

SLS INTERNATIONAL INC  
Form S-2/A  
February 09, 2005

**As filed with the Securities and Exchange Commission on February 9, 2005**

**Registration Statement No. 333-122480**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**PRE-EFFECTIVE**

**AMENDMENT NO. 1**

**TO**

**FORM S-2**

**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

**SLS INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

**DELAWARE**

**3651**

**52-2258371**

(State or other jurisdiction of (Primary Standard Industrial  
incorporation or organization) Classification Code Number)

(I.R.S. Employer  
Identification No.)

**3119 SOUTH SCENIC**

**SPRINGFIELD, MISSOURI 65807**

**(417) 883-4549**

(Address and telephone number of principal executive offices)

**JOHN M. GOTT**

**3119 SOUTH SCENIC**

**SPRINGFIELD MISSOURI 65807**

**(417) 883-4549**

(Name, address, and telephone number of agent for service)

*copies to:*

**JEFFREY M. MATTSON**

**FREEBORN & PETERS LLP**

**311 SOUTH WACKER DRIVE, SUITE 3000**

**CHICAGO, IL 60606-6677**

**(312) 360-6312**

(Name, address, and telephone number for copies of all communications)

**APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC:** As soon as practicable after this Registration Statement becomes effective.

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. ☐

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 the registrant elects to deliver its latest annual report to security holders, or a complete and legible facsimile thereof, pursuant to Item 11(a)(1) of this Form, check the following box. ☐

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. ☐

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

#### CALCULATION OF REGISTRATION FEE

		PROPOSED		
TITLE OF EACH		PROPOSED	MAXIMUM	AGGREGATE
CLASS OF	MAXIMUM	MAXIMUM	AGGREGATE	AMOUNT OF
SECURITIES TO BE	AMOUNT TO BE	OFFERING PRICE	OFFERING	REGISTRATION
REGISTERED	REGISTERED(1)	PER UNIT	PRICE	FEE (3)
Common stock,				
\$.001 par value	19,100,000	\$2.41 (2)	\$46,031,000	\$5,417.85

(1)

This number represents the estimated number of shares issuable upon the conversion or exercise, as applicable, of the preferred stock, warrants and options described in this Registration Statement, including an additional 4,000,000

shares that may be issuable in satisfaction of the premium on the Series C Preferred Stock earned prior to the conversion thereof or as a result of potential adjustments to the preferred stock or the warrants. This number is subject to adjustment to prevent dilution resulting from stock splits, stock dividends, the issuance of common stock or securities convertible into or exercisable for common stock at prices below certain thresholds or similar events. Therefore, pursuant to Rule 416 under the Securities Act of 1933, as amended, this Registration Statement also registers such indeterminate number of shares as may be issuable in connection with stock splits, stock dividends, other antidilution adjustments or similar events.

(2)

This price is used solely for the purposes of computing the amount of the registration fee pursuant to Rule 457(c) of the Securities Act and is estimated, based on the average of the bid and asked price of the common stock at the close of trading on February 1, 2005.

(3)

Previously paid.

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 said Section 8(a), may determine.

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**SUBJECT TO COMPLETION, DATED FEBRUARY 9, 2005.**

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 is effective. This Prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any state where the offer or sale is not permitted.

**PROSPECTUS**

**SLS INTERNATIONAL, INC.**

**19,100,000 SHARES OF COMMON STOCK**

**OFFERED BY SELLING STOCKHOLDERS**

This prospectus relates to the sale, from time to time, of up to 19,100,000 shares of our common stock by the selling stockholders listed under the heading **Selling Stockholders** in this prospectus. Only 300,000 of such shares are currently outstanding. The selling stockholders may receive the remainder of the shares of common stock upon conversion of our outstanding Series C Preferred Stock and upon exercise of options and warrants, some of which are currently outstanding and some of which may be issued in the future. The shares of our common stock offered under this prospectus may be sold by the selling stockholders, their pledgees, donees, transferees and successors-in-interest. For additional information on the selling stockholders' possible methods of sale, you should refer to the section in this prospectus entitled **Plan of Distribution**. We will not receive any proceeds from the sale of our shares by the selling stockholders or from the conversion of the Series C Preferred Stock.

Our common stock is quoted on the Nasdaq Over-The-Counter Bulletin Board under the symbol **SITI.OB**. On February 1, 2005, the last reported sale price for our common stock as reported on the Nasdaq Over-The-Counter Bulletin Board was \$2.38 per share.

A copy of our most recent annual report on Form 10-K or Form 10-KSB, as well as a copy of our most recent quarterly report of Form 10-Q or Form 10-QSB, accompanies this prospectus. **The date of this prospectus is February 9, 2005. You should read this entire prospectus, including the documents incorporated by reference, before you invest.**

**The securities offered in this prospectus involve a high degree of risk. See **Risk Factors** beginning on page 4 for information you should consider before purchasing our common stock.**

**NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THE PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

**SLS INTERNATIONAL, INC.**

3119 South Scenic

Springfield, Missouri 65807

(417) 883-4549

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Unless otherwise specified, the information in this prospectus is set forth as of February 9, 2005, and we anticipate that changes in our affairs will occur after such date. We have not authorized any person to give any information or to make any representations, other than as contained in this prospectus, in connection with the offer contained in this prospectus. If any person gives you any information or makes representations in connection with this offer, do not rely on it as information we have authorized. This prospectus is not an offer to sell our common stock in any state or other jurisdiction to any person to whom it is unlawful to make such offer.

## **PROSPECTUS SUMMARY**

This summary does not contain all of the information that you should consider before investing in our common stock. You should carefully read the entire prospectus including Risk Factors, the consolidated financial statements and the incorporated documents before making an investment decision.

### **The Company**

We manufacture premium-quality loudspeakers and sell them through our dealer networks. The speakers use our proprietary ribbon-driver technology and are generally recognized in the industry as high-quality systems. We sell a Professional Line of loudspeakers; a Commercial Line of loudspeakers; Home Theater systems; a line for recording and broadcast studios; a line for contractor installations and touring companies; and line of in-wall, in-ceiling, and outdoor loudspeakers; and a line for the cinema and movie theater market. Our executive offices are located at 3119 South Scenic, Springfield, Missouri, 65807, with telephone number (417) 883-4549.

### **The Offering**

This prospectus relates to the sale, from time to time, of up to 19,100,000 shares of our common stock by the selling stockholders listed under the heading Selling Stockholders in this prospectus. Only 300,000 of such shares are currently outstanding. The selling stockholders may receive the remainder of the shares of common stock upon conversion of our outstanding Series C Preferred Stock and upon exercise of options and warrants, some of which are currently outstanding and some of which may be issued in the future. On January 3, 2005, there were 41,751,080 shares of our common stock outstanding. Assuming the exercise of all of the options and warrants described above, and the conversion of all of the Series C Preferred Stock, the 19,100,000 shares offered by this prospectus represents 31.4% of our total common stock outstanding on January 3, 2005.

The prices at which the selling stockholders may sell the shares will be determined by the prevailing market price for the shares or in negotiated transactions. We will not receive any proceeds from the sale of our shares by the selling stockholders or from the conversion of the Series C Preferred Stock. We may receive up to \$39,500,000 from the exercise of the currently outstanding options and warrants, if they are exercised in full, and an undeterminable amount of additional proceeds from the options and warrants that may be issued in the future. We will use the proceeds from any exercise of options and warrants for working capital purposes.

### **OTC Bulletin Board Symbol**

Our stock trades on the Nasdaq Over-The-Counter Bulletin Board under the symbol SITI.OB. On February 1, 2005, the last reported sale price for our common stock was \$2.38 per share.

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## Accompanying Documents

A copy of our most recent annual report on Form 10-K or Form 10-KSB, as well as a copy of our most recent quarterly report of Form 10-Q or Form 10-QSB, accompanies this prospectus.

## RECENT EVENTS

On January 4, 2005, we completed a private placement of our newly designated Series C Convertible Preferred Stock for an aggregate purchase price of \$15 million. The investors also received five-year warrants to purchase an aggregate of 6,000,000 shares of our common stock at an exercise price of \$6.00 per share, subject to certain adjustments. The securities were purchased by BayStar Capital II, L.P., PSO Trading IV, LLC, HFTP Investment L.L.C., and Royal Bank of Canada. The preferred stock is initially convertible, at the holder's option, into an aggregate of 6,000,000 shares of our common stock, at a conversion price of \$2.50 per share, subject to certain adjustments, and accrues a 6% premium to the stated value of the shares of preferred stock, which would be convertible into additional shares of common stock. We may redeem the warrants (or require the holder to exercise them) and may require holders to convert the preferred stock to common stock if certain conditions are met. See Description of Capital Stock Preferred Stock Series C Convertible Preferred Stock and Description of Capital Stock Warrants Warrants Issued in Connection with the Series C Preferred Stock for a description of the rights of the holders of the Series C Preferred Stock and the warrants issued in connection therewith.

In a private placement that closed on July 27, 2004, we sold 272,100 shares of the Series B Preferred Stock for \$5,442,000, which have converted or are convertible into 2,721,000 shares of our common stock. We also issued a total of 2,846,000 Class C Warrants, 2,721,000 of which were attached to shares of the Series B Preferred Stock and 125,000 of which were issued to Kenny Securities for services as a placement agent.

In March 2004, we completed a merger of Evenstar, Inc. into a newly formed, wholly owned subsidiary. As a result of the merger, we now own, through the subsidiary, certain technologies and proprietary rights, including those embodied in one issued patent and one patent application. The technologies consist of digital amplification technologies that we intend to use in our loudspeakers and in stereo amplifiers in a product line complementary to our loudspeakers. We intend to sell these products through our current distribution channels, as well as through relationships that we expect to develop with mass merchandisers and real estate developers. In exchange for such technologies, we paid \$300,000 in cash and issued 300,000 shares of our common stock to the seller. Simultaneously with the acquisition, we hired Joel Butler as director of our electronics division.

On December 4, 2004, we entered into a Lease Agreement with Bull Creek Ranch LLC. Pursuant to the agreement, we agreed to lease approximately 150,000 square feet of property in Ozark, Missouri through February 28, 2010 at a

base rent of \$18,750 per month for the first twelve months and \$28,125 thereafter, with adjustments and additional charges set forth in the agreement. The agreement also provides us with an option to purchase the property for \$3,500,000, increasing by 5% for each year after the first year of the lease term. We intend to

complete a move to this new location in approximately six months. The foregoing summary description of the agreement is qualified in its entirety by reference to the terms of the agreement, which is filed as an exhibit hereto.

Beginning in 2004, we have been paying \$2,500 per month to Michael Maples, a member of our board of directors, to oversee the work by outside consultants performed in connection with our Sarbanes-Oxley Act compliance efforts.

### **INCORPORATION BY REFERENCE**

The Securities and Exchange Commission allows us to incorporate by reference certain of our publicly filed documents into this prospectus, which means that information included in those documents is considered part of this prospectus. We incorporate by reference into this prospectus:

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Our most recent annual report on Form 10-K or Form 10-KSB filed with the Securities and Exchange Commission; and

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All of our filings pursuant to Sections 13(a) or 15(d) under the Securities Exchange Act of 1934, as amended, since the date of the filing of our most recent Annual Report on Form 10-K or Form 10-KSB.

A copy of our most recent annual report on Form 10-K or Form 10-KSB, as well as a copy of our most recent quarterly report of Form 10-Q or Form 10-QSB, accompanies this prospectus. Upon written or oral request, we will provide to you free of charge a copy of any or all of the documents incorporated by reference, other than exhibits to such documents unless the exhibits are specifically incorporated by reference in those documents. You should direct any requests for documents to:

John M. Gott

3119 South Scenic

Springfield Missouri 65807

(417) 883-4549

### **FURTHER INFORMATION**

We are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, and file reports, proxy statements and other information with the Securities and Exchange Commission. These reports, proxy statements and other information may be inspected and copied at the public reference facilities maintained by the Securities and Exchange Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the Securities and Exchange Commission's regional offices. You can obtain copies of these materials from the Public Reference Section of the Securities and Exchange Commission upon payment of fees

prescribed by the Securities and Exchange Commission. You 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's Web site contains reports, proxy and information statements and other information regarding registrants that file electronically with the Securities and Exchange Commission. The address of that site is <http://www.sec.gov>.

We have filed a registration statement on Form S-2 with the Securities and Exchange Commission under the Securities Act with respect to the securities offered in this prospectus. This prospectus, which is filed as part of a registration statement, does not contain all of the information set forth in the registration statement, some portions of which have been omitted in accordance with the Securities and Exchange Commission's rules and regulations. Statements made in this prospectus as to the contents of any contract, agreement or other document referred to in this prospectus are not necessarily complete and are qualified in their entirety by reference to each such contract, agreement or other document which is filed as an exhibit to the registration statement. The registration statement may be inspected without charge at the public reference facilities maintained by the Securities and Exchange Commission, and copies of such materials can be obtained from the Public Reference Section of the Securities and Exchange Commission at prescribed rates.

## **RISK FACTORS**

*An investment in our common stock involves various risks, including those described in the risk factors below. You should carefully consider these risk factors, together with all of the other information included and incorporated by reference in this report, before you decide to invest in our common stock. If any of the following risks, or any other risks not described below, develop into actual events, then our business, financial condition, results of operations, or prospects could be materially adversely affected, the market price of our common stock could decline further and you could lose all or part of your investment.*

### **RISKS RELATED TO OUR BUSINESS**

***We Have a History of Losses and May Not Be Profitable in the Future if We Do Not Achieve Sufficient Revenue to Absorb Recent and Planned Expenditures.***

We have experienced significant operating losses since investing in the development of ribbon driver technology in 1998 and, through December 31, 2003, have an accumulated retained deficit of approximately \$10,843,561. If we do not achieve continued revenue growth sufficient to absorb our recent and planned expenditures, we could experience additional losses in future periods. These losses or fluctuations in our operating results could cause the market value of our common stock to decline.

***We Will Depend on Additional Capital.***

Our ability to implement our strategy and expand our operations largely depends on our access to capital. To implement our long-term strategy, we plan to make ongoing expenditures for the expansion and improvement of our product line and the promotion of our products. To date, we have financed our operations primarily through sales of equity and the issuance of notes. We will need to issue additional equity or other securities to obtain the financing required

to continue our operations. However, additional capital may not be available on terms acceptable to us. Our failure to obtain sufficient additional capital could curtail or alter our growth strategy or delay needed capital expenditures.

***Our Dependence upon Third-Party Dealers for Sales Makes Us Vulnerable to the Efforts of Others Which Are Beyond Our Control.***

Our distributors may not continue their current relationships with us and they may give higher priority to the sale of our competitors' products. In addition, to be effective, distributors must devote significant technical, marketing and sales resources to an often lengthy sales cycle. Our current and future distributors may not devote sufficient resources to market our products effectively and economic or industry conditions may adversely affect their ability to market or sell for us. A reduction in sales efforts or a discontinuation of distribution of our products by any distributor could lead to reduced sales and greater net losses.

***We May Not Gain Market Acceptance of Our Ribbon Driver Technology.***

We believe that revenues from our ribbon driver product line will account for a material portion of our revenue for the foreseeable future. Our future financial performance will depend on the market acceptance of our ribbon driver technology and products. To date, we have had limited sales of products containing our new technology ribbon drivers. If our ribbon driver technology and product line do not gain sufficient positive market acceptance, we may not achieve anticipated revenue, profits or continued viability.

***In the Loudspeaker Market, We Are Subject to Intense Competition.***

Although our ribbon driver loudspeaker products are relatively new and emerging, the markets for loudspeaker products are extremely competitive and we expect such competition to increase. The market for sound enhancement products in general is intensely competitive and sensitive to new product introductions or enhancements and marketing efforts by our competitors. The market is sustained by ongoing technological developments, frequent new product announcements and introductions, evolving industry standards and changing customer requirements. We expect to experience increasing levels of competition in the future. Although we have attempted to design our loudspeaker systems to compete favorably with competitive products, we may not be able to establish and maintain our competitive position against current or potential competitors. Aggressive competition could cause us to have sales and profitability below expectations.

***If We Are Unable to Hire or Retain Qualified and Skilled Personnel as Necessary, We May Not Be Able to Develop New Products or Successfully Manage Our Business.***

We believe our success will depend in large part upon our ability to identify, attract and retain highly skilled managerial, engineering, sales and marketing, finance and operations personnel. However, we may not be successful in identifying, attracting and retaining such personnel. Our success also depends to a great degree upon the continued contributions of our key management, engineering, sales and marketing, finance and manufacturing personnel, many of whom would be difficult to replace. In particular, we believe that our future success depends on John Gott, Chief Executive Officer. We presently maintain key person life insurance on Mr. Gott in the amount of \$5 million, but we do not have an employment contract with him. If we

experience the loss of the services of any of our key personnel, we may be unable to identify, attract or retain qualified personnel in the future. This could make it difficult for us to manage our business and meet key objectives, or achieve or sustain profits.

***Our Recurring Losses and Dependence Upon Additional Financing Have Caused Our Auditors to Issue a Statement Indicating Substantial Doubt as to Our Ability to Continue as a Going Concern.***

The accountants' audit report on our financial statements for the year ended December 31, 2003 included a statement that, because of recurring losses and our dependency on the sale of securities or obtaining debt financing, there was a substantial doubt about our ability to continue as a going concern. If we are unable to raise additional financing to cover operating expenses and derive additional revenue from sales, we may no longer be a viable business.

***Our Patent Application May Not Be Issued and Even If It Is Issued, We Still May Not Be Able to Adequately Protect the Patent or Our Other Intellectual Property.***

In September 2002, we filed a U.S. patent application on our proprietary ribbon driver technology. Our success will depend in significant part on our ability to obtain, preserve and defend U.S. patent protection for this technology. The patent may not be issued from the patent application. The issuance of a patent is not conclusive as to its validity or enforceability and, if a patent is issued, it is uncertain how much protection, if any, will be given to our patent if we attempt to enforce it. Litigation, which could be costly and time consuming, may be necessary to enforce our current patents or any patent issued in the future or to determine the scope and validity of the proprietary rights of third parties. A competitor may successfully challenge the validity or enforceability of a patent or challenge the extent of the patent's coverage. If the outcome of litigation is adverse to us, third parties may be able to use our patented technology without payment to us. Even if we are successful in defending such litigation, the cost of litigation to uphold the patent can be substantial. On March 12, 2004, we acquired Evenstar, Inc., by a merger with and into our newly formed, wholly owned subsidiary, Evenstar Mergersub, Inc. Evenstar is the owner of one issued patent and a second patent that was issued in September 2004. The patents are for Evenstar's digital amplification technology, which provides for substantially reduced production costs compared to amplifiers of comparable quality.

It is possible that competitors may infringe our patents or successfully avoid them through design innovation. To stop these activities we may need to file a lawsuit. These lawsuits are expensive and would consume time and other resources. In addition, there is a risk that a court would decide that our patent is not valid, that we do not have the right to stop the other party from using the inventions, or that the competitor's activities do not infringe our patent.

Our competitive position is also dependent upon unpatented technology and trade secrets, which may be difficult to protect. Others may independently develop substantially equivalent proprietary information and techniques that would

legally circumvent our intellectual property rights. Currently, we have not registered any potential trademarks and we may not be able to obtain registration for such trademarks.

***The Use of Our Technologies Could Potentially Conflict With the Rights of Others.***

Our competitors, or others, may have or may acquire patent rights that they could enforce against us. If our products conflict with patent rights of others, third parties could bring legal actions against us or our suppliers or customers, claiming damages and seeking to enjoin manufacturing and marketing of the affected products. If these legal actions are successful, in addition to any potential liability for damages, we could be required to alter our products or obtain a license in order to continue to manufacture or market the affected products. We may not prevail in any legal action and a required license under the patent may not be available on acceptable terms or at all. The cost to us of any litigation or other proceeding relating to intellectual property rights, even if resolved in our favor, could be substantial.

***We Must Expand Our Operations to Commercialize Our Products, Which We May Not Be Able to Do.***

We will need to expand and effectively manage our operations and facilities to successfully pursue and complete our commercialization efforts. We will need to add personnel, including management, and expand our capabilities, which may strain our existing managerial, operational, financial and other resources. To compete effectively and manage our growth, we must train, manage and motivate a substantially larger employee base, accurately forecast demand for our products and implement operational, financial and management information systems. In the event that we fail to expand or manage our growth effectively or if we cannot recruit qualified employees, our commercialization efforts could be curtailed or delayed.

***We May Acquire Other Businesses or Technologies, and We May Not be Able to Integrate and Operate the Acquisitions.***

In March 2004 we acquired Evenstar, Inc. From time to time, we have considered the acquisition of other businesses or other technologies, and we continue to consider such acquisitions as opportunities arise. Some of these businesses and technologies, including Evenstar, are directly related to our business and others are not. If we make any such acquisitions, we may not be able to efficiently combine our operations with those of the businesses or technologies we acquire without encountering difficulties. These difficulties could result from a variety of issues, including incompatible operating practices, corporate cultures, product lines, or technologies. As a result, we may have difficulties in integrating, managing and operating the acquired businesses and technologies.

**RISKS RELATED TO OUR SECURITIES AND THIS OFFERING**

***Since Our Common Stock is Thinly Traded, It Can Be Subject to Extreme Rises or Declines in Price, and You May Not Be Able to Sell Your Shares at or Above the Price You Paid.***

You may have difficulty reselling shares of our common stock. You may not be able to resell your shares at or above the price you paid, or at a fair market value. The stock markets often experience significant price and volume changes that are not related to the operating performance of individual companies. These broad market changes may cause the market price of our common stock to decline regardless of how well we perform as a company.

***Future Sales of Common Stock Could Depress the Price of Our Common Stock.***

Future sales of substantial amounts of our common stock pursuant to Rule 144 under the Securities Act of 1933 or otherwise could have a material adverse impact on the market price for the common stock at the time. On February 1, 2005, there were approximately 25,011,318 outstanding shares of our common stock held by stockholders that are deemed restricted securities as defined by Rule 144 under the Securities Act. Under certain circumstances, these shares may be sold without registration pursuant to the provisions of Rule 144. In general, under Rule 144, a person (or persons whose shares are aggregated) who has held the stock for one year may, under certain circumstances, sell within any three-month period a number of restricted securities which does not exceed the greater of 1% of the shares outstanding or the average weekly trading volume during the four calendar weeks preceding the notice of sale required by Rule 144. In addition, Rule 144 permits, under certain circumstances, the sale of restricted securities without any quantity limitations by a non-affiliate who has held the security for two years. Any sales of shares by stockholders pursuant to Rule 144 may have a depressive effect on the price of our common stock.

***We May Have Liability for Prior Issuances of Our Stock.***

From May 1, 2002 through May 10, 2004, warrant holders exercised 2,545,800 of our Class A Warrants and 22,600 of our Class B Warrants for a total of 2,568,400 shares of common stock. The warrant holders paid an aggregate of \$1,340,700 for these exercises. From May 1, 2002 through May 10, 2004, the registration statement that we filed with the U.S. Securities and Exchange Commission to register the common stock issuable upon exercise of these warrants may not have been current because the registration statement had not been amended to include our most recent audited financial statements. As a result, the former warrant holders may be entitled to demand a rescission of their previous exercises of common stock. We intend to make a rescission offer to all warrant holders who exercised warrants during the period from May 1, 2002 through May 10, 2004. Once made, the rescission offer is expected to remain open for 30 days. The rescission offer would require us to repurchase the shares of common stock issued upon exercise of the warrants at their original exercise price, \$.50 for the Class A Warrants and \$3.00 for the Class B Warrants, at each warrant holder's option. If all warrant holders accepted the rescission offer, we would be required to pay \$1,340,700 plus interest, which amount would be reduced to the extent of the proceeds from any sales of the underlying common stock by the former warrant holders. Acceptance of the rescission offer by all former warrant holders could have a material adverse effect. The current market price is over the \$.50 exercise price of the Class A Warrants, and if that remains true, we would expect no former holders of Class A Warrants to accept the rescission offer. The current market price is below the \$3.00 exercise price of the Class B Warrants. Only 22,600 Class B Warrants were exercised during the rescission offer period, making our potential rescission liability to the former Class B Warrant holders equal to \$67,800 plus interest, which amount would be reduced to the extent of any sales of the underlying common stock by the former warrant holders.

***Shares of Convertible Preferred Stock May Not Have Been Validly Issued.***

In 2001 - 2003, we sold shares of our Convertible Preferred Stock, which is sometimes reflected in our financial statements as our Series A Preferred Stock. We recently discovered that

the certificate of designation for the Convertible Preferred Stock had not been filed, and we made such filing in December 2004. The delay in filing the certificate of designation may have resulted in the shares of Convertible Preferred Stock not being validly issued under Delaware law. We are assessing the effects of the delay and determine what actions we will take, if any, to remedy the effects of the delay. To date, we have issued 1,891,473 shares of the Convertible Preferred Stock, all of which were issued prior to the filing of the certificate of designation and 350,873 of which remain outstanding. All other shares have converted to common stock on a 10-to-1 basis, at a conversion price of \$0.25 per share.

***Our Internal Controls Over Financial Reporting May Not be Effective and Our Independent Auditors May Not be Able to Certify as to Their Effectiveness.***

We are evaluating our internal controls over financial reporting in order to allow management to report on, and our independent auditors to attest to, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002 and rules and regulations of the SEC thereunder. 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. The management certification and auditor attestation requirements of Section 404 will initially apply to us as of December 31, 2005. In the course of our ongoing Section 404 evaluation, we will seek to identify areas of internal controls that need improvement and to design enhanced processes and controls to address these and any other issues that might be identified through this review. In the evaluation process, we may identify conditions that may result in significant deficiencies or material weaknesses in the future.

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 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, including 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.

We expect to incur expenses of an aggregate of approximately \$200,000 in 2005 in connection with our compliance with Section 404.

***Certain Restrictive Covenants May Limit Our Ability to Raise Additional Capital and Affect Other Aspects of Our Business.***

In our January 2005 private placement of Series C Preferred Stock and warrants, we entered into a securities purchase agreement with the investors. The agreement contains numerous covenants that limit our financing and other activities, including those described in the following paragraphs.

So long as at least 3,750 shares of the Series C Preferred Stock are outstanding and held by the original purchasers thereof, we may not pay any cash dividends, make distributions, redeem or repurchase any capital stock, or repay or prepay any indebtedness of ours other than as expressly required pursuant to the terms of such indebtedness.

So long as any shares of the Series C Preferred Stock are beneficially owned by the original purchasers thereof, we may not issue or sell any rights, warrants or options to subscribe for or purchase our common stock, or any other securities directly or indirectly convertible into or exchangeable or exercisable for our common stock, at an effective conversion, exchange or exercise price that varies or may vary with the market price of our common stock.

Prior to January 3, 2007, the investors in the January 2005 private placements have a right to participate in any issuance of equity securities, equity-linked securities, or convertible debt, subject to certain exceptions. The participation rights may prevent other potential investors from making offers for, or entering into agreements to purchase, our securities and thereby limiting our ability to raise capital.

***We Are Obligated to Redeem Our Series C Preferred Stock Upon the Occurrence of Certain Events.***

Pursuant to the terms of the certificate of designation for our Series C Preferred Stock, we are required to redeem the Series C Preferred Stock upon the occurrence of certain events, including the following:

.

our common stock is suspended from trading on any of, or is not listed or quoted (and authorized) for trading on at least one of, the New York Stock Exchange, the American Stock Exchange, the Nasdaq National Market, the Nasdaq SmallCap Market or the Nasdaq Over-The-Counter Bulletin Board for an aggregate of ten or more trading days in any twelve-month period;

.

the registration statement of which this prospectus is a part, after being declared effective, cannot be used by the holders of Series C Preferred Stock for the resale of all of the common stock issuable to them for an aggregate of more than 20 days, subject to certain exceptions;

.

we make an assignment for the benefit of creditors, or apply for or consent to the appointment of a receiver or trustee for us or for a substantial part of our property or business, or such a receiver or trustee shall otherwise be appointed;

.

bankruptcy, insolvency, reorganization or liquidation proceedings or other proceedings for the relief of debtors shall be instituted by or against us or any subsidiary of ours and if instituted against us or any of our subsidiaries by a third party, shall not be dismissed within 60 days of their initiation;

.

if at least 3,750 shares of Series C Preferred Stock are outstanding and held by the original purchasers thereof and we do any of the following:

(a)

sell, convey or dispose of all or substantially all of our assets;

(b)

consummate specified mergers, consolidations or business combinations;

(c)

engage in transactions providing for sales or issuances by us or our stockholders that result in the purchaser owning or having the right to acquire greater than 35% of the outstanding shares of our common stock (calculated on a fully diluted basis); or

(d)

issue or agree to issue any equity or equity-linked securities or debt that is convertible into equity or in which there is an equity component, subject to certain exceptions;

.

we either fail to make any payment with respect to any of our indebtedness in excess of \$250,000, subject to certain exceptions, or default under any agreement binding us, subject to certain exceptions; or

.

we breach any material term under the certificate of designation for our Series C Preferred Stock, the Series C Preferred Stock securities purchase agreement, the registration rights agreement or the warrants attached to the Series C Preferred Stock, subject to certain exceptions.

Any such redemption would be made at a premium in excess of the purchase price of the shares of Series C Preferred Stock, as determined by a formula set forth in the certificate of designation for the Series C Preferred Stock. These requirements may cause us to pay a significant amount of money to redeem the Series C Preferred Stock or may cause us to avoid taking certain actions in order to prevent the occurrence of such redemption requirement. See Description of Capital Stock Preferred Stock - Series C Convertible Preferred Stock.

**We May Be Required to Pay Substantial Amounts to the Investors in Our January 2005 Private Placement Upon the Occurrence of Certain Events.**

In connection with the January 2005 private placement of our Series C Preferred Stock and warrants, we agreed to file the registration statement of which this prospectus forms a part, to register the resale of shares of our common stock by the investors in the private placement, as further described in this prospectus. We have an obligation to register additional shares that may be issuable from time to time as a result of potential adjustments to the preferred stock and warrants.

If the registration statement is not filed by February 2, 2005, or is not declared effective by April 3, 2005, then we are required to pay each investor an amount equal to the product of (x) the number of shares of Series C Preferred Stock held by such investor (plus any shares of preferred stock that have been converted into shares of our common stock then held by such investor as if such shares of preferred stock had not been so converted) multiplied by the per share purchase price, multiplied by (y) .01, for each thirty-day period (or portion thereof) beginning April 3, 2005 and ending July 2, 2005, and .02 for each thirty-day period beginning July 2, 2005 (or portion thereof) and prior to the date the registration statement is declared effective by the SEC; provided that in the event the SEC commences a review of the registration statement, the amount payable to each investor shall begin accruing on May 3, 2005, and not April 3, 2005. Assuming that the 6,000,000 shares of Series C Preferred Stock currently outstanding remain the number outstanding during such periods, then the amounts payable pursuant to such provisions are \$150,000 through July 2, 2005 and \$300,000 thereafter.

Such amount would also be payable upon certain other events, including (a) the number of the investors' shares registered on this registration statement (or any other registration statement) is less than the number then issued or issuable to such investors pursuant to the Series C Preferred Stock and warrants; (b) sales of our common stock can not be made pursuant to this registration statement; or (c) our common stock is not traded, listed or included for quotation, as applicable, on the Nasdaq Over-The-Counter Bulletin Board, certain stock exchanges or certain automated quotation systems.

The effectiveness of our registration statement is subject to action by the SEC, which is beyond our control, and the other events described above may also be beyond our control.

### **FORWARD-LOOKING STATEMENTS**

This registration statement, as well as our other reports filed with the SEC and our press releases and other communications, contain forward-looking statements made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995. Forward-looking statements include all statements regarding our expected financial position, results of operations, cash flows, dividends, financing plans, strategy, budgets, capital and other expenditures, competitive positions, growth opportunities, benefits from new technology, plans and objectives of management, and markets for stock. These forward-looking statements are based largely on our expectations and, like any other business, are subject to a number of risks and uncertainties, many of which are beyond our control. The risks include those stated in the Risk Factors section of this registration statement and economic, competitive and other factors affecting our operations, markets, products and services, expansion strategies and other factors discussed elsewhere in this registration statement and the other documents we have filed with the Securities and Exchange Commission. In light of these risks and uncertainties, there can be no assurance that the forward-looking information contained in this registration statement will in fact prove accurate, and our actual results may differ materially from the forward-looking statements.

### **USE OF PROCEEDS**

We will receive no proceeds from the sale of shares of common stock in this offering. However, if all of the warrants and options are exercised in full, we may receive up to \$1,500,000 in proceeds from the exercise of warrants held by The Shemano Group, up to \$2,000,000 in proceeds from the exercise of the options held by 3CD Consulting and an undeterminable amount of additional proceeds from the exercise of the options held by C. Curtis Hargis, Co. and George Fallica. Any proceeds received upon the exercise of such options and warrants will be used for working capital and general corporate purposes.



## SELLING STOCKHOLDERS

Under this prospectus, the selling stockholders may offer up to an aggregate of 19,100,000 shares of our common stock, which shares of common stock are or will be issuable upon conversion of the Series C Preferred Stock and upon exercise of the options and warrants described above. Of such 19,100,000 shares, 300,000 have been issued; 14,800,000 are issuable pursuant to the conversion or exercise of preferred stock, options and warrants that have been issued or may be issued; and 4,000,000 may be issued in satisfaction of the premium on our Series C Preferred Stock or as a result of potential adjustments to the preferred stock or the warrants. On January 3, 2005, there were 41,751,080 shares of our common stock outstanding. Assuming the exercise of all of the options and warrants described above, and the conversion of all of the Series C Preferred Stock, the 19,100,000 shares offered by this prospectus represent 31.4% of our total common stock outstanding on January 3, 2005. The selling stockholders are not required to sell their shares, and any sale of common stock by any selling stockholder is entirely at the discretion of such selling stockholder.

The following table details, as of February 2, 2005, the name of each selling stockholder, the number of shares of common stock issuable to a selling stockholder assuming conversion of all preferred stock and exercise of all warrants and options currently outstanding the number of shares of common stock beneficially owned by the selling stockholder (without giving effect to the accrual of premium on the Series C Preferred Stock), and the number of shares of common stock that may be offered for resale under this prospectus by such selling stockholders or its pledgees, donees, assignees, transferees or successors in interest who, together with the selling stockholders, we collectively refer to in this prospectus as the selling stockholders. Because each selling stockholder may offer all, some or none of the shares of common stock it holds, and because there are currently no agreements, arrangements, or understandings with respect to the sale of any of the shares, no definitive estimate as to the number of shares that will be held by each selling stockholder after the offering can be provided. The number of shares of common stock beneficially owned by the selling stockholder is determined under the rules and regulations promulgated by the Securities and Exchange Commission pursuant to Section 13(d) of the Exchange Act. The table has been prepared on the assumption that all shares offered under this prospectus will be sold in the offering and that such shares will be sold to parties unaffiliated with the selling stockholders. The Shemano Group, Inc. acted as a finder for our private placement of Series C Preferred Stock. C. Curtis Hargis Co., George Fallica, New AV Ventures, and 3CD Consulting, LLC have been consultants to the Company. No other selling stockholder nor any of their affiliates have held a position or office, or had any other material relationship, with us.

<b>Selling Stockholder</b>	<b>Shares Issuable Assuming Full Conversion and Exercise</b>	<b>Percentage of Outstanding Shares Assuming Full Conversion and Exercise (2)</b>	<b>Shares Beneficially Owned Before Offering (3)</b>	<b>Percentage of Outstanding Shares Beneficially Owned Before Offering (3)</b>	<b>Shares of Common Stock Covered by this Prospectus</b>	<b>Shares to be Owned After Offering</b>
Baystar Capital II, L.P.	4,800,000 (1)	10.3%	2,192,799	4.99%	6,400,000 (4)	0
C. Curtis Hargis Co.	500,000	1.2%	500,000	1.2%	500,000	0
George Fallica	700,000	1.6%	700,000	1.6%	700,000	0
HFTP Investment L.L.C.	3,000,000 (1)	6.7%	2,192,799	4.99%	4,000,000 (4)	0
New AV Ventures, LLC	300,000	*	*	*	300,000	0
PSO Trading IV, LLC	1,600,000 (1)	3.7%	1,600,000	3.7%	2,133,333 (4)	0
Royal Bank of Canada	2,600,000 (1)	5.9%	2,192,799	4.99%	3,466,667 (4)	0
The Shemano Group, Inc.	600,000	1.4%	600,000	1.4%	600,000	0
3CD Consulting, LLC	1,000,000	2.3%	1,000,000	2.3%	1,000,000	0
<b>TOTAL</b>	<b>15,100,000</b>	<b>26.6%</b>			<b>19,100,000</b>	<b>0</b>

\*Less than 1%

(1)

One-half of this amount is issuable pursuant to conversion of the outstanding Series C Preferred Stock and the other half is issuable upon exercise of warrants. The certificate of designation for our Series C Preferred Stock and the terms of the warrants referred to above prevent us from issuing shares of our common stock in connection with the conversion of our Series C Preferred Stock or the exercise of the warrants referred to above to the extent that such conversion or exercise would result in the holder or its affiliate (or any person whose beneficial ownership would be aggregated with the holder) beneficially owning in excess of 4.99% of the outstanding shares of our common stock following such conversion or exercise. However, the 4.99% limitation would not prevent the holder from acquiring and selling in excess of 4.99% of our common stock through a series of exercises and conversions. These amounts do not reflect premium accrued on the Series C Preferred Stock.

(2)

Percentage of outstanding shares is based on 41,751,080 shares of common stock, which consists of the number of shares outstanding on January 3, 2005, plus the assumed exercise of the options and/or warrants held by the selling stockholder. These percentages do not reflect the limitations on conversion and exercise described in footnote 1 above.

(3)

These amounts and percentages reflect the limitations on conversion and exercise described in footnote 1 above.

(4)

This amount includes additional shares that may be issued to each of Baystar Capital II, L.P., HFTP Investment L.L.C., PSO Trading IV, LLC or Royal Bank of Canada as a result of the premium on the Series C Preferred Stock or as a result of potential adjustments to the preferred stock or the warrants.

### **Holders of Series C Preferred Stock and Warrants**

On January 4, 2005, we completed a private placement of our newly designated Series C Convertible Preferred Stock for an aggregate purchase price of \$15 million. The investors also received five-year warrants to purchase an aggregate of 6,000,000 shares of our common stock at an exercise price of \$6.00 per share, subject to certain adjustments. The securities were purchased by BayStar Capital II, L.P., PSO Trading IV, LLC, HFTP Investment L.L.C., and Royal Bank of Canada. The preferred stock is initially convertible, at the holder's option, into an aggregate of 6,000,000 shares of our common stock, at a conversion price of \$2.50 per share, subject to certain adjustments, and accrues, on a cumulative basis, a 6% premium to the stated value of the shares of preferred stock, which premium, when accrued, would be convertible into additional shares of common stock. We may redeem the warrants (or require the holder to exercise them) and may require holders to convert the preferred stock to common stock if certain conditions are met.

In connection with the private placement, we agreed to file the registration statement of which this prospectus forms a part, covering resales of the common stock currently issuable upon conversion of the preferred stock and exercise of the warrants, as well as 4,000,000 additional shares that may be issuable as a result of the premium on the preferred stock earned prior to the conversion thereof or as a result of potential adjustments to the preferred stock or the warrants. We are obligated to register additional shares that may be issuable from time to time as a result of potential adjustments to the preferred stock and warrants. We intend to supplement this prospectus or amend the registration statement of which this prospectus is a part to the extent necessary to satisfy this obligation. We are subject to penalties if, among other reasons, the registration statement is not effective by April 3, 2004, subject to certain exceptions.

### **New AV Ventures**

On January 31, 2005 we entered into a consulting agreement with New AV Ventures, LLC, pursuant to which we issued 300,000 restricted shares of our common stock to New AV

Ventures and agreed to grant options to George Fallica, the managing member of New AV Ventures, to purchase shares of our common stock, from time to time to the extent earned under the terms of the consulting agreement, but not to exceed 700,000 shares. The exercise price per share will equal the average price of our common stock for the five trading days immediately prior to January 1 of the year in which such options are issued. Pursuant to such agreement, we agreed to register such shares as part of this registration statement.

### **3CD Consulting**

On January 31, 2005 and effective as of November 2004, we entered into a consulting agreement with 3CD Consulting, LLC, pursuant to which we granted options to purchase 1,000,000 shares of our common stock at an exercise price of \$2.00 per share. Pursuant to such agreement, we agreed to register such shares as part of this registration statement.

### **W. Curtis Hargis Co.**

In December 2004, we entered into a consulting services agreement with W. Curtis Hargis Co.. Pursuant to the agreement, we engaged W. Curtis Hargis Co. to arrange meetings with certain retail businesses to discuss a possible agreement to sell our products and assist with presentations to be made at any such meetings, and we agreed to pay a 2% cash commission of the net sales realized plus options upon signing a contract with such retail business and additional options upon sales to such retail business, but not to exceed 500,000 shares. Pursuant to such agreement, we agreed to register such shares as part of this registration statement. The foregoing summary description of the

agreement is qualified in its entirety by reference to the terms of the agreement, which is filed as an exhibit hereto.

## **The Shemano Group**

In November 2004, we entered into a non-exclusive finder's agreement with The Shemano Group, Inc. pursuant to which Shemano introduced to us the investors who participated in the private placement of Series C Convertible Preferred Stock that closed on January 4, 2005. As compensation for the services to be provided under such agreement, we agreed to pay Shemano (a) a cash placement fee equal to 6% of the gross offering funds received in the private placement; and (b) warrants to purchase, at the lesser of \$2.50 per share or the conversion price of any equity securities sold, 40,000 shares of our common stock for each \$1,000,000 received by us in the private placement. Pursuant to the finder's agreement we issued warrants to purchase up to 600,000 shares of our common stock at \$2.50 per share to Shemano in connection with the private placement. Pursuant to such agreement, we agreed to register such shares as part of this registration statement.

## **PLAN OF DISTRIBUTION**

The common stock offered by this prospectus may be offered from time to time by the selling stockholders. The common stock may be sold or distributed from time to time by the selling stockholders and any of their pledgees, assignees, transferors, donees and successors in interest directly to one or more purchasers or through agents, broker/dealers or underwriters at market prices prevailing at the time of sale, at prices related to the prevailing market prices, at negotiated prices, or at fixed prices, which may be changed. Each selling stockholder will act

independently in making decisions with respect to the timing, manner and size of each sale of the shares covered in this prospectus. The sale of the common stock offered by this prospectus may be effected in one or more of the following methods:

.

ordinary brokers' transactions and transactions in which the broker/dealer solicits purchasers, which may include long sales and short sales effected after the effective date of the registration statement of which this prospectus is a part;

.

transactions involving cross or block trades in which the broker/dealer will attempt to sell shares of the common stock as agent but may position and resell portions of the block as principal to facilitate the transactions;

.

through agents, broker/dealers, or underwriters;

.

at the market to or through market makers or into an existing market for the common stock;

.

in other ways not involving market makers or established trading markets, including direct sales to purchasers or sales effected through agents;

.

in privately negotiated transactions;

.

an exchange distribution in accordance with the rules of the applicable exchanges;

.

settlement of short sales;

.

through transactions in swaps, options or other derivative securities (whether exchange listed or otherwise);

.

any combination of the foregoing; and

.

any other method permitted from time to time by applicable law.

In order to comply with the securities laws of certain states, if applicable, the shares may be sold only through registered or licensed brokers or dealers.

The selling stockholders may pledge their shares to their brokers under the margin provisions of customer agreements. If a selling stockholder defaults on a margin loan, the broker may, from time to time, offer and sell the pledged shares. Broker-dealers engaged by a selling stockholder may arrange for other broker-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the selling stockholders (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated.

The selling stockholders and any broker-dealers or agents that are involved in selling the shares may be deemed to be underwriters within the meaning of the Securities Act of 1933, as amended, in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act of 1933, as amended.

We will pay all of the fees and expenses incident to the registration, offering, and sale of the shares to the public other than commissions or discounts of underwriters, broker-dealers, or agents. We have also agreed to indemnify the selling stockholders and related persons against specified liabilities, including liabilities under the Securities Act.

While they are engaged in a distribution, if any, of the shares included in this prospectus the selling stockholders 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 stockholders, any affiliated purchasers, and any broker-dealer or other person who participates in the distribution, if any, from bidding for or purchasing, or attempting to induce any person to bid for or purchase any security that is the subject of the distribution, if any, until the entire distribution is complete. Regulation M also prohibits any bids or purchases made in order to stabilize the price of a security in connection with the distribution, if any, of that security. All of the foregoing may affect the marketability of the shares offered by this prospectus.

The selling stockholders may also sell shares under Rule 144 promulgated under the Securities Act of 1933, as amended, rather than selling under this prospectus. This offering will terminate on the date that all shares offered by this prospectus have been sold by the selling stockholders or are eligible for sale under Rule 144(k).

## **DESCRIPTION OF CAPITAL STOCK**

### **Common Stock**

Our authorized capital stock consists of 75,000,000 shares of common stock, par value \$.001 per share. On January 3, 2005, there were outstanding a total of 41,751,080 shares of common stock. The holders of shares of common stock:

.

have equal ratable rights to dividends on funds legally available for dividends, provided dividends are declared by the our Board of Directors

.  
are entitled to share proportionately in all of our assets available for distribution to holders of common stock upon any sale, dissolution or winding up of our affairs

.  
do not have priority rights to subscribe for future offerings of shares of common stock by us

.  
do not have any priority rights to convert their shares of common stock into any of our other securities

.  
do not have rights to subscribe for shares or convert their shares

.  
have no right to have their shares redeemed by us

.  
are entitled to one vote per share on all matters upon which stockholders may vote at all meetings of stockholders

All shares of common stock now outstanding are fully paid for and are not assessable by us; and all the shares of common stock that are the subject of this offering, when issued, will be fully paid for and will not be assessable by us.

The holders of shares of our common stock do not have cumulative voting rights, which are rights to accumulate votes to be cast for directors in an election. In this way a stockholder could vote his or her entire total of votes for one director only, and not vote for any other director. However, because there is no cumulative voting, the holders of more than 50% of the outstanding shares, when voting for the election of directors, can elect all of the directors to be elected, if they so choose. As a result, the holders of the remaining shares will not be able to elect any of our directors. On January 3, 2005, Mr. Gott and his affiliates owned shares and options to acquire shares representing an aggregate

of approximately 17.9% of our outstanding common stock. Such a concentration of ownership could have an adverse effect on the price of the common stock. It may have the effect of delaying or preventing a change in control, including transactions in which stockholders might otherwise receive a premium for their shares over the then current market prices.

Some provisions of our certificate of incorporation and bylaws could make it more difficult for a third party to acquire us even if a change of control would be beneficial to our stockholders. These provisions include:

.  
authorizing the issuance of preferred stock without common stockholder approval

.  
prohibiting cumulative voting in the election of directors

.  
limiting the persons who may call special meetings of stockholders

### **Preferred Stock**

Our authorized capital stock also includes 5,000,000 shares of preferred stock, \$.001 par value, of which (a) 2,000,000 shares have been designated Convertible Preferred Stock, (b)

1,000,000 shares have been designated Series B Preferred Stock, and (c) 25,000 shares have been designated Series C Preferred Stock. Our articles of incorporation authorize a class of preferred stock commonly known as a blank check preferred stock. Specifically, the preferred stock may be issued from time to time by the board of directors as shares of one or more classes or series. Our board of directors, subject to the provisions of our Certificate of Incorporation and limitations imposed by law, is authorized to adopt resolutions to issue the shares; to fix the number of shares; to change the number of shares constituting any series; to provide for or change the voting powers, designations, preferences, and relative, participating, optional or other special rights, qualifications, limitations or restrictions; the dividend rights, including whether dividends are cumulative; to fix dividend rates; to fix terms of redemption, including sinking fund provisions; to fix redemption prices; to fix conversion rights; and to fix liquidation preferences of the shares constituting any class or series of the preferred stock.

In each such case, we will not need any further action or vote by our stockholders. One of the effects of undesignated preferred stock may be to enable the board of directors to render more difficult or to discourage an attempt to obtain control of us by means of a tender offer, proxy contest, merger or otherwise, and thereby to protect the continuity of our management. The issuance of shares of preferred stock pursuant to the board of director's authority described above may adversely affect the rights of holders of common stock. For example, preferred stock issued by us may rank prior to the common stock as to dividend rights, liquidation preference or both, may have full or limited voting rights and may be convertible into shares of common stock. Accordingly, the issuance of shares of preferred stock may discourage bids for the common stock at a premium or may otherwise adversely affect the market price of the common stock.

### ***Convertible Preferred Stock***

We designated 2,000,000 shares as Convertible Preferred Stock, 1,891,473 of which were sold in a private placement that commenced in September 2001 and concluded in July 2003.

*Ranking.* The Convertible Preferred Stock ranks senior to our common stock with respect to payment of dividends and amounts upon any liquidation, dissolution or winding up.

*Conversion.* The shares of Convertible Preferred Stock are convertible to common stock one year from the date of purchase at a conversion rate of 10 shares of common stock for each share of preferred stock.

*Dividends.* The holders of shares of Convertible Preferred Stock are not entitled to receive any dividends.

*Voting.* The holders of shares of Convertible Preferred Stock are not entitled to vote on any matters submitted to a vote of shareholders, except those matters required by law to be submitted to such holders.

***Series B Convertible Participating Preferred Stock***

We designated 1,000,000 shares as Series B Convertible Participating Preferred Stock, 272,100 of which were sold from time to time for \$5,442,000 in a private placement in 2004.

*Ranking.* The Series B Preferred Stock ranks senior to our Convertible Preferred Stock with respect to payment of dividends and amounts upon any liquidation, dissolution or winding up.

*Conversion.* The shares of the Series B Preferred Stock are convertible to common stock six months from the date of issuance at a conversion rate of 10 shares of common stock for each share of preferred stock.

*Dividends.* The holders of shares of the Series B Preferred Stock are entitled to receive any dividends pro rata with the holders of each other class of capital stock or series of preferred stock that is entitled to receive dividends.

*Voting.* The holders of shares of the Series B Preferred Stock are not entitled to vote on any matters submitted to a vote of shareholders, except those matters required by law to be submitted to such holders.

### ***Series C Convertible Preferred Stock***

We designated 25,000 shares as Series C Convertible Preferred Stock. On January 4, 2005, we completed a private placement of 15,000 shares of the Series C Preferred Stock for an aggregate purchase price of \$15 million. See Recent Events.

*Ranking.* The Series C Preferred Stock ranks senior to our common stock, Convertible Preferred Stock and Series B Preferred Stock with respect to payment of dividends and amounts upon any liquidation, dissolution or winding up.

*Dividends.* The holders of shares of the Series C Preferred Stock shall not be entitled to receive any dividends.

*Voting.* The holders of shares of the Series C Preferred Stock shall not be entitled to vote on any matters submitted to a vote of shareholders, except those matters required by law to be submitted to such holders.

*Participation.* The Series C Preferred Stock provides that, subject to certain conditions and exceptions, if we issue any securities that are convertible into or exercisable or exchangeable for our common stock, or option or warrants or other rights to purchase or subscribe for our common stock pro rata to the record holders of any class of our common stock, then the holders of the preferred stock, upon conversion of the preferred stock shall be entitled to receive such

securities, options, warrants or other purchase rights.

*Conversion.* Each share of the Series C Preferred Stock is initially convertible, at the holder's option, into 400 shares of common stock, at a conversion price of \$2.50 per share, subject to certain adjustments, and accrues a 6% premium to the stated value of the shares of preferred stock (which is initially \$1,000 per share), which would be convertible into additional shares of common stock. If the number of outstanding shares of our common stock is increased or decreased by a stock split, stock dividend, combination, reclassification or other similar event, the conversion price shall be proportionately reduced or increased. If we issue our common stock

at a price less than the conversion price of the preferred stock, the conversion price of the preferred stock shall be adjusted downward pursuant to a weighted-average anti-dilution adjustment formula set forth in the certificate of designation for the preferred stock.

Following one year after the registration statement of which this prospectus forms a part is declared effective by the Securities and Exchange Commission, the Series C Preferred Stock contains a mandatory conversion provision whereby we can require the holder of each share to convert their shares provided the closing price of our stock for any 20 consecutive trading-day period is equal to or exceeds 200% of the exercise price and other conditions are met. If any holder of Series C Preferred Stock fails to convert its shares as required, then at any time during the 10 business day period following required conversion date, we may repurchase such holder's shares of Series C Preferred Stock for a price of \$0.40 share of Series C Preferred Stock.

The certificate of designation for our Series C Preferred Stock prevents us from issuing shares of our common stock in connection with the conversion of our Series C Preferred Stock to the extent that such conversion would result in the holder or its affiliate (or any person whose beneficial ownership would be aggregated with the holder) beneficially owning in excess of 4.99% of the outstanding shares of our common stock following such conversion.

*Redemption.* Pursuant to the terms of the certificate of designation for our Series C Preferred Stock, we are required to redeem the Series C Preferred Stock upon the occurrence of certain events, including the following:

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our common stock is suspended from trading on any of, or is not listed or quoted (and authorized) for trading on at least one of, the New York Stock Exchange, the American Stock Exchange, the Nasdaq National Market, the Nasdaq SmallCap Market or the Nasdaq Over-The-Counter Bulletin Board for an aggregate of ten or more trading days in any twelve-month period;

.

the registration statement of which this prospectus is a part, after being declared effective, cannot be used by the holders of Series C Preferred Stock for the resale of all of the common stock issuable to them for an aggregate of more than 20 days, subject to certain exceptions;

.

we make an assignment for the benefit of creditors, or apply for or consent to the appointment of a receiver or trustee for us or for a substantial part of our property or business, or such a receiver or trustee shall otherwise be appointed;

.

bankruptcy, insolvency, reorganization or liquidation proceedings or other proceedings for the relief of debtors shall be instituted by or against us or any subsidiary of ours and if instituted against us or any of our subsidiaries by a third party, shall not be dismissed within 60 days of their initiation;

.

if at least 3,750 shares of Series C Preferred Stock are outstanding and held by the original purchasers thereof and we do any of the following:

(a)

sell, convey or dispose of all or substantially all of our assets;

(b)

consummate specified mergers, consolidations or business combinations;

(c)

engage in transactions providing for sales or issuances by us or our stockholders that result in the purchaser owning or having the right to acquire greater than 35% of the outstanding shares of our common stock (calculated on a fully diluted basis); or

(d)

issue or agree to issue any equity or equity-linked securities or debt that is convertible into equity or in which there is an equity component, subject to certain exceptions;

.

we either fail to make any payment with respect to any of our indebtedness in excess of \$250,000, subject to certain exceptions, or default under any agreement binding us, subject to certain exceptions; or

.

we breach any material term under the certificate of designation for our Series C Preferred Stock, the Series C Preferred Stock securities purchase agreement, the registration rights agreement or the warrants attached to the Series C Preferred Stock, subject to certain exceptions.

Any such redemption would be made at a premium in excess of the purchase price of the shares of Series C Preferred Stock, as determined by a formula set forth in the certificate of designation for the Series C Preferred Stock. These requirements may cause us to pay a significant amount of money to redeem the Series C Preferred Stock or may cause us to avoid taking certain actions in order to prevent the occurrence of such redemption requirement.

*Restricted Actions.* If at least 3,750 shares of Series C Preferred Stock are held by the original purchasers thereof, we shall not take certain actions, including the following, without first obtaining the approval of the holders of a majority of the shares then outstanding:

.

alter or change the rights, preferences or privileges of the Series C Preferred Stock, or increase the authorized number of shares of Series C Preferred Stock;

.

alter or change the rights, preferences or privileges of any capital stock of the Corporation so as to affect adversely the Series C Preferred Stock;

.

create or issue any capital stock that ranks equal to or senior to the Series C Preferred Stock;

.

issue any additional shares of Series C Preferred Stock;

.

redeem, repurchase or otherwise acquire, or declare or pay any cash dividend or distribution on, any Junior Securities;  
or

.

issue any debt security or incur any indebtedness (including any capital lease obligation) that would have any preference over the Series C Preferred Stock upon our liquidation, or redeem, repurchase, prepay or otherwise acquire any outstanding debt security or indebtedness, subject to certain exceptions.

## Stock Option Plan

Our Board of Directors approved the SLS International, Inc. 2000 Stock Purchase and Option Plan (the Plan ) and the plan was approved by existing stockholders.

Our Board of Directors administers the Plan. The Plan affords key employees, officers, and consultants, who are responsible for our continued growth, an opportunity to acquire an investment interest in SLS, and to create in such individuals a greater incentive and concern for the welfare of SLS. By means of this 2000 Stock Purchase and Option Plan, we seek to retain the

services of persons now holding key positions and to secure the services of persons capable of filling such positions.

We have reserved up to 2,000,000 shares of common stock for issuance upon exercise of options that may be issued from time to time under the Plan. The shares to be issued are subject to adjustment in the event of stock dividends, splits and other events that affect the number of shares of common stock outstanding.

*Maximum Purchase.* The options offered in the plan are a matter of separate inducement and are in addition to any salary or other compensation for the services of any key employee or consultant. The options granted under the plan are intended to be either incentive stock options or non-qualified or non-statutory stock options.

*Option.* Participants will receive such options as are granted from time to time by the Board of Directors. The option will state the number of shares and price of common stock to be purchased upon exercise of the options by the option holder.

*Exercise Price.* The purchase price per share purchasable under an option will be determined by the Board of Directors. However, for statutory options, the purchase price shall not be less than 90% of the fair market value of a share on the date of grant of such option. Furthermore, any option granted to a participant under the plan who, at the time the option is granted, is one of our officers or directors, the purchase price shall not be less than 100% of the fair market value of a share on the date of grant of such option. In the case of an incentive stock option granted to a participant who, at the time the option is granted, is a 10% stockholder, the purchase price for each share will be an amount not less than 110% of the fair market value per share on the date the incentive stock option is granted.

*Term of Option.* The term of each option shall be fixed by the Administrator which in any event will not exceed a term of 10 years from the date of the grant.

*Termination of Employment.* The Administrator will have the right to specify the effect to a participant upon his or her retirement, death, disability, leave of absence or any other termination of employment during the term of any option.

*Amendments.* The Board of Directors may amend, suspend, discontinue or terminate the Plan; provided, however, that, without approval of our stockholders, no such amendment, suspension, discontinuation or termination will be made that would (1) cause Rule 16b-3 under the Securities Exchange Act of 1934 to become unavailable with respect to the Plan; (2) violate

the rules or regulations of any national securities exchange on which our shares are traded or the rules or regulations of the NASD that are applicable to us; or (3) cause us to be unable, under the Internal Revenue Code, to grant investment stock options under the Plan.

## **Warrants**

### ***Class A and Class B Warrants***

We issued Class A Warrants and Class B Warrants as part of the units offered in the private placement of our Convertible Preferred Stock that commenced in September, 2001 and concluded in July, 2003. Each warrant provides the right to purchase one share of common stock at a specified price. The Class A Warrant was originally exercisable for a term of 6 months at a price of \$.50 per share. The Class B Warrant was originally exercisable for 2 years after exercise of the attached Class A Warrant at a price of \$3.00 per share. Through a series of extensions, the Class A Warrants and the Class B Warrants remained exercisable through August 4, 2004. The Class A Warrants and Class B Warrants were immediately detachable from the common stock but were not separable from each other until the Class A Warrant was exercised. The Class A Warrants were immediately exercisable after they were issued. Any Class A Warrant or Class B Warrant that was not exercised on or prior to August 4, 2004 is void and of no effect.

### ***Class C Warrants***

We sold Class C Warrants as part of our 2004 private placement of Series B Preferred Stock. Ten Class C Warrants were attached to each share of Series B Preferred Stock. Each Class C Warrant has a term of three years (unless we extended the term) and provides the right to purchase one share of common stock at a price of \$7.00 per share. The Class C Warrants are immediately exercisable and detachable from the shares of Series B Preferred Stock. If the average closing market price for our common stock is equal to or greater than \$10.50 per share for a period of 30 days, then we are entitled to repurchase such warrants, with 30 days notice, at a price of \$.001 per warrant.

In connection with the private placement of Series B Preferred Stock, we entered into an agreement with Kenny Securities Corp. to provide certain services to us. As compensation for such services, we agreed to pay Kenny Securities (a) a cash placement fee equal to 7% of the amount sold by Kenny Securities in the private placement; (b) warrants to purchase, at \$2.00 per share, a number of shares of common stock equal to 10% of the number of shares issuable upon conversion of the Series B Preferred Stock sold by Kenny Securities; and (c) Class C Warrants for the same number of shares. We issued warrants to purchase up to 125,000 shares of our common stock at \$2.00 per share to Kenny Securities for sales made by Kenny Securities in the private placement. Kenny Securities also received Class C Warrants to purchase 125,000 shares of our common stock, which shares are included in the shares offered hereby.

If we issue additional shares to others for any reason, other than a consolidation, merger, stock split, or sale of all of our assets, the holder of the warrants will have no rights to purchase any more shares than are represented by the warrants. In addition, no adjustment or change in the exercise price of each warrant will be made, except if a stock split is declared by us. In case of a stock split, the exercise price of the warrants shall be adjusted higher or lower depending upon whether the stock split is a reverse stock split or forward stock split. A forward stock split means

the shares are being split so that more shares will be outstanding after the stock split. In a forward stock split, the exercise price of the warrants shall be adjusted to permit the purchase of more shares of stock for the original exercise price. If there is a reverse stock split, there will be a reduction in outstanding shares and the exercise price of the warrant shall purchase fewer shares.

In the private placement of Series B Preferred Stock, which closed on July 27, 2004, 272,100 shares of the Series B Preferred Stock were sold for \$5,442,000. We issued 2,846,000 Class C Warrants, 2,721,000 of which were attached to shares of the Series B Preferred Stock and 125,000 of which were issued to Kenny Securities.

### ***Warrants Issued in Connection with Series C Preferred Stock***

In the private placement of Series C Preferred Stock that was consummated on January 4, 2005, investors received a warrant to purchase 400 shares of common stock for each share of Series C Preferred Stock purchased in the private placement. The warrants are immediately exercisable and remain exercisable for a term of five years at an exercise price of \$6.00 per share. If the warrants are not exercised on or prior to January 4, 2010 (or such later date as extended under certain circumstances), the warrants shall be void and of no effect. Following one year after this Registration Statement is declared effective by the Securities and Exchange Commission, each warrant contains a call option whereby, so long as certain conditions are met, we can require the holder of each warrant to either (a) exercise their warrant or (b) tender their warrant provided the closing price of our stock for any 20 consecutive trading-day period is equal to or exceeds 200% of the exercise price. The warrants provide that if we issue any securities that are convertible into or exercisable or exchangeable for our common stock, or option or warrants or other rights to purchase or subscribe for our common stock pro rata to the record holders of any class of our common stock, then the holders of the warrants, upon exercise of the warrants shall be entitled to receive such securities, options, warrants or other purchase rights. If we issue our common stock at a price less than the exercise price of the warrants, the exercise price of the warrants shall be adjusted downward pursuant to a formula set forth in the warrants.

The warrants prevent us from issuing shares of our common stock in connection with the exercise of the warrants to the extent that such exercise would result in the holder or its affiliate (or any person whose beneficial ownership would be aggregated with the holder) beneficially owning in excess of 4.99% of the outstanding shares of our common stock following such exercise.

Unless and until any Class A, Class B, or Class C Warrant or any warrant issued in connection with the Series C Preferred Stock, is exercised, each warrant holder will not own any equity interest by virtue of his or its ownership of the warrant. The warrant holder may not vote as a stockholder. The warrant holder also will not have rights to any distributions to stockholders unless and until the warrant is exercised and we receive the cash consideration for the purchase of the common stock. We have reserved a number of shares of common stock equal to the number of warrants issued.



### **Potential Liabilities Related to Issuances of Securities**

In 2001 - 2003, we sold shares of our Convertible Preferred Stock, which is sometimes reflected in our financial statements as our Series A Preferred Stock. We recently discovered that the certificate of designation for the Convertible Preferred Stock had not been filed, and we made such filing in December 2004. The delay in filing the certificate of designation may have resulted in the shares of Convertible Preferred Stock not being validly issued. We are making an assessment of the effects of the delay and determining what actions we will take, if any, to remedy the effects of the delay. To date, we have issued 1,891,473 shares of the Convertible Preferred Stock, all of which were issued prior to the filing of the certificate of designation and 350,873 of which remain outstanding. All other shares have converted to common stock on a 10-to-1 basis, at a conversion price of \$0.25 per share.

From May 1, 2002 through May 10, 2004, warrant holders exercised 2,545,800 of our Class A Warrants and 22,600 of our Class B Warrants for a total of 2,568,400 shares of common stock. The warrant holders paid an aggregate of \$1,340,700 for these exercises. From May 1, 2002 through May 10, 2004, the registration statement that we filed with the U.S. Securities and Exchange Commission to register the common stock issuable upon exercise of these warrants may not have been current because the registration statement had not been amended to include our most recent audited financial statements. As a result, the former warrant holders may be entitled to demand a rescission of their previous exercises of common stock. We intend to make a rescission offer to all warrant holders who exercised warrants during the period from May 1, 2002 through May 10, 2004. Once made, the rescission offer is expected to remain open for 30 days. The rescission offer would require us to repurchase the shares of common stock issued upon exercise of the warrants at their original exercise price, \$.50 for the Class A Warrants and \$3.00 for the Class B Warrants, at each warrant holder's option. If all warrant holders accepted the rescission offer, we would be required to pay \$1,340,700 plus interest, which amount would be reduced to the extent of the proceeds from any sales of the underlying common stock by the former warrant holders. Acceptance of the rescission offer by all former warrant holders could have a material adverse effect. The current market price is over the \$.50 exercise price of the Class A Warrants, and if that remains true, we would expect no former holders of Class A Warrants to accept the rescission offer. The current market price is below the \$3.00 exercise price of the Class B Warrants. Only 22,600 Class B Warrants were exercised during the rescission offer period, making our potential rescission liability to the former Class B Warrant holders equal to \$67,800 plus interest, which amount would be reduced to the extent of any sales of the underlying common stock by the former warrant holders.

### **Penny Stock Rules**

It is likely public transactions in our stock will be covered by the Penny Stock rules, which impose significant restrictions on broker-dealers and may affect the resale of our stock. A penny stock is generally a stock that:

Is not listed on a national securities exchange or Nasdaq;

.

Is listed in pink sheets or on the NASD Over-The-Counter Bulletin Board;

.

Has a price per share of less than \$5.00; and

.

Is issued by a company with net tangible assets less than \$5 million.

The penny stock trading rules impose additional duties and responsibilities upon broker-dealers and salespersons effecting purchase and sale transactions in common stock and other equity securities, including:

.

Determination of the purchaser's investment suitability;

.

Delivery of certain information and disclosures to the purchaser; and

.

Receipt of a specific purchase agreement from the purchaser prior to effecting the purchase transaction.

Many broker-dealers will not effect transactions in penny stocks, except on an unsolicited basis, in order to avoid compliance with the penny stock trading rules. It is likely our common stock will be covered by the penny stock trading rules. Therefore, such rules may materially limit or restrict a holder's ability to resell our common stock, and the liquidity typically associated with other publicly traded equity securities may not exist.

## **LEGAL MATTERS**

Legal matters in connection with this offering will be passed upon by Freeborn & Peters LLP, 311 South Wacker Drive, Suite 3000.

## **EXPERTS**

The audited financial statements of the Company as of December 31, 2003 and 2002 and for each of the three years in the period ended December 31, 2003 appearing in this prospectus and in the registration statement of which this prospectus forms a part, have been audited by Weaver & Martin, LLC, independent public accountants. Their report, which appears elsewhere herein, includes an explanatory paragraph as to the ability of SLS to continue as a going concern. The financial statements are included in reliance upon such report and upon the authority of such firm as an expert in auditing and accounting.

## PART II. INFORMATION NOT REQUIRED IN PROSPECTUS

### ITEM 14. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION

The following table sets forth the expenses expected to be incurred in connection with the issuance and distribution of the securities being registered.

SEC Registration	\$	5,418
Legal Fees and Expenses*	\$	30,000
Accounting Fees*	\$	3,000
Miscellaneous*	\$	5,000
Total.	\$	43,418

\* Estimated

### ITEM 15. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Our By-Laws provide that we shall, to the extent not prohibited by law, indemnify any person who was a director or officer, or any person who was serving at our request as a director, officer, partner or trustee of another entity, from claims, losses, and expenses incurred by reason of the fact that such person served as such director, officer, partner or trustee, subject to certain conditions.

Section 145 of the General Corporation Law of the State of Delaware permits a corporation, under specified circumstances, to indemnify its directors, officers, employees or agents against expenses (including attorney's fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by them in connection with any action, suit or proceeding brought by third parties by reason of the fact that they were or are directors, officers, employees or agents of the corporation, if such directors, officers, employees or agents acted in good faith and in a manner they reasonably believed to be in or not opposed to the best interests of the corporation and, with respect to any criminal action or proceeding, had no reason to believe their conduct was unlawful. In a derivative action, *i.e.*, one by or in the right of the corporation, indemnification may be made only for expenses actually and reasonably incurred by directors, officers, employees or agents in connection with the defense or settlement of an action or suit, and only with respect to a matter as to which they shall have acted in good faith and in a manner they reasonably believed to be

in or not opposed to the best interests of the corporation, except that no indemnification shall be made if such person shall have been adjudged liable to the corporation, unless and only to the extent that the court in which the action or suit was brought shall determine upon application that the defendant directors, officers, employees or agents are fairly and reasonably entitled to indemnify for such expenses despite such adjudication of liability.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the Company pursuant to the foregoing provisions, or otherwise, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and

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is therefore unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Company of expenses incurred or paid by a director, officer or controlling person of the company 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, unless in the opinion of its counsel that the matter has been settled by controlling precedent, the company will 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.

## ITEM 16. EXHIBITS

The exhibits to this registration statement are listed below. Other than exhibits that are filed herewith, all exhibits listed below are incorporated herein by reference. Exhibits indicated by an asterisk (\*) are the management contracts and compensatory plans, contracts or arrangements required to be filed as exhibits to this registration statement.

### Exhibit

Number	Exhibit	Where Located
2.1	Plan of Reorganization	Exhibit 2 to Registration Statement on Form SB-2 filed August 15, 2000
3.1	Articles of Incorporation	Exhibit 3(i) to Registration Statement on Form SB-2 filed August 15, 2000
3.2	Amendment and Restatement of Certificate of Incorporation	Exhibit 3(ii) to Registration Statement on Form SB-2 filed August 15, 2000
3.3	Certificate of Designations, Convertible Preferred Stock	Exhibit 3.1 to Form 8-K filed January 6, 2005
3.4	Certificate of Designations, Series B Preferred Stock	Exhibit 4.1 to Form 10-QSB filed August 13, 2004
3.5	Certificate of Designation, Series C Preferred Stock	Exhibit 3.2 to Form 8-K filed January 6, 2005
3.6	By-Laws	Exhibit 3(iii) to Registration Statement on Form SB-2 filed August 15, 2000
3.7	Amendment to By-Laws (Article VIII)	Exhibit 3.4 to Annual Report on Form 10-KSB filed March 30, 2004
3.8	Amendment to By-Laws effective January 31, 2005	Exhibit 3.1 to Form 8-K filed February 4, 2005

4.1	Specimen Certificate of Common Stock	Exhibit 4(i) to Amendment No. 1 to Registration Statement on Form SB-2 filed December 1, 2000
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**Exhibit**

<b>Number</b>	<b>Exhibit</b>	<b>Where Located</b>
4.2	Form of Class A Warrant	Exhibit 4(ii) to Registration Statement on Form SB-2 filed August 15, 2000
4.3	Form of Class B Warrant	Exhibit 4(iii) to Registration Statement on Form SB-2 filed August 15, 2000
4.4	Form of Class C Warrant	Exhibit 4.2 to Form 10-QSB filed August 13, 2004
5.1	Consent and Opinion of Freeborn & Peters LLP	Exhibit 5.1 to Registration Statement on Form S-2 filed February 2, 2005
10.1	Commercial Property Lease Agreement between Scenic Properties, Inc., and SLS International, Inc., dated September 1, 2003	Exhibit 10.1 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.2	Agreement dated February 24, 2000 between Igor Levitsky and Sound and Lighting Specialists, Inc.	Exhibit 10(i) to Amendment No. 1 to Registration Statement on Form SB-2 filed December 1, 2000
10.3	Assignment of Technology Rights by Igor Levitsky dated November 9, 2000	Exhibit 10(iii) to Amendment No. 1 to Registration Statement on Form SB-2 filed December 1, 2000
10.4	Form of Distributor Agreement	Exhibit 10(iv) to Amendment No. 2 to Registration Statement on Form SB-2 filed January 16, 2001
10.5	2000 Stock Purchase and Option Plan*	Exhibit 99(i) to Registration Statement on Form SB-2 filed August 15, 2000
10.6	Form of Option*	Exhibit 99(ii) to Registration Statement on Form SB-2 filed August 15, 2000
10.7	Letter Agreement, dated January 5, 2002 between SLS International, Inc. and Internet PR Group Inc.	Exhibit 10.1 to Amendment No. 1 to Form 10-QSB for quarter ended March 31, 2002, filed May 21, 2003
10.8	Share Purchase Agreement, dated January 22, 2002 between SLS International, Inc. and Herbie Herbert	Exhibit 10.2 to Amendment No. 1 to Form 10-QSB for quarter ended March 31, 2002, filed May 21, 2003
10.9	Share Purchase Agreement, dated January 22, 2002 between SLS International, Inc. and Thomas Panos	Exhibit 10.3 to Amendment No. 1 to Form 10-QSB for quarter ended March 31, 2002, filed May 21, 2003

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**Exhibit**

<b>Number</b>	<b>Exhibit</b>	<b>Where Located</b>
10.10	Consulting Agreement, dated April 9, 2002, between SLS International, Inc. and The Equitable Group, LLC	Exhibit 10.1 to Amendment No. 1 to  Form 10-QSB for quarter ended June 30, 2002, filed May 21, 2003
10.11	Letter Agreement, dated April 2, 2002, between SLS International, Inc. and Muir Crane & Co.	Exhibit 10.2 to Amendment No. 1 to  Form 10-QSB for quarter ended June 30, 2002, filed May 21, 2003
10.12	Letter Agreement, dated April 18, 2002, between SLS International, Inc. and Sam F. Hamra	Exhibit 10.3 to Amendment No. 1 to  Form 10-QSB for quarter ended June 30, 2002, filed May 21, 2003
10.13	Consulting Services Agreement, dated June 19, 2002, between SLS International, Inc. and Liquid Solutions Corp.	Exhibit 10.4 to Amendment No. 1 to  Form 10-QSB for quarter ended June 30, 2002, filed May 21, 2003
10.14	Letter Agreement, dated July 17, 2002, between SLS International, Inc. and Alfred V. Greco PLLC regarding settlement of Alfred V. Greco v. SLS International, Inc.	Exhibit 10.1 to Amendment No. 1 to  Form 10-QSB for quarter ended September 30, 2002, filed May 21, 2003
10.15	Letter Agreement, dated July 17, 2002, between SLS International, Inc. and Alfred V. Greco PLLC regarding services to be provided by Alfred V. Greco PLLC	Exhibit 10.2 to Amendment No. 1 to  Form 10-QSB for quarter ended September 30, 2002, filed May 21, 2003
10.16	Consulting Agreement, dated August 15, 2002, between SLS International, Inc. and Atlantic Services Ltd.	Exhibit 10.3 to Amendment No. 1 to  Form 10-QSB for quarter ended September 30, 2002, filed May 21, 2003
10.17	Consulting Agreement, dated September 10, 2002, between SLS International, Inc. and Art Malone Jr.	Exhibit 10.4 to Amendment No. 1 to Form 10-QSB for quarter ended September 30, 2002, filed May 21, 2003
10.18	Settlement Agreement and General Release dated April 1, 2003 between McQuarterGroup and SLS International, Inc.	Exhibit 10.20 to Form 10-KSB for year ended December 31, 2002, filed May 21, 2003
10.19	Letter Agreement dated October 25, 2002 between SLS International, Inc. and Patrick J. Armstrong	Exhibit 10.21 to Form 10-KSB for year ended December 31, 2002, filed May 21, 2003



**Exhibit**

<b>Number</b>	<b>Exhibit</b>	<b>Where Located</b>
10.20	Letter Agreement dated October 25, 2002 between SLS International, Inc. and Larry R. Stessel	Exhibit 10.22 to Form 10-KSB for year ended December 31, 2002, filed May 21, 2003
10.21	Consulting Agreement, dated November 18, 2002 between SLS International, Inc. and Atlantic Services Ltd.	Exhibit 10.23 to Form 10-KSB for year ended December 31, 2002, filed May 21, 2003
10.22	Investor Relations and Financial Public Relations Consulting Agreement, dated December 15, 2002, between SLS International, Inc. and Worldwide Financial Marketing, Inc.	Exhibit 10.24 to Form 10-KSB for year ended December 31, 2002, filed May 21, 2003
10.23	Consulting Agreement dated February 20, 2003, between SLS International, Inc. and Tom Puccio	Exhibit 10.1 to Form 10-QSB for quarter ended March 31, 2003, filed June 16, 2003
10.24	Option Agreement, dated as of May 19, 2003, between the Company and Steerpike (Overseas) Ltd.	Exhibit 10.1 to Form 10-QSB for quarter ended June 30, 2003, filed August 14, 2003
10.25	Letter Agreement, dated as of May 19, 2003, between the Company and Steerpike (Overseas) Ltd.	Exhibit 10.2 to Form 10-QSB for quarter ended June 30, 2003, filed August 14, 2003
10.26	Letter Agreement, dated as of May 19, 2003, between the Company and Steerpike Inc.	Exhibit 10.3 to Form 10-QSB for quarter ended June 30, 2003, filed August 14, 2003
10.27	Letter Agreement, dated as of July 10, 2003, between the Company and Alfred V. Greco PLLC, amending prior letter agreement, dated July 17, 2002, concerning the settlement of certain litigation between such parties	Exhibit 10.4 to Form 10-QSB for quarter ended June 30, 2003, filed August 14, 2003
10.28	Consulting Agreement, dated as of July 14, 2003, between SLS International, Inc. and Atlantic Services Ltda.	Exhibit 10.2 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.29	Consulting Agreement, dated as of July 22, 2003, between SLS Loudspeakers and Atlantic Services Ltda.	Exhibit 10.3 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003

**Exhibit**

<b>Number</b>	<b>Exhibit</b>	<b>Where Located</b>
10.30	Consulting Agreement, dated as of August 11, 2003, between SLS International, Inc. and G. Ghecko Enterprises	Exhibit 10.4 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.31	Contract for Promotional Services, dated July 14, 2003, between Ronald E. Gee and SLS International, Inc.	Exhibit 10.5 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.32	Contract for Promotional Services, dated August 5, 2003, between Ronald E. Gee and SLS International, Inc.	Exhibit 10.6 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.33	Contract for Promotional Services, dated September 5, 2003, between Ronald E. Gee and SLS International, Inc.	Exhibit 10.7 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.34	Consulting Agreement, dated as of August 11, 2003, between SLS Loudspeakers and Berkshire International, LLC	Exhibit 10.8 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.35	Letter Agreement, dated August 29, 2003, between SLS International and Art Malone, Jr.	Exhibit 10.9 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.36	Consulting Agreement, dated August 21, 2003, between SLS International, Inc. and Grant Galloway	Exhibit 10.10 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.37	Agreement, dated July 31, 2003 between SLS International, Inc. and Wall Street Investor Relations Corp.	Exhibit 10.11 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.38	30 Days Public Relations Services Contracts, dated July 23, 2003, between Fitzgerald Galloway Consulting and SLS International, Inc.	Exhibit 10.12 to Form 10-QSB for quarter ended September 30, 2003, filed November 11, 2003
10.39	Merger Agreement, dated March 12, 2004, among SLS International, Inc., Evenstar, Inc., Joel A. Butler, David L. Butler, Patrick D. Butler, and Evenstar Mergersub, Inc.	Exhibit 10.1 to Form 8-K filed March 17, 2004

**Exhibit**

<b>Number</b>	<b>Exhibit</b>	<b>Where Located</b>
10.40	Employment Agreement, dated March 12, 2004, between SLS International, Inc. and Joel A. Butler	Exhibit 10.2 to Form 8-K filed March 17, 2004
10.41	Consulting Services Agreement, dated October 28, 2003, between SLS International, Inc. and Zane Sellis	Exhibit 10.41 to Annual Report on Form 10-KSB filed March 30, 2004
10.42	Consulting Services Agreement, dated November 6, 2003, between SLS International, Inc. and George Iordanou	Exhibit 10.42 to Annual Report on Form 10-KSB filed March 30, 2004
10.43	Consulting Services Agreement, dated November 10, 2003, between SLS International, Inc. and William F. Fischbach	Exhibit 10.43 to Annual Report on Form 10-KSB filed March 30, 2004
10.44	Consulting Services Agreement, dated November 20, 2003, between SLS International, Inc. and Edward Decker	Exhibit 10.44 to Annual Report on Form 10-KSB filed March 30, 2004
10.45	Consulting Services Agreement, dated November 20, 2003, between SLS International, Inc. and Christopher Obssuth	Exhibit 10.45 to Annual Report on Form 10-KSB filed March 30, 2004
10.46	Stipulation for Entry of Judgment and Mutual General Release	Exhibit 10.46 to Annual Report on Form 10-KSB filed March 30, 2004
10.47	Stock Option Agreement, dated February 9, 2004, between SLS International, Inc., and Ryan Schinman	Exhibit 10.1 to Quarterly Report on Form 10-QSB filed May 17, 2004
10.48	Letter Agreement, dated May 19, 2004, between SLS International, Inc., and Kenny Securities Corp.	Exhibit 10.2 to Quarterly Report on Form 10-QSB filed May 17, 2004
10.49	Promotion Agreement, dated June 2, 2004, between SLS International, Inc. and Global Drumz, Inc.	Exhibit 10.1 to Form 10-QSB filed August 13, 2004
10.50	Option Agreement, dated June 2, 2004, between SLS International, Inc. and Global Drumz, Inc.	Exhibit 10.2 to Form 10-QSB filed August 13, 2004

**Exhibit**

<b>Number</b>	<b>Exhibit</b>	<b>Where Located</b>
10.51	Redeemable Warrant, dated June 2, 2004, issued by SLS International, Inc. in favor of Global Drumz, Inc.	Exhibit 10.3 to Form 10-QSB filed August 13, 2004
10.52	Redeemable Warrant, dated March 23, 2004, issued by SLS International, Inc. in favor of Kenny Securities Corp.	Exhibit 10.4 to Form 10-QSB filed August 13, 2004
10.53	Strategic Alliance Agreement Addendum, dated October 19, 2004, between Bohlender-Graebener Corporation and SLS International, Inc.	Exhibit 10.1 to Form 10-QSB for quarter ended September 30, 2004, filed November 15, 2004
10.54	Consulting Services Agreement, dated December 8, 2004, between SLS International, Inc. and W. Curtis Hargis, Co.	Exhibit 10.1 to Form 8-K filed December 17, 2004
10.55	Lease Agreement, dated December 4, 2004, between Bull Creek Ranch LLC and SLS International, Inc.	Exhibit 10.2 to Form 8-K filed December 17, 2004
10.56	Non-Exclusive Finder's Agreement, dated December 8, 2004, between SLS International, Inc. and The Shemano Group, Inc.	Exhibit 10.1 to Form 8-K filed January 6, 2005
10.57	Option Agreement, dated as of May 19, 2003, between SLS International, Inc. and Beth Broday	Exhibit 10.2 to Form 8-K filed January 6, 2005
10.58	Securities Purchase Agreement, dated January 3, 2005, among SLS International, Inc., Baystar Capital II, L.P., PSO Trading IV, LLC, HFTP Investment L.L.C., and Royal Bank of Canada	Exhibit 10.3 to Form 8-K filed January 6, 2005
10.59	Registration Rights Agreement, dated January 3, 2005, among SLS International, Inc., Baystar Capital II, L.P., PSO Trading IV, LLC, HFTP Investment L.L.C., and Royal Bank of Canada	Exhibit 10.4 to Form 8-K filed January 6, 2005
10.60	Warrant, dated January 4, 2005, issued to Baystar Capital II, L.P.	Exhibit 10.5 to Form 8-K filed January 6, 2005

**Exhibit**

<b>Number</b>	<b>Exhibit</b>	<b>Where Located</b>
10.61	Warrant, dated January 4, 2005, issued to PSO Trading IV, LLC	Exhibit 10.6 to Form 8-K filed January 6, 2005
10.62	Warrant, dated January 4, 2005, issued to HFTP Investment L.L.C.	Exhibit 10.7 to Form 8-K filed January 6, 2005
10.63	Warrant, dated January 4, 2005, issued to Royal Bank of Canada	Exhibit 10.8 to Form 8-K filed January 6, 2005
10.64	Consulting Agreement, dated January 31, 2005, between SLS International, Inc. and New AV Ventures, LLC	Exhibit 10.1 to Form 8-K filed February 4, 2005
10.65	Consulting Agreement, dated January 31, 2005 and effective as of November 18, 2004, between SLS International, Inc. and 3CD Consulting, LLC	Exhibit 10.2 to Form 8-K filed February 4, 2005
21	List of Subsidiaries of SLS International, Inc.	Exhibit 21 to Form 10-KSB for year ended December 31, 2003, filed March 30, 2004
<u>23</u>	Consent of Weaver & Martin LLC Independent Certified Public Accountants	Filed herewith.
99.1	Consent Order of Missouri Securities Division and SLS International, Inc.	Exhibit 99(iv) to Post-Effective Amendment No. 1 filed May 30, 2001
99.2	Promotional Shares Lock-In Agreement	Exhibit 99(v) to Post-Effective Amendment No. 1 filed May 30, 2001
99.3	Modification to Consent Order of Missouri Securities Division and SLS International, Inc.	Exhibit 99.1 to Post-Effective Amendment No. 2 filed February 9, 2004

## ITEM 17. UNDERTAKINGS

The undersigned 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 align="right" valign="bottom" width="9%">

Cash paid for income tax

\$38,832 \$-

Cash paid for interest

\$46,929 \$263,975

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

WIDEPOINT CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

WidePoint Corporation (“WidePoint,” the “Company,” “we,” or “our”) is a provider of technology-based products and services to both the government sector and commercial markets. WidePoint was incorporated in Delaware on May 30, 1997. We have grown through the merger with and acquisition of highly specialized regional IT consulting companies.

Our expertise lies within three business segments operated through six wholly-owned operational entities. Our three business segments include: Wireless Mobility Management (formerly referred to as our “Wireless Telecommunications Expense Management Services” segment), Cybersecurity Solutions (formerly referred to as our “Identity Management” segment), and IT Consulting Services and Products. These segments offer unique solutions and proprietary intellectual property (“IP”) in mobile and wireless full life cycle management solutions; cybersecurity solutions with specific subject matter expertise, U.S. government certifications and authorizations, and IP in identity management and information assurance services utilizing certificate-based security solutions; and other associated IT consulting services and products through which we provide specific subject matter expertise in IT Architecture and Planning, Software Implementation Services, IT Outsourcing, and Forensic Informatics.

WidePoint has three material operational entities, Operational Research Consultants, Inc. (“ORC”), iSYS, LLC (“iSYS”), and WidePoint IL, Inc. (“WP IL”) (operating in conjunction with WP NBIL, Inc.), and with two early stage development companies: Protexx Acquisition Corporation, doing business as Protexx, and Advanced Response Concepts Corporation, doing business as Advanced Response Concepts. ORC specializes in IT integration and secure authentication processes and software, and is a provider of services to the U.S. Government. ORC has been at the forefront of implementing Public Key Infrastructure (“PKI”) technologies. PKI technology uses a class of algorithms in which a user can receive two electronic keys, consisting of a public key and a private key, to encrypt any information and/or communication being transmitted to or from the user within a computer network and between different computer networks. PKI technology is rapidly becoming the technology of choice to enable security services within and between different computer systems utilized by various agencies and departments of the U.S. Government. iSYS specializes in mobile telecommunications expense management services and forensic informatics, as well as information assurance services, predominantly to the U.S. Government. WP IL and WP NBIL provide information technology consulting services predominately to large commercial enterprises. Protexx specializes in identity assurance and mobile and wireless data protection services.

On January 29, 2010, we completed the asset purchase and assumption of certain liabilities from Vuance, Inc, including acquisition of their Government Services Division. These assets are now housed in our wholly owned subsidiary Advanced Response Concepts Corporation. Advanced Response Concepts develops and markets leading-edge secure critical response management solutions designed to improve coordination within emergency services and critical infrastructure agencies.

Our staff consists of business process and computer specialists who help our government and civilian customers augment and expand their resident technologic skills and competencies, drive technical innovation, and help develop and maintain a competitive edge in today’s rapidly changing technological environment in business. Our organization emphasizes an intense commitment to our people, our customers, and the quality of our solutions offerings. As a services organization, our customers are our primary focus.

The condensed consolidated balance sheet as of June 30, 2010, the condensed consolidated statements of operations and statements of cash flows for the three months and six months ended June 30, 2010 and 2009, respectively, have

been prepared by the Company and are unaudited. The condensed consolidated balance sheet as of December 31, 2009 was derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

The unaudited condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Pursuant to such rules and regulations, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles ("GAAP") have been condensed or omitted. It is the opinion of management that all adjustments (which include normal recurring adjustments) necessary for a fair statement of financial results are reflected in the interim periods presented. The results of operations for the three months and six months, respectively, ended June 30, 2010 are not indicative of the operating results for the full year.

## 2. Significant Accounting Policies

### Accounting Standards Updates

In September, 2009, FASB issued Accounting Standard Update No. 13 (“ASU 13”), Multiple Element Revenue Arrangements, which applies to ASC Topic 605, Revenue Recognition. ASU 13, among other things, establishes the use of the best estimate of selling price to determine the separate units of accounting in a multiple element arrangement in the absence of vendor-specific objective evidence or third party evidence. ASU 13 also removes the requirement to use the residual method to allocate arrangement consideration to the separate units of accounting in an arrangement, and instead requires the use of management’s best estimate of the relative selling prices of each unit of accounting to determine the consideration allocation. ASU 13 is effective for arrangements entered into or materially modified in a fiscal year beginning on or after June 15, 2010. This update to the ASC will be applied on a prospective basis, and management is in the process of evaluating whether the update will materially change the pattern and timing of the Company’s recognition of revenue.

### Significant Customers

For the three months and six months ended June 30, 2010, three customers, the Transportation Security Administration (“TSA”), the Department of Homeland Security (“DHS”), and the Washington Headquarters Services (“WHS”), an agency within the Department of Defense (“DoD”) that provides services for many DoD agencies and organizations, represented the percentages of our revenue set forth in the table below. Due to the nature of our business and the relative size of certain contracts, which are entered into in the ordinary course of business, the loss of any single significant customer could have a material adverse effect on our results of operations.

Customer Name	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010 (%)	2009 (%)	2010 (%)	2009 (%)
Revenue	Revenue	Revenue	Revenue	Revenue
TSA	20%	22%	22%	23%
DHS	18%	27%	19%	24%
WHS	16%	19%	17%	18%

Effective July 31, 2010, WHS pass-through billing services contract lapsed. Over the past six months this represented approximately \$6 million in revenue.

### Concentrations of Credit Risk

Financial instruments potentially subject the Company to credit risk, which consist of cash and cash equivalents and accounts receivable. As of June 30, 2010 and December 31, 2009, respectively, three customers represented the percentages of our accounts receivable and unbilled accounts receivable as set forth in the table below:

Customer Name	As of June 30, 2010 (%)	As of December 31, 2009 (%)
	Receivables	Receivables
DHS	19%	30%
TSA	23%	26%
WHS	4%	20%



## Fair Value of Financial Instruments

The Company's financial instruments include cash equivalents, accounts receivable, notes receivable, accounts payable, short-term debt and other financial instruments associated with the issuance of the common stock. The carrying values of cash equivalents, accounts receivable, notes receivable, and accounts payable approximate their fair value because of the short maturity of these instruments. The carrying amounts of the Company's bank borrowings under its credit facility approximate fair value because the interest rates are reset periodically to reflect current market rates.

### Accounts Receivable

The majority of the Company's accounts receivable is due from the federal government and established private sector companies in the following industries: manufacturing, customer product goods, direct marketing, healthcare, and financial services. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are usually due within 30 to 60 days and are stated at amounts due from customers net of an allowance for doubtful accounts if deemed necessary. Customer account balances outstanding longer than the contractual payment terms are reviewed for collectability and after 90 days are considered past due.

The Company determines its allowance for doubtful accounts by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

The Company has not historically maintained a bad debt reserve for our federal government or commercial customers as we have not witnessed any material or recurring bad debt charges and the nature and size of the contracts has not necessitated the Company's establishment of such a bad debt reserve. Upon specific review and our determination that a bad debt reserve may be required, we will reserve such amount if we view the account as potentially uncollectable.

The Company is following a customer's procedural guidelines in pursuing final approval and collection of a single sales invoice of approximately \$500,000. In September of 2010 we will be filing further information as we follow the procedural guidelines in response to our efforts to collect this invoice. The aging of this invoice exceeds the 90 day past due threshold noted above. However, the Company believes that it is adequately responded to the procedural requirement to allow us to substantiate the billing and we believe it is probable that the balance will be fully collected upon completion of the procedural process we are following to collect this invoice.

### Basic and Diluted Net Income Per Share

Basic net income per share includes no dilution and is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted net income per share includes the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Net income per common share was computed as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
Basic Net Income Per Common Share:				
Net income	\$ 412,682	\$ 250,652	\$ 651,980	\$ 379,577

Weighted average number of common shares	61,375,333	58,305,514	61,375,333	58,300,044
Income per common share	\$ 0.01	\$ 0.00	\$ 0.01	\$ 0.01
Diluted net Income per Common Share:				
Net income	\$ 412,682	\$ 250,652	\$ 651,980	\$ 379,577
Weighted average number of common shares	61,375,333	58,305,514	61,375,333	58,300,044
Incremental shares from assumed conversions of stock options	1,923,822	3,256,737	1,788,491	2,488,037
Adjusted weighted average number of common shares	63,299,155	61,562,251	63,163,824	60,788,081
Income per common share	\$ 0.01	\$ 0.00	\$ 0.01	\$ 0.01

## Stock-based compensation

The Company recognizes share-based compensation ratably using the straight-line attribution method over the requisite service period. In addition, the Company is required to estimate the amount of expected forfeitures when calculating share-based compensation.

The amount of compensation expense recognized during the three month and six month periods ended June 30, 2010 and 2009, respectively, under our plans was comprised of the following:

	Three Months ended June 30,		Six Months ended June 30,	
	2010	2009	2010	2009
General and administrative expense	\$ 27,565	\$ 75,857	\$ 56,745	\$ 106,587
Share-based compensation before taxes	27,565	75,857	56,745	106,587
Total net share-based compensation expense	\$ 27,565	\$ 75,857	\$ 56,745	\$ 106,587
Net share-based compensation expenses per basic and diluted common share	- 0 -	- 0 -	- 0 -	- 0 -

Since we have cumulative operating tax losses as of June 30, 2010, for which a valuation allowance has been established, we recorded no income tax benefits for share-based compensation arrangements. Additionally, no incremental tax benefits were recognized from stock options exercised during the three months and six months ended June 30, 2010, which would have resulted in a reclassification to reduce net cash provided by operating activities with an offsetting increase in net cash provided by financing activities.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option pricing model, which uses the assumptions of no dividend yield, risk-free interest rates and expected life in years of approximately 3 years. The option awards are for the period from 1999 through 2010. Expected volatilities are based on the historical volatility of our common stock. The expected term of options granted is based on analyses of historical employee termination rates and option exercises. The risk-free interest rates are based on the U.S. Treasury yield for a period consistent with the expected term of the option in effect at the time of the grant.

	Six Months Ending June 30, 2010
Expected dividend yield	0
Expected volatility	102%
Risk-free interest rate	1.40%
Expected life – Employees options	3.0 years
Expected life – Board of directors options	n/a

Share-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. The estimated forfeiture rates are based on analyses of historical data, taking into account patterns of involuntary termination and other factors. A summary of the option activity under our plans during the six month periods ended June 30, 2010 and 2009 is presented below:

## NON-VESTED

	# of Shares	Weighted average grant date fair value per share
Non-vested at January 1, 2010	1,215,004	\$ 0.39
Granted	75,000	\$ 0.41
Vested	120,001	\$ 0.05
Forfeited	-	-
Non-vested at March 31, 2010	1,170,003	\$ 0.43
Granted	-	-
Vested	31,250	\$ 0.44
Forfeited	-	-
Non-vested at June 30, 2010	1,138,753	\$ 0.43
Non-vested at January 1, 2009	1,314,000	\$ 0.57
Granted	-	-
Vested	119,996	\$ 0.80
Forfeited	-	-
Non-vested at March 31, 2009	1,194,004	\$ 0.55
Granted	25,000	\$ 0.54
Vested	-	-
Forfeited	-	-
Non-vested at June 30, 2009	1,219,004	\$ 0.39

## OUTSTANDING AND EXERCISABLE

	# of Shares	Weighted average grant date fair value per share
Total outstanding at January 1, 2010	4,517,411	\$ 0.54
Issued	75,000	-
Cancelled	1,000	\$ 0.65
Exercised	-	-
Total outstanding at March 31, 2010	4,591,411	\$ 0.54

Total exercisable at March 31, 2010	3,421,408	\$	0.44
Issued	-		-
Cancelled	7,611	\$	0.45
Exercised	-		-
Total outstanding at June 30, 2010	4,583,800	\$	0.54
Total exercisable at June 30, 2010	3,445,047	\$	0.44
Total outstanding at January 1, 2009	8,523,411	\$	0.45
Issued	-		-
Cancelled	1,000	\$	1.35
Exercised	30,000		0.13
Total outstanding at March 31, 2009	8,492,411	\$	0.45
Total exercisable at March 31, 2009	7,298,407	\$	0.38
Issued	25,000	\$	0.54
Cancelled	-		-
Exercised	-		-
Total outstanding at June 30, 2009	8,517,411	\$	0.40
Total exercisable at June 30, 2009	7,298,407	\$	0.32

The aggregate remaining contractual lives in years for the options outstanding and exercisable on June 30, 2010 were 4.18 and 3.44, respectively. In comparison, the aggregate remaining contractual lives in years for the options outstanding and exercisable on June 30, 2009, were 2.78 and 2.03, respectively.

Aggregate intrinsic value represents total pretax intrinsic value (the difference between WidePoint's closing stock price on June 30, 2010, and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2010. The intrinsic value will change based on the fair market value of WidePoint's stock. The total intrinsic values of options outstanding and exercisable as of June 30, 2010, were \$1,506,694 and \$1,458,143, respectively. The total intrinsic value of options exercised for the second quarter of fiscal 2010 was \$0. The Company issues new shares of common stock upon the exercise of stock options. At June 30, 2010, 4,436,438 Shares were available for future grants under the Company's 2008 Stock Incentive Plan.

At June 30, 2010, the Company had approximately \$285,000 of total unamortized compensation expense, net of estimated forfeitures, related to stock option plans that will be recognized over the weighted average period of 3.53 years.

#### Non-Employee Stock-based Compensation:

The Company accounts for stock-based non-employee compensation arrangements using the fair value recognition provisions of ASC 505-50, "Equity-Based Payments to Non-Employees" (formerly known as FASB Statement 123, Accounting for Stock-Based Compensation and "Emerging Issues Task Force" EITF 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services).

### 3. Debt

On May 25, 2010 the Company entered into an Amended Commercial Loan Agreement with Cardinal Bank (the "2010 Debt Modification Agreement"). Pursuant to the 2010 Debt Modification Agreement, the repayment date of the revolving credit facility was extended from June 1, 2010, to September 1, 2010, and advances under the revolving credit facility now will bear interest at a variable rate equal to the prime rate plus 0.5% with an interest rate floor of 5%. Borrowings under the 2009 Commercial Loan Agreement (as amended by the 2010 Debt Modification Agreement) are collateralized by the Company's eligible contract receivables, inventory, all of its stock in certain of its subsidiaries and certain property and equipment. As part of the credit facility, the Company must comply with certain financial covenants that include tangible net worth and interest coverage ratios. The Company was in full compliance with these financial covenants on August 16, 2010. The Company is presently working with Cardinal Bank on renewing the credit facility and expects to renew the credit facility prior to September 1, 2010.

The Company also has a four-year term note with Cardinal Bank that we entered into January 2008 in the principal amount of \$2 million, which bears interest at the rate of 7.5% with 48 equal principal and interest payments. At June 30, 2010, we owed approximately \$1.0 million under the term note.

#### 4. Goodwill and Intangible Assets

Goodwill is to be reviewed at least annually for impairment. The Company has elected to perform this review annually on December 31st of each calendar year. We have not identified any impairment as of June 30, 2010.

The changes in the carrying amount of goodwill for the six-month period ended June 30, 2010 and for the year ended December 31, 2009, respectively, are as follows:

	Total
Balance as of December 31, 2009	\$ 9,770,647
Advanced Response Concepts asset purchase	704,866
Balance as of June 30, 2010	\$ 10,475,513

#### Purchased and Internally Developed Intangible Assets

The following table summarizes purchased and internally developed intangible assets subject to amortization:

	As of June 30, 2010		Weighted Average Amortization Period (in years)
	Gross Carrying Amount	Accumulated Amortization	
<b>Purchased Intangible Assets</b>			
ORC Intangible (includes customer relationships and PKI business opportunity purchase accounting preliminary valuations)	\$ 1,145,523	\$ (1,132,146)	5
iSYS (includes customer relationships, internal use software and trade name)	\$ 1,230,000	\$ (644,168)	5
Protexx (Identity Security Software)	\$ 506,463	\$ (323,574)	3
Advanced Response Concepts (includes preliminary values for customer relationships and first responder security software)	\$ 381,420	\$ (39,731)	4
	\$ 3,263,406	\$ (2,139,619)	4
<b>Internally Developed Intangible Assets</b>			
ORC PKI-I Intangible (Related to internally generated software)	\$ 334,672	\$ (329,822)	6
ORC PKI-II Intangible (Related to internally generated software)	\$ 649,991	\$ (604,880)	6
ORC PKI-III Intangible (Related to internally generated software)	\$ 211,680	\$ (152,880)	3
ORC PKI-IV Intangible (Related to internally generated software)	\$ 42,182	\$ (30,465)	3
ORC PKI-V Intangible (Related to internally generated software)	\$ 147,298	\$ (16,366)	3
	1,385,823	\$ (1,134,413)	5

Total	\$ 4,649,229	\$ (3,274,032)	5
Aggregate Amortization Expense:			
For the three months ended 6/30/10	\$ 220,354		
For the six months ended 6/30/10	\$ 423,395		
Estimated Amortization Expense:			
For the year ending 12/31/10	\$ 728,409		
For the year ending 12/31/11	\$ 474,912		
For the year ending 12/31/12	\$ 332,121		
For the year ending 12/31/13	\$ 255,204		
For the year ending 12/31/14	\$ 7,946		
Total	\$ 1,798,592		

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The total weighted average life of all of the intangibles is approximately 3 years.

There were no amounts of research and development assets acquired or written-off during the three month or six month period ended June 30, 2010.

## 5. Income Taxes

The Company accounts for income taxes in accordance with ASC 740, "Income Taxes" (formerly known as SFAS No. 109, "Accounting for Income Taxes"). Deferred tax assets and liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. Income tax accounting guidance requires that the net deferred tax asset be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the net deferred tax asset will not be realized. The Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. The Company's assessments of its tax positions did not result in changes that had a material impact on results of operations, financial condition or liquidity. As of June 30, 2010 and December 31, 2009, the Company had no unrecognized tax benefits. While the Company does not have any interest and penalties in the periods presented, the Company's policy is to recognize such expenses as tax expense.

The Company files U.S. federal income tax returns with the Internal Revenue Service (“IRS”) as well as income tax returns in various states. The Company may be subject to examination by the IRS for tax years 2002 through 2009. Additionally, the Company may be subject to examinations by various state taxing jurisdictions for tax years 2002 through 2009. The Company is currently under examination by the IRS for its fiscal period ending December 31, 2008. The Company is not currently under examination by the IRS for any other fiscal period and is not currently under examination by any other state taxing authority.

As of June 30, 2010, the Company had net operating loss (NOL) carry forwards of approximately \$15 million to offset future taxable income. There are also up to approximately \$8 million in state tax NOL carry forwards. These carry forwards expire between 2010 and 2029. In assessing the ability to realize deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon generation of future taxable income during the periods in which those temporary differences become deductible. Based upon the level of historical losses that may limit utilization of NOL carry forwards in future periods, management is unable to predict whether these net deferred tax assets will be utilized prior to expiration. Under the provision of the Tax Reform Act of 1986, when there has been a change in an entity’s ownership of 50 percent or greater, utilization of net operating loss carry forwards may be limited. As a result of WidePoint’s equity transactions, the Company’s net operating losses will be subject to such limitations and may not be available to offset future income for tax purposes. In the fourth quarter of 2009, the Company completed its “Section 382” analysis and preliminarily determined that some of the Company’s net operating losses may be limited as a result of expirations that may occur prior to the utilization of those net operating losses under the limitations from certain changes of control that occurred in past years. Such limitations will result in approximately \$4,907,000 of tax benefits related to federal NOL carryforwards that will expire unused. Accordingly, the related NOL carryforwards have been removed from deferred tax assets accompanied by a corresponding reduction of the valuation allowance. Due to the existence of the valuation allowance, limitations created by future ownership changes, if any, related to our operations in the U.S. will not impact our effective tax rate.

No stock options have been exercised in the six months ending June 30, 2010. Therefore, no tax benefit has been realized during the three or six month periods ending June 30, 2010, respectively. For the three and six months ending June 30, 2009, respectively, no tax benefit has been realized because of the existence of net operating loss carryforwards. There will be no credit to additional paid in capital for such stock option exercises until the associated benefit is realized through a reduction of income taxes payable.

The Company has determined that its net deferred tax asset did not satisfy the recognition criteria and, accordingly, established a valuation allowance for 100 percent of the net deferred tax asset.

The Company incurred a deferred income tax expense of approximately \$39,000 for the three months ended June 30, 2010, and June 30, 2009, respectively. This deferred income tax expense is attributable to the differences in our treatment of the amortization of goodwill for tax purposes versus book purposes as it relates to our acquisition of iSYS in January 2008. Because the goodwill is not amortized for book purposes but is for tax purposes, the related deferred tax liability cannot be reversed until some indeterminate future period when the goodwill either becomes impaired and/or is disposed of. The deferred tax liability can be offset by deferred income tax assets that may be recognized in the future and the deferred tax expense is a non-cash expense. Income tax accounting guidance requires the expected timing of future reversals of deferred tax liabilities to be taken into account when evaluating the realizability of deferred tax assets. Therefore, the reversal of deferred tax liabilities related to the goodwill is not to be considered a source of future taxable income when assessing the realization of deferred tax assets. Because the Company has a valuation allowance for the full amount of the deferred income tax asset, the deferred income liability associated with the tax deductible goodwill has been recorded and not offset against existing deferred income tax assets.

## 6. Segment reporting

Segments are defined by authoritative guidance as components of a company in which separate financial information is available and is evaluated by the chief operating decision maker, or a decision making group, in deciding how to allocate resources and in assessing performance. Management evaluates segment performance primarily based on revenue and segment operating income.

The Company operates as three segments, which include Wireless Mobility Management, Cybersecurity Solutions, and IT Consulting Services and Products.

Segment operating income consists of the revenues generated by a segment, less the direct costs of revenue and selling, general and administrative costs that are incurred directly by the segment. Unallocated corporate costs include costs related to administrative functions that are performed in a centralized manner that are not attributable to a particular segment. These administrative function costs include costs for corporate office support, all office facility costs, costs relating to accounting and finance, human resources, legal, marketing, information technology and company-wide business development functions, as well as costs related to overall corporate management.

The following tables set forth selected segment and consolidated operating results and other operating data for the periods indicated. Segment operating income consists of the revenues generated by a segment, less the direct costs of revenue and selling, general and administrative costs that are incurred directly by the segment. Unallocated corporate costs include costs related to administrative functions that are performed in a centralized manner that are not attributable to a particular segment. Management does not analyze assets for decision making purposes as it relates to the segments below. Accordingly, information is not available for long-lived assets or total assets.

Three Month Period Ending June 30, 2010

	Wireless	Cyber	Consulting	Corp	Consol
Revenue	\$ 6,885,987	\$ 2,486,820	\$ 3,079,313	\$ -	\$ 12,452,120
Operating income including amortization and depreciation expense	567,288	596,061	54,803	(706,853)	511,299
Interest Income (expense), net				(20,562)	(20,562)
Pretax income					490,737
Income tax expense				(78,055)	(78,055)
Net income					412,682

Three Month Period Ending June 30, 2009

	Wireless	Cyber	Consulting	Corp	Consol
Revenue	\$ 7,114,365	\$ 1,336,238	\$ 1,941,679	\$ -	\$ 10,392,282
Operating income (loss) including amortization and depreciation expense	608,314	259,663	151,485	(700,537)	318,925
Interest Income (expense), net				(29,050)	(29,050)
Pretax income					289,875
Income tax expense				(39,223)	(39,223)
Net income					250,652

## Six Month Period Ending June 30, 2010

	Wireless	Cyber	Consulting	Corp	Consol
Revenue	\$ 13,805,799	\$ 3,912,327	\$ 5,897,050	\$ -	\$ 23,615,176
Operating income including amortization and depreciation expense	1,246,532	881,427	162,217	(1,479,594)	810,582
Interest Income (expense), net				(41,325)	(41,325)
Pretax income					769,257
Income tax expense				(117,277)	(117,277)
Net income					651,980

## Six Month Period Ending June 30, 2009

	Wireless	Cyber	Consulting	Corp	Consol
Revenue	\$ 13,470,825	\$ 2,744,090	\$ 4,312,749	\$ -	\$ 20,527,664
Operating income (loss) including amortization and depreciation expense	1,210,668	485,092	168,162	(1,310,639)	553,283
Interest Income (expense), net				(95,261)	(95,261)
Pretax income					458,022
Income tax expense				(78,445)	(78,445)
Net income					379,577

## 8. Advanced Response Concepts Corporation Asset Purchase.

On January 29, 2010, the Company, together with its wholly-owned subsidiary, Advanced Response Concepts Corporation, a Delaware corporation (“Advanced Response Concepts”), entered into an Asset Purchase Agreement with Vuance, Inc. (“Vuance”), a Delaware corporation, and Vuance’s sole shareholder, Vuance, Ltd., a public company organized in the State of Israel under the Israeli Companies Law (the “Vuance Agreement”), pursuant to which Advanced Response Concepts acquired certain assets and assumed certain liabilities of Vuance as further specified in the Vuance Agreement. Advanced Response Concepts acquired all assets of the collective business of Vuance relating to its Government Services Division. The purchased assets include, but are not limited to, the operation by Vuance of identity assurance and priority resource management solutions; crime scene management and information protection, and other activities related or incidental thereto; and the development, maintenance, enhancement and provision of software, services, products and operations for identity management and information protection, which are offered primarily to state and local government agency markets.

The acquisition of Vuance was accounted for using the acquisition method of accounting. The fair value of the consideration was approximately \$684,000. Based upon a review of the costs of performing certain assumed obligations we increased the amount reserved to perform these obligation approximately \$76,000 increasing the consideration to approximately \$759,000.

The Company has engaged a valuation consultant to assist in finalizing the determination of the purchase price and fair value of assets and liabilities acquired. This process has not been completed as of the end of the quarter. As such, amounts disclosed are provisional and subject to change based on the final determination of the purchase price and fair value of assets and liabilities acquired. The purchase price was based upon management's estimates and assumptions using the latest available information. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed in this business combination:

	Advanced Response Concepts Jan. 29, 2010
Consideration:	
Cash	\$ 370,000
Cash to be paid (post-closing adjustments)	89,478
Contingent consideration arrangement	300,000
Fair value of total consideration transferred	\$ 759,478
Approximate acquisition related costs (including general & administrative expenses in WidePoint's income statement for the period ending June 30, 2010)	\$ 70,000
Recognized amounts of identifiable assets acquired & liabilities assumed:	
Current Assets	\$ 42,000
Property, plant, and equipment, net	43,675
Identifiable intangible assets	381,420
Current liabilities assumed	(412,483)
Total identifiable net assets & liabilities assumed	54,612
Goodwill	704,866
Total	\$ 759,478

The operations of Advanced Response Concepts have been included in the Company's results of operations beginning on January 29, 2010, the acquisition date.

The earnout provision of the Vuance Agreement provides for additional consideration of up to \$1,500,000 during the earnout period of the calendar years 2010 - 2012, subject to Advanced Response Concepts receiving minimum qualified revenues of at least \$4,000,000 per year. In the event Advanced Response Concepts receives at least \$4,000,000 in qualified revenues in an earnout year, then Vuance will have the right to receive an earnout payment equal to twenty percent (20%) of the amount by which such qualified revenues for that earnout year exceed \$4,000,000; provided, however, that the first \$270,000 of any such earnout payment will be retained by the Company for its sole account as reimbursement for certain accounts payable and deferred revenue liabilities assumed by Advanced Response Concepts in connection with the Vuance Agreement.



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

The following discussion and analysis of the financial condition and results of operations of the Company should be read in conjunction with the financial statements and the notes thereto which appear elsewhere in this quarterly report and the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

The information set forth below includes forward-looking statements. Certain factors that could cause results to differ materially from those projected in the forward-looking statements are set forth below. Readers are cautioned not to put undue reliance on forward-looking statements. The Company disclaims any intent or obligation to update publicly these forward-looking statements, whether as a result of new information, future events or otherwise.

### Overview

WidePoint Corporation is a technology-based provider of products and services to both the government sector and commercial markets. WidePoint was incorporated in Delaware on May 30, 1997. We have grown through the merger with and acquisition of highly specialized regional IT consulting companies.

Our expertise lies in three business segments operated through six wholly-owned operational entities. Our three business segments include: Wireless Mobility Management (formerly referred to as our "Wireless Telecommunications Expense Management Services" segment), Cybersecurity Solutions (formerly referred to as our "Identity Management" segment), and IT Consulting Services and Products. These segments offer unique solutions and proprietary intellectual property ("IP") in mobile and wireless full life cycle management solutions; cybersecurity solutions with specific subject matter expertise, U.S. government certifications and authorizations, and IP in identity management and information assurance services utilizing certificate-based security solutions; and other associated IT consulting services and products through which we provide specific subject matter expertise in IT Architecture and Planning, Software Implementation Services, IT Outsourcing, and Forensic Informatics.

See Note 7 to the Condensed Consolidated Financial Statements included in this report for a description of the operating results for each segment.

We intend to continue to market and sell our technical capabilities into the governmental and commercial marketplace. Further, we are continuing to actively search out new synergistic acquisitions that we believe may further enhance our present base of business and service offerings, which has already been augmented by our acquisitions of ORC and iSYS, our asset purchases of Protexx and Advanced Response Concepts, and our internal growth initiatives.

With the addition of the customer base and the increase in revenues attributable to our iSYS acquisition, WidePoint's opportunity to leverage and expand further into the federal government marketplace has improved substantially. iSYS's past client successes, top security clearances for their personnel, and additional breadth of management talent have expanded the Company's reach into markets that previously were not fully accessible to WidePoint. Further supplemented by the addition of the Protexx and Advanced Response Concepts asset acquisitions, the Company intends to continue to leverage the synergies between its newly-acquired operating subsidiaries, and cross sell its technical capabilities into each separate marketplace serviced by our respective business segments.

Our revenues and operating results may vary significantly from quarter-to-quarter, due to revenues earned on contracts, the number of billable days in a quarter, the timing of the pass-through of other direct costs, the commencement and completion of contracts during any particular quarter, the schedule of the government agencies for awarding contracts, the term of each contract that we have been awarded and general economic conditions. Because a significant portion of our expenses, such as personnel and facilities costs, are fixed in the short

term, successful contract performance and variation in the volume of activity, as well as in the number of contracts commenced or completed during any quarter, may cause significant variations in operating results from quarter to quarter.

As a result of our ORC and iSYS acquisitions, which predominantly operate in the U.S. federal government marketplace, we rely upon a larger portion of our revenues from the federal government directly or as a subcontractor. The federal government's fiscal year ends September 30. If a budget for the next fiscal year has not been approved by that date, our clients may have to suspend engagements that we are working on until a budget has been approved. Such suspensions may cause us to realize lower revenues in the fourth calendar quarter (first quarter of the government's fiscal year). Further, a change in senior government officials, or realignment of responsibilities, may negatively affect the rate at which the federal government purchases the services that we offer.

As a result of the factors above, period-to-period comparisons of our revenues and operating results may not be meaningful. These comparisons are not indicators of future performance and no assurances can be given that quarterly results will not fluctuate, causing a possible material adverse effect on our operating results and financial condition.

In addition, most of WidePoint's current costs consist primarily of the salaries and benefits paid to WidePoint's technical, marketing and administrative personnel as well as vendor-related costs in connection with our Wireless Mobility Management segment. As a result of our plan to expand WidePoint's operations through a combination of internal growth initiatives and merger and acquisition opportunities, WidePoint expects such costs to increase. WidePoint's profitability also depends upon both the volume of services performed and the Company's ability to manage costs. As a significant portion of the Company's cost is labor related, WidePoint must effectively manage these costs to achieve and grow its profitability. The Company must also manage our telephony airtime plans and other vendor related offerings under our mobile telecom managed services provided to our customers as they also represent a significant portion of our costs. To date, the Company has attempted to maximize its operating margins through efficiencies achieved by the use of its proprietary methodologies, and by offsetting increases in consultant salaries with increases in consultant fees received from its clients. The uncertainties relating to the ability to achieve and maintain profitability, obtain additional funding to partially fund the Company's growth strategy and provide the necessary investment to continue to upgrade its management reporting systems to meet the continuing demands of the present regulatory changes affect the comparability of the information reflected in the financial information presented above.

Our staff consists of business process and computer specialists who help our government and civilian customers augment and expand their resident technological skills and competencies, drive technical innovation, and help develop and maintain a competitive edge in today's rapidly changing technological environment in business. Our organization emphasizes an intense commitment to our people, our customers, and the quality of our solutions offerings. As a services organization, our customers are our primary focus.

## Results of Operations

### Three Months Ended June 30, 2010 as Compared to Three Months Ended June 30, 2009

Revenues, net. Revenues for the three month period ended June 30, 2010, were approximately \$12.5 million as compared to approximately \$10.4 million for the three month period ended June 30, 2009. The increase in revenues was primarily attributable to increases in our Cyber security and consulting segments as a result of the performance of recent contract awards and expansions.

- Our Wireless Mobility Management segment experienced decreased revenue of approximately 3% from approximately \$7.1 million for the quarter ended June 30, 2009 to approximately \$6.9 million for the quarter ended June 30, 2010. The decrease in revenue was predominately the result of a one-time sale of equipment of approximately \$500,000 that occurred in the second quarter of 2009 that did not recur in the second quarter of 2010. Excluding the one-time equipment sale in the second quarter of 2009, we witnessed revenue growth of approximately 5% in the second quarter of 2010 as compared to the second quarter of 2009. Effective July 31, 2010, WHS pass-through billing services contract lapsed. Over the past six months this represented approximately \$6 million in revenue. Short-term, we may witness a reduction or variability in revenue growth as the revenue mix in this segment experiences a reduction of billable calling minutes as compared to managed fees as we shift our attention to expanding the fee portion of our sales mix. We are presently pursuing several significant service contract award opportunities at a number of federal agencies and are also initiating a new strategy to expand into state and local municipalities and commercial enterprises by utilizing intermediary sales channels to potentially expand our reach beyond the federal sector and help to support the long-term growth of this segment.

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Our Cyber Security Solutions segment experienced revenue growth of approximately 86% from approximately \$1.3 million for the three month period ended June 30, 2009 to approximately \$2.5 million for the three month period ended June 30, 2010. This growth was primarily a result of increases in our credential sales associated with several initiatives requiring the use of those credentials by government agencies and a result of contract awards made during the quarter to our newly established subsidiary Advanced Response Concepts. We anticipate that this segment should continue to demonstrate revenue growth in the future as various federal agency mandates continue to be implemented in order to strengthen their requirements for greater levels of identity management and better protect the federal information technology infrastructure within federal agencies. We have entered into a number of affiliations with partners who support the end user base, which facilitate access to these various federal agencies and the related technology infrastructure in order to take advantage of these identity management improvement mandates. We believe these new partnerships should widen our sales reach.

- Our IT Consulting Services and Products segment experienced revenue growth of approximately 59%. Revenues increased from approximately \$1.9 million for the three month period ended June 30, 2009 to approximately \$3.1 million for the three month period ended June 30, 2010. This positive revenue performance primarily resulted from new contract awards and renewals and expansion work from our current customer base occurring in this quarter. We anticipate that this segment should continue to grow at a moderate rate but given the nature and variability of the products and services we offer within this segment the growth may be erratic.

**Cost of sales.** Cost of sales for the three month period ended June 30, 2010 was approximately \$9.5 million (or 76% of revenues), as compared to cost of sales of approximately \$8.2 million (or 79% of revenues), for the three month period ended June 30, 2009. This overall increase in cost of sales was primarily attributable to an increase in revenues. The decrease in our cost of sales as a percentage of revenues was primarily attributable to margin improvements in all three of our segments. Our Wireless Mobility Management and Cyber Security Solutions segments realized greater margins from the benefit of economies of scale, with our direct costs centers realizing greater efficiencies. Our IT Consulting Services and Products segment realized greater margins as a result of a larger mix of higher margin consulting services, versus a lesser amount of lower margin software reselling that was realized during the quarter. We anticipate improvements in our costs of sales as a percentage basis as our Wireless Mobility Management and Cyber Security Solutions segments add economies of scale, which may be partially offset at times by the fluctuation in our IT Consulting Services and Products segment revenue mix.

**Gross profit.** Gross profit for the three month period ended June 30, 2010 was approximately \$2.9 million (or 24% of revenues), as compared to gross profit of approximately \$2.2 million (or 21% of revenues) for the three month period ended June 30, 2009. The percentage of gross profit was higher in the second quarter of 2010 as compared to the second quarter of 2009 as a result of higher margins associated with improved economies of scale in our Wireless Mobility Management and Cyber Security Solutions segments, and a greater mix of higher margin direct consulting services as compared to lower margin software reselling in our IT Consulting Services and Products segment. We anticipate gross profit as a percentage of revenues should increase as cost of sales as a percentage of revenues decreases due to a greater mix of higher margin services. We believe that as revenues expand in the future, there will be periods of variability in margin growth associated with changes in our product mix.

**Sales and marketing.** Sales and marketing expense for the three month period ended June 30, 2010 was approximately \$488,000 (or 4% of revenues), as compared to approximately \$265,000 (or 3% of revenues) for the three month period ended June 30, 2009. The absolute dollar amount of sales and marketing expanded as we increased our sales and marketing capabilities through the addition of several new hires, tools, and services infrastructure improvements. We believe that with our niche capabilities and the present latent demand for our services the investment within our sales and marketing will support our ability to continue to expand our revenues.

**General and administrative.** General and administrative expenses for the three month period ended June 30, 2010 were approximately \$1.9 million (or 15% of revenues) as compared to approximately \$1.6 million (or 15% of revenues) for the three month period ended June 30, 2009. This increase in general and administrative expenses was primarily attributable to increases in general and administrative costs, including those related to the Company's addition of a new subsidiary, Advanced Response Concepts, that added to our general and administrative expense base, additional non-recurring associated carrying costs for consultants incurred in connection with security clearance approvals, as well as the payments of certain performance bonuses that were awarded. As we continue our efforts to comply with pending additional financial compliance requirements, we anticipate that our general and administrative costs may rise slightly in the future as our support costs rise to facilitate our expectations of a greater revenue base. We believe that our general and administrative costs on a percentage of revenue will level out or decrease in future financial reporting periods.

**Depreciation.** Depreciation expense for the three month period ended June 30, 2010, was approximately \$49,000 (or less than 1% of revenues), as compared to approximately \$41,000 of such expenses (or less than 1% of revenues) for

the three month period ended June 30, 2009. This increase in depreciation expense over such expenses for the three month period ended June 30, 2009 was primarily attributable to recent acquisitions of additional depreciable assets. We do not anticipate any material changes within depreciation expense in the short-term. However, as our revenue base increases within our Wireless Mobility Management and Cyber Security Solutions segments, there may be a need from time to time to increase the purchase of equipment in support of new revenue streams that may then raise our depreciation expenses.

**Interest income.** Interest income for the three month period ended June 30, 2010 was approximately \$2,000 (or less than 1% of revenues), as compared to approximately \$5,000 (or less than 1% of revenues) for the three month period ended June 30, 2009. This decrease in interest income for the three month period ended June 30, 2010 was primarily attributable to lesser amounts of invested cash and cash equivalents, combined with lower short-term interest rates that were available to the Company on investments in interest bearing accounts. We do not anticipate any material changes in trends in our interest income for the near-term as a result of continuing low short-term interest rates presently payable by financial institutions in connection with the present monetary policy of the U.S. federal government.

**Interest expense.** Interest expense for the three month period ended June 30, 2010 was approximately \$23,000 (or less than 1% of revenues) as compared to approximately \$34,000 (or less than 1% of revenues) for the three month period ended June 30, 2009. This decrease in interest expense for the three month period ended June 30, 2010 was primarily attributable to lesser expenses associated with the debt instruments held by the Company. We anticipate our interest expense will continue to decrease as the Company continues to pay down the principal on its term note held by Cardinal Bank.

**Income taxes.** Income taxes for the three month periods ended June 30, 2010 and June 30, 2009 were approximately \$78,000 and \$39,000, respectively. The increase was predominately attributable to the inclusion of our estimate for alternative minimum taxes. The Company also incurred a deferred income tax expense of approximately \$39,000 for each three month period, as a result of the recognition of a deferred tax liability attributable to the differences in our treatment of the amortization of goodwill for tax purposes versus book purposes as it relates to our acquisition of iSYS in January 2008. As goodwill is amortized for tax purposes but not book purposes and is considered a permanent asset rather than a temporary asset, the related deferred tax liability cannot be reversed until some indeterminate future period when the goodwill either becomes impaired and/or is disposed of.

**Net income.** As a result of the above, the net income for the three month period ended June 30, 2010 was approximately \$413,000 as compared to the net income of approximately \$251,000 for the three month period ended June 30, 2009.

#### Six Months Ended June 30, 2010 as Compared to Six Months Ended June 30, 2009

**Revenues, net.** Revenues for the six month period ended June 30, 2010 were approximately \$23.6 million as compared to approximately \$20.5 million for the three month period ended June 30, 2009. The increase in revenues was primarily attributable to increases in all three of our segments as a result of the performance of recent contract awards and expansions.

- Our Wireless Mobility Management segment experienced revenue growth of approximately 2% from approximately \$13.5 million for the six months ended June 30, 2009 to approximately \$13.8 million for the six months ended June 30, 2010. The positive revenue performance primarily resulted from the execution of new contract awards and renewals and expansion work from our current customer base. Effective July 31, 2010, WHS pass-through billing services contract lapsed. Over the past six months this represented approximately \$6 million in revenue. Short-term we may witness a reduction or variability in revenue growth as the revenue mix in this segment experiences a reduction of billable calling minutes as compared to managed fees as we shift our attention to expanding the fee portion of our sales mix. We are presently pursuing several significant service contract award opportunities at a number of federal agencies and are also initiating a new strategy to expand into state and local municipalities and commercial enterprises by utilizing intermediary supply channels to potentially expand our reach beyond the federal sector and help to support the long-term growth of this segment.
- Our Cyber Security Solutions segment experienced solid revenue growth of approximately 43% to approximately \$3.9 million for the six month period ended June 30, 2010 from approximately \$2.7 million for the six month

period ended June 30, 2009. This growth was primarily a result of increases in our credential sales associated with several initiatives requiring the use of those credentials by government agencies and as a result of contract awards made during the second quarter to our newly established subsidiary, Advanced Response Concepts. We have entered into a number of affiliations with partners who support the end user base, which facilitate access to these various federal agencies and the related technology infrastructure in order to take advantage of these identity management improvement mandates. We believe these new partnerships should widen our sales reach, which we anticipate should support the continued long-term growth of this segment.

- Our IT Consulting Services and Products segment experienced revenue growth of approximately 37% during the six month period ended June 30, 2010. Revenues increased from approximately \$4.3 million for the six month period ended June 30, 2009 to \$5.9 million for the six month period ended June 30, 2010. This positive revenue performance primarily resulted from new contract awards and renewals and expansion work from our current customer base. We anticipate that this segment should continue to realize modest growth but given the nature and variability of the products and services we offer within this segment, the growth may be erratic.

**Cost of sales.** Cost of sales for the six month period ended June 30, 2010 was approximately \$18.2 million (or 77% of revenues), as compared to cost of sales of approximately \$16.3 million (or 79% of revenues), for the six month period ended June 30, 2009. This absolute increase in cost of sales was primarily attributable to an increase in revenues. The decrease in our cost of sales as a percentage of revenues was primarily attributable to margin improvements in all three of our segments. Our Wireless Mobility Management and Cyber Security Solutions segments realized greater margins from the benefit of economies of scale with our direct costs centers realizing greater efficiencies. Our IT Consulting Services and Products segment realized greater margins as a result of a larger mix of higher margin consulting services, versus a lesser amount of lower margin software reselling that was realized during the quarter. We anticipate improvements in our costs of sales on a percentage basis as our Wireless Mobility Management and Cyber Security Solutions segments add economies of scale, which may be partially offset at times by the fluctuation in our IT Consulting Services and Products segment revenue mix.

**Gross profit.** Gross profit for the six month period ended June 30, 2010 was approximately \$5.5 million (or 23% of revenues) as compared to gross profit of approximately \$4.2 million (or 21% of revenues), for the six month period ended June 30, 2009. The percentage of gross profit was higher in the first quarter of 2010 as compared to the first quarter of 2009 as a result of higher margins associated with improved economies of scale in our Wireless Mobility Management and Cyber Security Solutions segments and a greater mix of higher margin direct consulting services as compared to lower margin software reselling in our IT Consulting Services and Products segment. We anticipate gross profit as a percentage of revenues should increase as cost of sales as a percentage of revenues decreases due to a greater mix of higher margin services. We believe as revenues expand in the future there will be periods of variability in margin growth associated with changes in our product mix.

**Sales and marketing.** Sales and marketing expense for the six month period ended June 30, 2010 was approximately \$831,000 (or 4% of revenues), as compared to approximately \$495,000 (or 2% of revenues), for the six month period ended June 30, 2009. The dollar amount of sales and marketing increased substantially as we increased our sales and marketing capabilities through the addition of several new hires, tools, and services infrastructure improvements, as well as business development expenditures in support of our Protexx and Advanced Response Concepts emerging market initiatives. We believe that with our niche capabilities and the present latent demand for our services the investment within our sales and marketing will support our ability to continue to expand our revenues.

**General and administrative.** General and administrative expenses for the six month period ended June 30, 2010 were approximately \$3.7 million (or 16% of revenues), as compared to approximately \$3.1 million (or 15% of revenues) for the six month period ended June 30, 2009. This increase in general and administrative expenses over those for the six months ended June 30, 2009, was primarily attributable to increases in general and administrative costs as we added a new subsidiary Advanced Response Concepts that added to our general and administrative expense base, along with; a one time increase in legal expenses associated with the purchase of the assets of the government business of Vuance, Inc., which we are operating as Advanced Response Concepts; some additional non-recurring associated carrying costs for consultants that we incurred in connection with pending security clearance approvals; and the payments of certain performance bonuses that were awarded. We anticipate that our general and administrative costs may rise slightly in the future as our support costs rise to facilitate our expectations of a greater revenue base as we continue our efforts to comply with pending additional financial compliance requirements. We believe that our general and administrative costs on a percentage of revenue basis will level out or decrease in future financial reporting periods.

Depreciation. Depreciation expense for the six month period ended June 30, 2010 was approximately \$98,000 (or less than 1% of revenues), as compared to approximately \$84,000 of such expenses (or less than 1% of revenues) for the six month period ended June 30, 2009. This increase in depreciation expense over those for the six month period ended June 30, 2009 was primarily attributable to recent acquisitions of additional depreciable assets. We do not anticipate any material changes within depreciation expense in the short-term. However, as our revenue base increases within our Wireless Mobility Management and Cyber Security Solutions segments, there may be a need from time to time to increase the purchase of equipment in support of new revenue streams that may then raise our depreciation expenses.

**Interest income.** Interest income for the six month period ended June 30, 2010 was approximately \$9,000 (or less than 1% of revenues), as compared to approximately \$19,000 (or less than 1% of revenues), for the six month period ended June 30, 2009. This decrease in interest income for the six month period ended June 30, 2010, was primarily attributable to lesser amounts of invested cash and cash equivalents, and combined with lower short-term interest rates that were available to the Company on investments in interest bearing accounts. We do not anticipate any material changes in trends in our interest income for the near-term as a result of continuing low short-term interest rates presently payable by financial institutions in connection with the present monetary policy of the U.S. federal government.

**Interest expense.** Interest expense for the six month period ended June 30, 2010 was approximately \$50,000 (or less than 1% of revenues), as compared to approximately \$114,000 (or less than 1% of revenues), for the six month period ended June 30, 2009. This decrease in interest expense for the six month period ended June 30, 2010, was primarily attributable to lesser expenses associated with the debt instruments held by the Company. We anticipate our interest expense will continue to decrease as the Company continues to pay down the principal on its term note held by Cardinal Bank.

**Income taxes.** Income taxes for the six month periods ended June 30, 2010 and June 30, 2009 were approximately \$117,000 and \$78,000, respectively. The increase was predominately attributable to the inclusion of our estimate for alternative minimum taxes. The Company also incurred a deferred income tax expense of approximately \$78,000 for each six month period, as a result of the recognition of a deferred tax liability attributable to the differences in our treatment of the amortization of goodwill for tax purposes versus book purposes as it relates to our acquisition of iSYS in January 2008. As goodwill is amortized for tax purposes but not book purposes and is considered a permanent asset rather than a temporary asset, the related deferred tax liability cannot be reversed until some indeterminate future period when the goodwill either becomes impaired and/or is disposed of.

**Net income.** As a result of the above, the net income for the six month period ended June 30, 2010 was approximately \$652,000 as compared to the net income of approximately \$380,000 for the six months ended June 30, 2009.

#### Liquidity and Capital Resources

The Company has, since inception, financed its operations and capital expenditures through the sale of preferred and common stock, seller notes, convertible notes, convertible exchangeable debentures, senior secured loans and the proceeds from the exercise of the warrants related to a convertible exchangeable debenture. During 2009 and through the period ended June 30, 2010, operations were primarily financed with working capital, senior debt, and stock option and warrant exercises.

Net cash used in operating activities for the three months ended June 30, 2010 was approximately \$0.5 million, as compared to cash used in operating activities of \$1.1 million for the three months ended June 30, 2009. This increase in cash used in operating activities for the three months ended June 30, 2010 was primarily a result of a decrease in accounts payable during the second quarter of 2010. The decrease in accounts payable resulted from an acceleration of payments to certain vendors who requested shorter payment terms and as a result of shorter payment terms associated with new vendors that we are establishing credit with in support of our newly established subsidiary Advanced Response Concepts. Net cash used in investing activities for the three months ended June 30, 2010 was approximately \$43,000, as compared to \$74,000 in cash used in investing activities for the three months ended June 30, 2009. The decrease in net cash used in investing activities was primarily attributable to decreased purchases of property and equipment by the Company. Net cash used in financing activities amounted to approximately \$196,000 in the three months ended June 30, 2010, as compared to net cash used in financing activities of approximately \$177,000 in the three months ended June 30, 2009. This increase in net cash used in financing activities primarily related to the reduction of debt during the three months ended June 30, 2010 as compared to the three months ended June 30, 2009. As a result of the Company's capital raising in 2008 and its profitability in 2009 and in the first six

months of 2010, the Company has had excess liquidity to pay down short-term and long-term debt, while still maintaining sufficient levels of capital resources to fund operations.

As of June 30, 2010, the Company had a net working capital of approximately \$4.3 million. The Company's primary source of liquidity consists of approximately \$2.6 million in cash and cash equivalents and approximately \$10.1 million of accounts receivable and unbilled accounts receivable. Current liabilities include approximately \$7.8 million in accounts payable and accrued expenses.

The Company's business environment is characterized by rapid technological change, periods of high growth and contraction and is influenced by material events such as mergers and acquisitions, with each of the foregoing able to substantially change the Company's outlook.

The Company has embarked upon several new initiatives to expand revenue growth which has included both acquisitions and organic growth. The Company requires substantial working capital to fund the future growth of its business, particularly to finance accounts receivable, sales and marketing efforts, and capital expenditures.

Currently there are no material commitments for capital expenditures and software development costs. Future capital requirements will depend on many factors, including the rate of revenue growth, if any, the timing and extent of spending for new product and service development, technological changes and market acceptance of the Company's services.

Management believes that its current cash position is sufficient to meet capital expenditure and working capital requirements for the near term. However, the growth and technological change of the market make it difficult to predict future liquidity requirements with certainty. Over the longer term, the Company must successfully execute its plans to increase revenue and income streams that will generate significant positive cash flows if it is to sustain adequate liquidity without impairing growth or requiring the infusion of additional funds from external sources. Additionally, a major expansion, such as that which occurred with the acquisition of iSYS or any other potential new subsidiaries, might require external financing that could include additional debt or equity capital. There can be no assurance that additional financing, if required, will be available on acceptable terms, if at all, for future acquisitions and/or growth initiatives. The Company presently has a unused credit facility for \$5 million that is expiring on September 1, 2010. We are presently completing the renewal of this credit facility with Cardinal Bank and expect that it will be renewed prior to the expiration of the present credit facility.

#### Off-Balance Sheet Arrangements

The Company has no existing off-balance sheet arrangements as defined under SEC regulations.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that material information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that the information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. We performed an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the existence of the material weaknesses discussed below in "Material Weakness in Internal Control Over Financial Reporting," our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of the end of the period covered by this report.



We do not expect that our disclosure controls and procedures will prevent all errors and all instances of fraud. Disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Further, the design of disclosure controls and procedures must reflect the fact that there are resource constraints, and the benefits must be considered relative to their costs. Because of the inherent limitations in all disclosure controls and procedures, no evaluation of disclosure controls and procedures can provide absolute assurance that we have detected all our control deficiencies and instances of fraud, if any. The design of disclosure controls and procedures also is based partly on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

#### Material Weakness in Internal Control Over Financial Reporting

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on this assessment, management concluded that our internal control over financial reporting was not effective as of December 31, 2009 due to the existence of the following material weaknesses:

Inadequate segregation of duties within a significant account or process. Management determined that it did not have appropriate segregation of duties within our internal controls that would ensure the consistent application of procedures in our financial reporting process by existing personnel. This control deficiency could result in a misstatement to substantially all of our financial statement accounts and disclosures that would result in a material misstatement to the annual or interim financial statements that would not be prevented or detected. Accordingly, management has concluded that this control deficiency constitutes a material weakness.

Lack of sufficient subject matter expertise. Management determined that it lacks certain subject matter expertise accounting for and the disclosure of complex transactions. Our financial staff currently lacks sufficient training or experience in accounting for complex transactions and the required disclosure therein.

#### Remediation Plan for Material Weaknesses

The material weaknesses described above in "Material Weaknesses in Internal Control Over Financial Reporting" comprise control deficiencies that we discovered during the financial close process for the December 31, 2009 fiscal period.

Management commenced a remediation plan during the first quarter of 2010 that will be implemented during our fiscal year 2010, which includes (i) recruiting and adding specific financial subject matter experts as consultants or employees to the financial staff, and (ii) augmenting and allowing for additional training and education for select members of our financial staff. Management is presently recruiting additional staff and has allowed for additional training and education of its present staff in addressing the material weaknesses.

We believe that these measures, if effectively implemented and maintained, will remediate the material weaknesses discussed above.

#### Changes in Internal Control Over Financial Reporting

We are currently undertaking the measures discussed above to remediate the material weaknesses discussed under “Material Weaknesses in Internal Control Over Financial Reporting” above. Those measures, described under “Remediation Plan for Material Weaknesses,” were commenced during the first quarter of 2010, will continue to be implemented during our fiscal year 2010, and will materially affect, or are reasonably likely to materially affect, our internal control over financial reporting.

Other than as described above, there have been no changes in our internal control over financial reporting during the three-month period ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Further, because of changes in conditions, effectiveness of internal controls over financial reporting may vary over time. Our system contains self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

## PART II – OTHER INFORMATION

### ITEM 5. OTHER INFORMATION.

On August 13, 2010, the Company entered into new employment agreements with each of Steve L. Komar, the Company's Chairman of the Board and Chief Executive Officer, and James T. McCubbin, the Company's Executive Vice President, Chief Financial Officer, Secretary and Treasurer. The prior employment agreements, each dated as of July 1, 2002 and as previously amended from time to time, between the Company and each of Messrs. Komar and McCubbin, respectively, expired on July 25, 2010. The following is a description of the new employment agreements between the Company and each of Messrs. Komar and McCubbin.

#### Steven L. Komar

On August 13, 2010, Mr. Komar, the Company's Chairman of the Board and Chief Executive Officer, entered into a new Employment Agreement with the Company (the "Komar Employment Agreement"), a complete copy of which is filed herewith as an exhibit to this Form 10-Q. The effective date of the Komar Employment Agreement is July 1, 2010 and the term of the Komar Employment Agreement continues until June 30, 2012, unless extended for a period of twelve months by mutual agreement of the parties.

Per the terms of the Komar Employment Agreement, Mr. Komar will receive a base salary of \$205,000 for the first year of the term, \$230,000 for the second year of the term, and \$255,000 for the optional third year of the term. Mr. Komar will also be eligible for annual bonus awards at the discretion of the Board of Directors, and will be eligible to participate in Company incentive stock, option and bonus plans. The Komar Employment Agreement entitles Mr. Komar to all employee benefits the Company makes available to its senior executives, as well as to certain benefits that have been offered to him to complete his overall annual compensation package. These benefits include a monthly home office and automobile expense allowance and a monthly phone allowance to cover expenses incurred in pursuit of Company business.

The Komar Employment Agreement contains a severance provision which provides that upon the termination of his employment without Cause (as defined in the Komar Employment Agreement) or his voluntary resignation for a Good Reason (as defined in the Komar Employment Agreement), Mr. Komar will receive severance compensation equal to the greater of (a) an amount equal to twelve (12) months of his base salary then in effect, or (b) an amount equal to Mr. Komar's base salary for the remainder of the term of the Komar Employment Agreement. The Komar Employment Agreement further provides that if within two years after a change in control of the Company there occurs any termination of Mr. Komar for any reason other than for Cause or a voluntary resignation without a Good Reason, then the Company will be required to pay to Mr. Komar a one time severance payment equal to the greater of (a) an amount equal to eighteen (18) months of his base salary then in effect, or (b) an amount equal to Mr. Komar's base salary for the remainder of the term of the Komar Employment Agreement. If Mr. Komar's employment terminates for any reason other than for Cause or a voluntary retirement without Good Reason, Mr. Komar will be eligible to participate, at the Company's expense, in all executive medical and dental plans provided by the Company for the remainder of the term of the Komar Employment Agreement. Mr. Komar will receive a payment equal to any

excise, income and other taxes resulting from the imposition of parachute penalties of the Internal Revenue Code or applicable state tax law.

In the event of his disability or death, Mr. Komar or his estate will receive a one time payment equal to the amount of base salary owed to Mr. Komar for the remainder of the term as if the Komar Employment Agreement had not been terminated by Mr. Komar's disability or death.

The Komar Employment Agreement also contains non-compete and non-solicitation provisions that provide that upon the termination of Mr. Komar's employment for Cause or Mr. Komar's resignation without Good Reason, Mr. Komar will be unable to engage in any business that is competitive with the Company anywhere in the United States or Puerto Rico and he will be unable to solicit any of the Company's employees, suppliers or customers for a period of twelve months (or eighteen (18) months if Mr. Komar is terminated with Cause or voluntarily resigns without Good Reason in connection with a change of control of the Company).

The foregoing description of the Komar Employment Agreement is qualified in its entirety by reference to the complete copy of such Komar Employment Agreement that is filed as Exhibit 10.1 to this Quarterly Report on Form 10-Q and is incorporated by reference herein.

James T. McCubbin

On August 13, 2010, James T. McCubbin, the Company's Executive Vice President, Chief Financial Officer, Secretary and Treasurer, entered into a new Employment Agreement with the Company (the "McCubbin Employment Agreement"), a complete copy of which is filed herewith as an exhibit to this Form 10-Q. The effective date of the McCubbin Employment Agreement is July 1, 2010 and the term of the McCubbin Employment Agreement continues until June 30, 2012, unless extended for a period of twelve months by mutual agreement of the parties.

Per the terms of the McCubbin Employment Agreement, Mr. McCubbin will receive a base salary of \$205,000 for the first year of the term, \$230,000 for the second year of the term, and \$255,000 for the optional third year of the term. Mr. McCubbin will also be eligible for annual bonus awards at the discretion of the Board of Directors, and will be eligible to participate in Company incentive stock, option and bonus plans. The McCubbin Employment Agreement entitles Mr. McCubbin to all employee benefits the Company makes available to its senior executives, as well as to certain benefits that have been offered to him to complete his overall annual compensation package. These benefits include a monthly home office and automobile expense allowance and a monthly phone allowance to cover expenses incurred in pursuit of Company business.

The McCubbin Employment Agreement contains a severance provision which provides that upon the termination of his employment without Cause (as defined in the McCubbin Employment Agreement) or his voluntary resignation for a Good Reason (as defined in the McCubbin Employment Agreement), Mr. McCubbin will receive severance compensation equal to the greater of (a) an amount equal to twelve (12) months of his base salary then in effect, or (b) an amount equal to Mr. McCubbin's base salary for the remainder of the term of the McCubbin Employment Agreement. The McCubbin Employment Agreement further provides that if within two years after a change in control of the Company there occurs any termination of Mr. McCubbin for any reason other than for Cause or a voluntary resignation without a Good Reason, then the Company will be required to pay to Mr. McCubbin a one time severance payment equal to the greater of (a) an amount equal to eighteen (18) months of his base salary then in effect, or (b) an amount equal to Mr. McCubbin's base salary for the remainder of the term of the McCubbin Employment Agreement. If Mr. McCubbin's employment terminates for any reason other than for Cause or a voluntary retirement without Good Reason, Mr. McCubbin will be eligible to participate, at the Company's expense, in all executive medical and dental plans provided by the Company for the remainder of the term of the McCubbin Employment Agreement. Mr. McCubbin will receive a payment equal to any excise, income and other taxes resulting from the imposition of parachute penalties of the Internal Revenue Code or applicable state tax law.

In the event of his disability or death, Mr. McCubbin or his estate will receive a one time payment equal to the amount of base salary owed to Mr. McCubbin for the remainder of the term as if the McCubbin Employment Agreement had not been terminated by Mr. McCubbin's disability or death.

The McCubbin Employment Agreement also contains non-compete and non-solicitation provisions that provide that upon the termination of Mr. McCubbin's employment for Cause or Mr. McCubbin's resignation without Good Reason, Mr. McCubbin will be unable to engage in any business that is competitive with the Company anywhere in the United States or Puerto Rico and he will be unable to solicit any of the Company's employees, suppliers or customers for a period of twelve months (or eighteen (18) months if Mr. McCubbin is terminated with Cause or voluntarily resigns without Good Reason in connection with a change of control of the Company).

The foregoing description of the McCubbin Employment Agreement is qualified in its entirety by reference to the complete copy of such McCubbin Employment Agreement that is filed as Exhibit 10.2 to this Quarterly Report on

Form 10-Q and is incorporated by reference herein.

ITEM 6. EXHIBITS.

EXHIBIT NO.	DESCRIPTION
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|------|--|
| 10.1 | Employment Agreement by and between the Company and Steve L. Komar, dated as of August 13, 2010 (Filed herewith).                                |
| 10.2 | Employment Agreement by and between the Company and James T. McCubbin, dated as of August 13, 2010 (Filed herewith).                             |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith).                             |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith).                             |
| 32   | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Filed herewith). |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

WIDEPOINT CORPORATION

Date: August 16, 2010

/s/ STEVE L. KOMAR  
Steve L. Komar  
President and Chief Executive Officer

Date: August 16, 2010

/s/ JAMES T. MCCUBBIN  
James T. McCubbin  
Vice President – Principal Financial  
and Accounting Officer