporated by reference to Exhibit 10.32 to Form S-1 filed October 20, 2006).
- 10.29 Restricted Bonus Stock Issuance Agreement between Stephen P. Herbert and USA Technologies, Inc. dated June 28, 2006 (Incorporated by reference to Exhibit 10.33 to Form S-1 filed October 20, 2006).
- 10.30 MasterCard PayPass Agreement dated as of November 9, 2006 between the Company and MasterCard International Incorporated (Incorporated by reference to Exhibit 10.34 to Form S-1/A filed December 7, 2006).
- 14.1 Code of Business Conduct and Ethics (Incorporated by reference to Exhibit 14.1 to Form 8-K filed on April 17, 2006).
- \*\*23.1 Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
- \*\*23.2 Consent of Goldstein Golub Kessler LLP, Independent Registered Public Accounting Firm.

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\*\* Filed herewith



## SCHEDULE II

**USA TECHNOLOGIES, INC.**  
**VALUATION AND QUALIFYING ACCOUNTS**  
**YEARS ENDED JUNE 30, 2006, 2005 AND 2004**

	ACCOUNTS RECEIVABLE			
	Balance at beginning of period	Additions (reductions) charged to earnings	Deductions uncollectible receivables written off, net of recoveries	Balance at end of period
June 30, 2006	\$ 196,000	131,000	98,000	\$ 229,000
June 30, 2005	\$ 240,000	(23,000)	20,000	\$ 196,000
June 30, 2004	\$ 65,000	194,000	19,000	\$ 240,000
	INVENTORY			
	Balance at beginning of period	Additions charged to earnings	Deductions shrinkage and obsolescence	Balance at end of period
June 30, 2006	\$ 321,000	484,000	546,000	\$ 259,000
June 30, 2005	\$ 229,000	286,000	194,000	\$ 321,000
June 30, 2004	\$ 63,000	190,000	24,000	\$ 229,000

**ITEM 17. 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 and 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.

(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.

(4) That, for purposes of determining liability under the Securities Act of 1933 to any purchaser, each prospectus filed pursuant to Rule 424(b) as part of a registration statement relating to an offering, other than registration statements relying on Rule 430B or other than prospectuses filed in reliance on Rule 430A, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such effective date, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use.

(5) That, for purposes of determining liability of the undersigned registrant under the Securities Act of 1933 to any purchaser in the initial distribution of the securities, the undersigned registrant undertakes that in a primary offering of securities of the undersigned registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

(i) Any preliminary prospectus or prospectus of the undersigned registrant relating to the offering required to be filed pursuant to Rule 424;

(ii) Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned registrant or used or referred to by the undersigned registrant;

(iii) The portion of any other free writing prospectus relating to the offering containing material information about the undersigned registrant or its securities provided by or on behalf of the undersigned registrant; and

(iv) Any other communication that is an offer in the offering made by the undersigned registrant to the purchaser.

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 SEC 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.

**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 Amendment No. 1 to Form S-1 and has duly caused this Amendment No. 1 to Registration Statement on Form S-1 to be signed on its behalf by the undersigned, thereunto duly authorized, in Malvern, Pennsylvania, on February 12, 2007.

USA TECHNOLOGIES, INC.

By: /s/ George R. Jensen, Jr.  
*George R. Jensen, Jr., Chairman  
and Chief Executive Officer*

Pursuant to the requirements of the Securities Act of 1933, as amended, this Amendment No. 1 to Registration Statement has been duly signed below by the following persons in the capacities and dates indicated.

<u>SIGNATURES</u>	<u>TITLE</u>	<u>DATE</u>
<u>/s/ George R. Jensen, Jr.</u> George R. Jensen, Jr.	Chairman of the Board of Directors and Chief Executive Officer (Principal Executive Officer)	February 12, 2007
<u>/s/ David M. DeMedio</u> David M. DeMedio	Chief Financial Officer (Principal Accounting Officer)	February 12, 2007
<u>/s/ Stephen P. Herbert</u> Stephen P. Herbert	Chief Operating Officer, President and Director	February 12, 2007
<u>*</u> William L. Van Alen, Jr.	Director	February 12, 2007
<u>/s/ Douglas M. Lurio</u> Douglas M. Lurio	Director	February 12, 2007
<u>*</u> Steven Katz	Director	February 12, 2007
<u>*</u> Albert Passner	Director	February 12, 2007
<u>*</u> Stephen W. McHugh	Director	February 12, 2007

\*Attorney-in-fact pursuant to Power of Attorney previously provided as part of the Registration Statement.

## Exhibit Index

Exhibit  
Number Description

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- 23.1 Consent of Ernst & Young LLP
- 23.2 Consent of Goldstein Golub Kessler LLP

**Exhibit 23.1**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the reference to our firm under the caption "Experts" and to the use of our report dated September 10, 2004, in Amendment No. 1 to the Registration Statement (Form S-1 No. 333-139883) and related Prospectus of USA Technologies, Inc. for the registration of 2,290,152 shares of its Common Stock.

*/s/ Ernst & Young LLP*

Philadelphia, Pennsylvania  
February 12, 2007

**Exhibit 23.2**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the reference to our firm under the caption "Experts" and to the use of our report dated September 1, 2006, except for Note 16, last paragraph, which is dated September 20, 2006, in the Amendment No. 1 to Registration Statement (Form S-1 No. 333-139883) and related Prospectus of USA Technologies, Inc. dated February 12, 2007.

*/s/ Goldstein Golub Kessler LLP*

New York, New York  
February 12, 2007



USA Technologies, Inc.  
100 Deerfield Lane, Suite 140  
Malvern, Pennsylvania 19355

February 12, 2007

Maryse Mills-Apenteng, Esquire  
Division of Corporation Finance  
Securities and Exchange Commission  
100 F Street NE  
Washington, D.C. 20549

Re: USA Technologies, Inc. (the "Company")  
Registration Statement on Form S-1  
Registration Statement No. 333-139883

Dear Ms. Apenteng:

We respectfully request that the Commission, acting pursuant to Section 8(a) of the Securities Act of 1933, and Rule 461, enter an appropriate order making the above-captioned Registration Statement (the "Registration Statement") effective on Tuesday, February 13, 2007 at 11:30 a.m., or as soon thereafter as practicable.

We hereby confirm that we are aware of our statutory responsibilities under the Securities Act of 1933 and the Securities Exchange Act of 1934, as they relate to the Registration Statement.

We hereby acknowledge that should the Commission or the staff, acting pursuant to delegated authority, declare the Registration Statement effective, we do not foreclose the Commission from taking any action with respect to the Registration Statement. We further acknowledge that the actions of the Commission or the staff, acting pursuant to delegated authority, in declaring the Registration Statement effective, does not relieve the Company from its full responsibility for the adequacy and accuracy of the disclosure in the Registration Statement. We further acknowledge that the Company may not assert the staff comments and the declaration of effectiveness as a defense in any proceeding initiated by the Commission or any person under the federal securities laws of the United States.

Very truly yours,

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