HEROES INC
Form 10-Q
June 11, 2001

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________ to ______________

Commission File No. 0-12597

HEROES, INC.
(Exact name of registrant as specified in its charter)

| Nevada | 11-1843262 |
|---|---|
| (State of Incorporation) | (I.R.S. Employer Identification No.) |

1980 Gallows Road, Suite 200, Vienna, Virginia 22182
(Address of principal executive offices)

(703) 761-1900
(Registrant's telephone number, including area code)

3455 Peachtree Road, NE, 5th Floor, Atlanta, GA 30326
(Former name, former address and former fiscal year, if changed since last report)

Check whether the registrant has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY
PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by court. Yes[ ] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS

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State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common Stock, $.001 par value per share, 40,285,760 shares issued and outstanding as of June 11, 2001.

Transitional Small Business Disclosure Format (check one): YES [ ] NO [X]

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PART 1

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HEROES, INC.

BALANCE SHEETS

ASSETS

| | March 31, 2001 (Unaudited) | December 31, 2000 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 150 | $ 70,268 |
| Accounts receivable | 8,859,617 | 8,859,617 |
| Other receivables | 26,596 | 36,145 |
| Employee advances | 4,076 | 5,025 |
| Refundable deposits | 46,572 | 46,572 |
| Prepaid maintenance and training costs | 70,501 | 318,585 |
| Other current assets | 48,222 | 48,222 |
| Total Current Assets | 9,055,735 | 9,384,434 |
| EQUIPMENT, less accumulated depreciation of $11,565 as of December 31, 2001 and $9,465 as of December 31, 2000 | 540,813 | 269,669 |
| OTHER ASSETS: | | |
| Other assets | 100 | 100 |
| Prepaid maintenance and training costs - long-term | -- | 191,997 |
| Total Other Assets | 100 | 192,097 |

| | | |
|---|---|---|
| Total Assets | $9,596,648 | $9,846,200 |
| | ========== | ========== |

(Continued)

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

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HEROES, INC.

BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

| | March 31, 2001 (Unaudited) | December 31, 2000 |
|---|---|---|
| CURRENT LIABILITIES: | | |
| Line of credit | $ 3,240,395 | $ 3,131,190 |
| Accounts payable and accrued expenses | 7,580,167 | 7,025,958 |
| Employee accounts payable | 33,372 | 56,934 |
| Accrued compensation | 431,656 | 185,174 |
| Deferred maintenance and training revenue | -- | 224,000 |
| Total Current Liabilities | 11,285,591 | 10,623,256 |
| DEFERRED MAINTENANCE AND TRAINING REVENUE - LONG-TERM | -- | 191,997 |
| STOCKHOLDERS' EQUITY: | | |
| Common stock 100 million shares authorized, $.001 par value, 39,855,258 shares issued and outstanding at March 31, 2001; 35,840,246 shares issued and outstanding at December 31, 2000 | 39,855 | 35,840 |
| Paid-in capital | 5,907,990 | 4,646,253 |
| Retained earnings (deficit) | (7,636,788) | (5,651,146) |
| Total Stockholders' Equity | (1,688,943) | (969,053) |
| Total Liabilities and Stockholders' Equity | $ 9,596,648 | $ 9,846,200 |
| | ============ | ============ |

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

HEROES, INC.

STATEMENTS OF INCOME
(UNAUDITED)

| | Three Months Ended March 31, 2001 | 2000 |
|---|---|---|
| REVENUES: | | |
| Training revenue | $ -- | $ 56,000 |
| Other income | -- | 1,682 |
| Total Revenues | -- | 57,682 |
| DIRECT COSTS: | | |
| Local school installations and training | 31,208 | 56,750 |
| Other | -- | 2,256 |
| Total Direct Costs | 31,208 | 59,006 |
| GROSS PROFIT (LOSS) | (31,208) | (1,324) |
| EXPENSES: | | |
| Advertising | 62,271 | -- |
| Consulting | 244,500 | -- |
| Depreciation and amortization | 2,100 | 48,320 |
| Interest and other bank fees | 109,206 | -- |
| Insurance | 68,856 | -- |
| Legal and accounting | 113,697 | 69,981 |
| Noncompete agreement | 53,333 | -- |
| Other subcontractors | -- | 14,623 |
| Payroll taxes | 114,218 | 15,260 |
| Rent | 39,961 | 17,410 |

(Continued)

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



HEROES, INC.

STATEMENTS OF INCOME
(UNAUDITED)

| | Three Months Ended March 31, 2001 | 2000 |
|---|---|---|
| Salaries | 742,740 | 217,833 |
| Software license and development | 151,261 | -- |
| Telephone | 45,489 | 25,783 |
| Travel | 75,213 | 7,249 |
| Other expenses | 131,591 | 29,089 |
| Total Expenses | 1,954,434 | 445,548 |
| LOSS BEFORE PROVISION FOR INCOME TAXES | (1,985,642) | (446,872) |
| PROVISION FOR INCOME TAXES | -- | -- |
| NET LOSS | $ (1,985,642) | $ (446,872) |
| NET LOSS PER SHARE: | | |
| Basic | $ (0.05) | $ (0.04) |
| SHARES USED IN COMPUTING NET LOSS PER SHARE: | | |
| Basic | 36,334,419 | 10,543,581 |

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

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HEROES, INC.

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)

| | Common Stock Shares | Amount | Paid-in Capital | R E (D |
|---|---|---|---|---|
| BALANCE at January 1, 2000 | 500 | $ 400 | $ -- | $ |
| Conversion of note payable to Spherus stock | 500 | -- | 250,000 | |
| Shares of Penn-Akron outstanding at merger | 10,542,581 | -- | (800) | |
| Recapitalization for change in | | | | |

| | | | | |
|---|---|---|---|---|
| par value | -- | 10,143 | (10,143) | |
| Shares issued in merger with Spherus Technologies, Inc. | 17,143,581 | 17,144 | 476,952 | |
| Subscription receivable for shares sold | 4,500,000 | 4,500 | 1,995,500 | |
| Payment of subscription receivable | -- | -- | -- | |
| Issuance of common stock for acquisition of Children's Heroes | 1,495,750 | 1,496 | (1,496) | |
| Issuance of common stock to reserve account | 687,500 | 687 | (687) | |
| Issuance of common stock for services | 1,469,834 | 1,470 | 1,936,927 | |
| Net loss for the year ended December 31, 2000 | -- | -- | -- | ( |
| BALANCE at December 31, 2000 | 35,840,246 | 35,840 | 4,646,253 | ( |
| Issuance of common stock to employees for services and expenses | 695,012 | 695 | 159,307 | |
| Capital contributions | -- | -- | 275,750 | |
| Issuance of common stock for private placement memorandum | 3,320,000 | 3,320 | 826,680 | |
| Net loss for the three months ended March 31, 2001 | -- | -- | -- | ( |
| BALANCE at March 31, 2001 | 39,855,258 | 39,855 | 5,907,990 | ( |

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





HEROES, INC.

STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Three Months Ended March 31, 2001 | Three Months Ended March 31, 2000 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |

| | | |
|---|---|---|
| Cash received from contracts | $ -- | $ 999,189 |
| Cash paid to subcontractors, vendors and employees | (902,624) | (1,137,015) |
| Interest received | -- | -- |
| Interest paid | -- | -- |
| Net Cash Used In Operating Activities | (902,624) | (137,826) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Investment in Sanswire.net, LLC | -- | (150,000) |
| Acquisition of equipment | (273,244) | (34,485) |
| Net Cash Used In Investing Activities | (273,244) | (184,485) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Cash received for note payable to stockholder | -- | 250,000 |
| Cash received for common stock | 1,105,750 | 345,800 |
| Net Cash Provided By Financing Activities | 1,105,750 | 595,800 |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (70,118) | 273,489 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 70,268 | 100 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $ 150 | $ 273,589 |

(Continued)

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





HEROES, INC.

STATEMENTS OF CASH FLOWS
(UNAUDITED)

RECONCILIATION OF NET LOSS TO NET CASH
(USED IN) PROVIDED BY OPERATING ACTIVITIES

| | Three Months Ended March 31, 2001 | 2000 |
|---|---|---|
| Net loss | $ (1,985,642) | $ (446,872) |

| | | |
|---|---|---|
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 2,100 | 47,928 |
| Issuance of common stock for services | 160,002 | 5,000 |
| Cash flows resulting from changes in: | | |
| Escrow for OneWeb | -- | 205,000 |
| Accounts receivable | -- | 998,757 |
| Prepaid maintenance costs | 440,081 | 48,735 |
| Other assets | 10,497 | (1,496) |
| Accounts payable | 554,209 | (512,598) |
| Accrued expenses | 332,126 | (426,280) |
| Deferred maintenance and training revenues | (415,997) | (56,000) |
| Net Cash Used In Operating Activities | $ (902,624) | $ (137,826) |

NONCASH INVESTING AND FINANCING TRANSACTIONS

During the three months ended March 31, 2001, the Company issued 695,012 shares of common stock for compensation to certain employees for total expense of $160,002.

During the three months ended March 31, 2000 a $250,000 note payable to a stockholder was converted to 500 shares of Spherus common stock prior to the merger.

During the three months ended March 31, 2000, the Company issued 50,000 shares of common stock for services at $.10 per share.

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





HEROES, INC.

NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. They do not include all information and notes required by accounting principles generally accepted in the United States for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to financial statement included in the financial statements on Form 10-K of Heroes, Inc. for the year ended December 31, 2000. In the opinion of management, all adjustments necessary to fairly present the financial position as of March 31, 2001, and the results of operations, the statements of cash flows, and changes in stockholders' equity for the three months ended March 31, 2001 and 2000 have been made. Results of operations for interim periods are not necessarily indicative of results for the entire year.

The Company prepares its financial statements in accordance with accounting principles generally accepted in the United States. These principles are established primarily by the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants. The preparation of financial statements in conformity with GAAP requires management to make estimates when recording transactions resulting from business operations, based on information currently available. As additional information becomes available (or actual amounts are determinable), the recorded estimates may be revised and reflected in operating results. Although some variability is inherent in these estimates, management believes the amounts provided are adequate.

2. GOING CONCERN

As displayed in the accompanying financial statements, the Company has suffered recurring losses from operations, its current liabilities exceed its current assets, and significant assets and liabilities are subject to significant change in the near term. These matters raise substantial doubts about the ability of the Company to continue in existence as a going concern. Management plans with respect to continuing as a going concern include primarily two areas. First, to devote appropriate resources to obtain a quick and favorable resolution of the matters related to its MRESAnet 2000 Project. Second, to begin substantial operations in the Children's Heroes division, which management believes will provide a profit to the Company. Management recognizes that additional working capital will be required for the Company to be successful in achieving these goals. Accordingly, continuation of the Company as a going concern is dependent upon obtaining additional working capital, either through additional equity funding or loans with appropriate repayment terms.



HEROES, INC.

NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

By letter dated March 1, 2001, the primary investor of the Company has committed to invest an additional $1.2 million over the next 90 days.

3. UNCERTAINTIES

At June 7, 2001, the uncertainties discussed in Note 2 to the December 31, 2000 financial statements had not been resolved.

4. COMMON STOCK

On January 10, 2001, the Company issued a private placement memorandum at an offering price of $.25 per unit. Each unit consists of one share of common stock, and one warrant of the company. The warrants entitle the holders to purchase one share of common stock for each warrant held at an exercise price of $.50 per share until January 15, 2004. As of March 31, 2001, 3,320,000 units have been sold for $830,000.

The Company also issued 800,000 warrants for consulting services which entitles the holders to purchase one share of common stock for each warrant held at exercise prices ranging from $.40 - $.50 per share vesting in 4 - 24 months.

During the three months ended March 31, 2001, 900,000 options to purchase common stock expired due to the resignation of an employee.

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

RESULTS OF OPERATIONS

Our revenues decreased to $0 for the three-month period ending March 31, 2001 from $57,682 for the three-month period ending March 31, 2000. This decrease is due to the fact no invoices for additional work to be performed in Year 2 of our three-year contract with our current customer, the Metropolitan Regional Educational Service Agency ("MRESA"), have been submitted, pending the outcome of an audit of MRESA by Arthur Andersen, LLP, and the determination by both the Federal Communications Commission ("FCC") and the SLD as to whether or not the MRESA project shall continue, and under what terms and conditions.

Our current customer is MRESA, an administrative services agency of the Georgia Department of Education. The MRESA jurisdiction covers over 11 school districts, and nearly 750 schools. Our contract with MRESA was executed in March 1999 and we began performance there under in August 1999. This contract continues for a three-year period. As of December 31, 1999, we had completed Year 1 of the three Years under this contract and installed our services at 192 schools. All invoices and installations for Year 1 were approved by MRESA. We began performance on Year 2 of our contract with MRESA in early May 2000. Lynxus, Inc. ("Lynxus"), our main contractor at that time, was responsible for all performance under the contract, including the procurement and installation of all equipment.

We are currently seeking additional customers for our schools deliverable and products, and believe that we will expand into a number of states and school districts within the next 12-24 months.

In August 2000, Arthur Andersen, LLP, began an audit of the Metropolitan Regional Educational Service Agency ("MRESA"). The MRESA contract is funded by the Schools and Libraries Division ("SLD") of the Universal Service Administrative Company. This is a non-profit entity under the jurisdiction of the Federal Communications Commission ("FCC"). The later administers all "E rate" funds, which was enacted pursuant to the Federal Telecommunications Act of 1996. The program under which the SLD provides funding to MRESA requires a 10% to 50% matching commitment for each school from private, corporate or charitable contributions. The audit is part of an ongoing program integrity process initiated by the SLD to ensure that applicants and vendors (beneficiaries) of the E-rate program comply fully with all FCC and SLD program guidelines, rules and regulations. A number of beneficiaries of the SLD program are audited annually. The determination of which beneficiaries are audited is done both randomly and based on the size of the beneficiary's award. We, as the service provider of the contract, are also being audited as part of this process. As of the date of this report, we have invoiced a total of $3,595,647.60 for services performed under our contract for Year 2 of this program to the SLD, with all invoices being approved by MRESA. As of the date of this report, $3,595,647.60 remains outstanding and unpaid by the SLD. We have also invoiced MRESA $2,600,735.40 for Year 2 matching funds which also remains outstanding as of the date of this report. We anticipate that payment from the SLD for past services performed by us will be forthcoming, subject to the approval by both the FCC and the SLD to continue the MRESA project. This is our first invoice to the SLD for Year 2, and there will be additional invoices for work performed. The total amount of these invoices to the SLD and MRESA for Year 2, as per our agreement, could eventually exceed $12,000,000.

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Our total cost of sales decreased to $31,208 for the three-month period ending March 31, 2001 from $59,006 for the same period in 2000. The $31,208 in costs incurred were for year 1 maintenance and corrective rework carried out on our behalf by Domain Networks.

Our salary expense increased to $742,740 from $217,833, primarily due to the addition of staff in preparation of launching the Children's Heroes electronic fundraising program, pursuant to the acquisition of Children's Heroes in October of 2000. Our Legal & Accounting expense increased to $113,697 from $69,981 primarily due to the ongoing legal proceedings with Lynxus, Inc. Our consulting expense increased to $244,500 from $0 as a result of the engagement of several consultants to assist the company on working towards resolution on the MRESAnet 2000 project. The $109,206 in Interest and Other Bank Fees was primarily accrued interest on the Prinvest line of credit.

LIQUIDITY AND CAPITAL RESOURCES

Our total current assets decreased from $9,384,434 to $9,055,735 primarily due to the write off of $224,000.00 in prepaid maintenance and training costs that was paid to Lynxus, Inc. As a result of their filing for bankruptcy protection, management feels this commitment to provide these services will not be upheld. Our total current liabilities increased to $11,285,591 from $10,623,256 primarily due to a $554,209 increase in our Accounts Payable.

Our total stockholder's equity decreased to ($1,688,943) at March 31, 2001 from ($969,053) at December 31, 2000. This increase was due mainly to a decrease to ($7,636,788) from ($5,651,146) in retained earnings.

We had $150 in cash as of March 31, 2001, and $22,676.63 as of June 1, 2001. Our continuation as a going concern is dependant upon our ability to obtain additional working capital. If adequate financing is not available or is not available on acceptable terms, our ability to meet our capital requirements may be significantly limited and could have a material adverse effect on us and ultimately could impair our ability to continue as a going concern.

PART 2

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS
None.
(b) REPORTS ON FORM 8-K
None.

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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 hereunto duly authorized.

Heroes, Inc.

/s/ Amer A. Mardam-Bey
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By: Amer A. Mardam-Bey
(President & CEO)

Date: June 8, 2001