K2 DIGITAL INC
Form 10QSB
August 20, 2001

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U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

(MARK ONE)

/X/ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001

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

COMMISSION FILE NO. 1-11873

K2 DIGITAL, INC.
(EXACT NAME OF SMALL BUSINESS ISSUER AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)

13-3886065
(I.R.S. EMPLOYER IDENTIFICATION NUMBER)

30 BROAD STREET, 16TH FLOOR
NEW YORK, NEW YORK 10004
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(212) 301-8800
(ISSUER'S TELEPHONE NUMBER, INCLUDING AREA CODE)

Check whether the issuer: (1) filed all reports required by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes /X/ No / /

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

CLASS	OUTSTANDING AT JULY 31, 2001
Common stock, par value $.01 per share..................	4,705,348

Transitional Small Business Disclosure Format (check one):

Yes / / No /X/

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K2 DIGITAL, INC. AND SUBSIDIARY

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PART I
FINANCIAL INFORMATION

ITEM 1. Financial Statements.

K2 DIGITAL, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
JUNE 30, 2001
(UNAUDITED)

ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 164,622
Accounts receivable, net of allowance for doubtful accounts of $50,000	283,482
Unbilled revenue	121,856
Prepaid expenses and other current assets	147,472
Investment in securities available for sale	34,100
Total current assets	751,532
FIXED ASSETS, net	430,196
RESTRICTED CASH	250,000
OTHER ASSETS	1,250
Total assets	$ 1,432,978

LIABILITIES & STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:	
Current portion of capital lease obligations	$ 23,575
Notes payable	250,000
Accounts payable	512,163
Accrued compensation and payroll taxes	128,234
Accrued expenses	189,451
Deferred revenue and customer advances	185,403
Current portion of deferred rent credit	34,698
Total current liabilities	1,323,524
LONG-TERM CAPITAL LEASE OBLIGATIONS	3,326
LONG-TERM DEFERRED RENT CREDIT	198,069
Total liabilities	1,524,919
STOCKHOLDERS' EQUITY:	
Preferred Stock, $0.01 par value, 1,000,000 shares authorized; 0 shares issued and outstanding	--
Common Stock, $0.01 par value, 25,000,000 shares authorized; 5,122,765 shares issued and 4,705,348 shares outstanding	51,228
Treasury stock, 417,417 shares at cost	(819,296)
Additional paid-in capital	8,288,184
Accumulated other comprehensive loss	(1,403,947)
Deferred compensation	(197,353)
Accumulated deficit	(6,010,757)
Total stockholders' equity	(91,941)
Total liabilities & stockholders' equity	$ 1,432,978

The accompanying notes are an integral part of these Consolidated Financial Statements.

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K2 DIGITAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS JUNE 30
	2001	2000	2001
	UNAUDITED	UNAUDITED	UNAUDITED
Gross revenues	$ 890,669	$ 1,641,896	$ 1,720,686
Less: pass-through costs	72,183	(993,560)	108,091
Net revenues	962,852	648,336	1,828,777
Direct salaries and costs	763,940	768,011	1,769,132
Selling, general and administrative expenses	1,007,755	768,458	2,083,719

Write off of deferred issuance and transaction costs	503,367	--	1,087,819
Assets impairment	222,748	--	222,748
Depreciation	93,904	86,075	184,370
Loss from operations before interest and other income, net and income taxes	$(1,628,862)	$ (974,208)	$(3,519,011)
Interest and other income, net	7,430	39,504	19,900
Provision for income taxes	(25,827)	6,750	(25,827)
Net income (loss)	$(1,595,605)	$ (941,454)	$(3,473,284)
Net Income (loss) per share --			
Basic and Diluted	$ (0.38)	$ (0.28)	$ (0.88)
Weighted average common shares outstanding - basic and diluted	4,235,299	3,361,779	3,959,859

The accompanying notes are an integral part of these Consolidated Financial Statements.

K2 DIGITAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

	SIX MONTHS ENDED JUNE 30, 2001 UNAUDITED	2000 UNAUDITED
CASH FROM OPERATING ACTIVITIES:		
Net Loss	$(3,473,284)	$(1,236,687)
Adjustments to reconcile net loss to net cash used In operating activities --		
Non-cash compensation expense	125,000	200,359
Write-off of deferred issuance and transaction costs	757,861	--
Assets impairment	222,748	--
Depreciation	184,370	165,492
Changes in --		
Accounts receivable, net	1,386,666	108,019
Prepaid expenses and other current assets	(33,404)	(56,544)
Unbilled revenue	360,917	39,690
Other assets	--	2,882
Accounts payable	(265,698)	252,720
Accrued compensation and payroll taxes	(66,412)	56,149
Other accrued expenses	(349,973)	283,241
Deferred revenue	(116,289)	--

Deferred rent	124,817	--
Net cash used in operating activities	$(1,142,681)	$ (184,679)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Gross proceeds from sale of investment securities	94,127	--
Purchase of equipment	(8,074)	(218,125)
Software development costs	--	(180,011)
Net cash used in investing activities	86,053	(398,136)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on capital lease obligations	(14,356)	(14,356)
Increase in Short Term Debt	250,000	
Equity Issuance	250,000	
Options exercised for cash	--	22,500
Net cash (used in) provided by financing activities	485,644	8,144
Net decrease in cash and cash equivalents	(570,984)	(574,671)
CASH AND CASH EQUIVALENTS, beginning of period	$ 735,606	$ 2,936,918
CASH AND CASH EQUIVALENTS, end of period	$ 164,622	$ 2,362,247
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for --		
Interest	$ 2,060	$ 1,690
Income taxes	--	$ 3,820

The accompanying notes are an integral part of these Consolidated Financial Statements.

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K2 DIGITAL, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. ORGANIZATION AND BUSINESS

K2 Digital, Inc., a Delaware corporation ("K2" or the "Company"), is a strategic digital services company, providing consulting and development services including analysis, planning, systems design, creative and implementation.

2. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company and reflect all adjustments, consisting only of normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of the financial position as of June 30, 2001 and the financial results for the three and six months ended June 30, 2001 and 2000, in accordance with generally accepted accounting principles for interim financial statements and pursuant to Form 10-QSB and Regulation S-B. Certain information and footnote disclosures normally included in the Company's annual audited consolidated financial statements have been condensed or omitted pursuant to such rules and regulations.

The results of operations for the three and six months ended June 30, 2001 and June 30, 2000, respectively, are not necessarily indicative of the results of operations to be expected for a full fiscal year. These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the fiscal year ended December 31, 2000, which are included in the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenues and expenses during the reporting periods. Actual results may differ from those estimates.

3. GOING CONCERN

The Company has incurred negative cash flows from operations and sustained net losses. Accordingly, the Company is dependent on obtaining financing to fund its operations. Management's plans include obtaining additional equity financing. This financing will be used to fund the operations of the Company. There is no assurance that such financing will be obtained and that, if additional financing is obtained, management's plans will be sufficient to sustain the Company as a going concern. The Company's independent public accountants have added an explanatory paragraph to their audit opinion issued in connection with the 2000 financial statements which states that the Company's losses since inception and dependence on outside financing raise substantial doubt about its ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

4. NET INCOME (LOSS) PER SHARE OF COMMON STOCK

SFAS 128, "Earnings per Share," establishes standards for computing and presenting earnings per share ("EPS"). The standard requires the presentation of basic EPS and diluted EPS. Basic EPS is calculated by dividing income available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted EPS is calculated by dividing income available to common stockholders by the weighted average number of shares of common stock outstanding adjusted to reflect potentially dilutive securities.

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In accordance with SFAS 128, the following table reconciles net loss and share amounts used to calculate basic and diluted loss per share:

	THREE MONTHS ENDED JUNE 30,		SIX MONTH JUNE
	2001	2000	2001
	UNAUDITED	UNAUDITED	UNAUDITED
Numerator: Net Loss	($1,595,605)	($ 941,454)	($3,473,284)
Denominator: Weighted average number of common shares outstanding - Basic and Diluted	4,235,299	3,361,779	3,959,849
Net loss per share --			

Basic and Diluted	($0.38)	($0.28)	($0.88)

* Excludes all outstanding stock options and warrants as of June 30, 2001 and 2000, as they are antidilutive.

5. INVESTMENT IN SECURITIES

As of June 30, 2001, the Company held 110,000 shares of common stock of 24/7 Media Inc. These shares have been classified as "investments in securities available for sale" as a result of the Company's ability and intent to sell such shares in the near future. In accordance with SFAS No. 115, the shares are stated at fair market value on the Company's June 30, 2001 consolidated balance sheet. The unrealized holding loss is reflected as "other comprehensive loss" in the stockholders' equity section of the balance sheet.

The following disclosures are presented in accordance with SFAS No. 115:

Equity Securities:

Aggregate fair market value............	$ 34,100
Gross unrealized holding loss..........	$ (1,403,947)

The Company did not sell any shares of capital stock of 24/7 Media Inc. during the quarter ended June 30, 2001.

6. FUSION CAPITAL AGREEMENT

On December 11, 2000, the Company entered into a common stock purchase agreement (the "Fusion Facility") with Fusion Capital Fund II, LLC ("Fusion Capital"). In May 2001, the Company issued 862,069 shares of common stock under the Fusion Facility in exchange for net proceeds of $250,000. Under the Company's current financial circumstances, it does not anticipate that it will be able to make any further issuances under the facility.

7. ASSETS IMPAIRMENT AND OTHER CHARGES

During the second quarter of 2001 the Company recorded assets impairment of $222,748. Such impairment was required to write off the remaining net book values of certain internal developed software, as management determined that no economic benefit of such software is feasible.

In addition, the Company recorded a charge of approximately $500,000 in order to write off stock issuance costs related to the Fusion Facility. Such charge was required as management determined that it would not be feasible to use such facility.

In the first quarter of 2001 the Company recorded a charge of $584,452 in order to write off proposed transaction costs due to termination of such proposed transaction.

8. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations ("FAS 141") and

No. 142, Goodwill and Other Intangible Assets ("FAS 142"). FAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under FAS 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually (or more frequently if impairment indicators arise) for impairment. Separable intangible assets that are not deemed to have indefinite lives will continue to be amortized over their useful lives (but with no maximum life). The amortization provisions of FAS 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill and intangible assets acquired prior to July 1, 2001, the Company is required to adopt FAS 142 effective January 1, 2002. The Company believes that the provisions of FAS 141 and FAS 142 will have a material effect on its results of operations and financial position.

9. SUBSEQUENT EVENTS

On May 15, 2001, the Company entered into a non-binding letter of intent with SGI Graphics LLC, a Delaware limited liability company ("SGI"), pursuant to which SGI plans, subject to certain conditions, to purchase approximately 6,526,449 shares of restricted common stock of K2, representing fifty-one percent (51%) of the issued and outstanding capital stock of K2 on a fully diluted basis (after giving effect to all outstanding warrants and to options having an exercise price less than $1.75), for a total purchase price of $2,000,000. Under the terms of the letter of intent, SGI would also receive warrants to purchase an additional 717,903 shares of K2 common stock. Concurrently with the execution of the letter of intent, K2 borrowed $250,000 from K2 Holdings LLC, a Delaware limited liability company and an affiliate of SGI, for working capital purposes pursuant to a short term promissory note secured by all of the assets of K2 (the "Bridge Loan"). The loan proceeds are to be credited toward the purchase price to be paid by SGI in the equity investment, if such investment is consummated. In connection with the Bridge Loan, on May 15, 2001, K2 also received an additional $250,000 equity investment through its equity facility established last year with Fusion Capital Fund II, LLC.

The consummation of the $2 million equity investment by SGI is subject to certain conditions, including the implementation of a pre-approved cost-reduction program by K2, a fairness opinion from the Company's financial advisors, the approval of the transaction by the shareholders of K2 and the execution of mutually satisfactory final documentation.

As of the date of filing of this Report, SGI and the Company have been unable to reach agreement on the terms of the equity investment, and, although neither party has terminated the letter of intent, management believes the prospects for reaching a definitive agreement that would result in the consummation of the equity investment are poor. On July 9, 2001, the Company received a notice from SGI and K2 Holdings LLC demanding repayment in full of the Bridge Loan on or before October 7, 2001 pursuant to the terms and conditions of the demand promissory note evidencing the Bridge Loan.

On March 13, 2001, the Staff of the Nasdaq Stock Market notified K2 that it had failed to demonstrate a closing bid price of at least $1.00 per share for 30 consecutive trading days and was in violation of Nasdaq Marketplace Rule 4310(c)(4). In accordance with applicable Nasdaq Marketplace rules, K2 was provided a 90-day grace period, through June 11, 2001, during which to regain compliance. On June 20, 2001, K2 requested a hearing, which effectively stayed the delisting. However, after submission of materials in support of K2's position to the Panel, the Panel decided to delist K2's common stock from the Nasdaq SmallCap Market as of the open of business on August 15, 2001.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following presentation of management's discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Company's (unaudited) Consolidated Financial Statements, the accompanying notes thereto and other financial information appearing elsewhere in this Report. This section and other parts of this Report contain forward-looking statements that involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in the forward-looking statements. Readers are encouraged to review "Factors Affecting Operating Results and Market Price of Stock" commencing on page 10 of the Company's 2000 Annual Report on Form 10-KSB for a discussion of certain of these risks and uncertainties.

RESULTS OF OPERATIONS

General

The Company works with clients to develop strategies for using new and emerging technologies to help the clients build one-to-one relationships with their customers, employees and vendors. Through the strategic and technical expertise, media knowledge, and creative talent of the Company's team of employees, the Company assists its clients in achieving a favorable return-on-investment from digital channels of e-commerce, information, customer support, advertising and entertainment. These channels include Web sites, transmission of broadband content, intranets, extranets, online media, and wireless appliances.

The Company currently provides its clients with a range of services, including: qualitative and quantitative research, usability labs to test graphical user interfaces, navigation, functionality and systems, positioning studies for online branding, strategic planning, e-commerce planning, business process reengineering, online media planning and buying, proprietary media partnerships, marketing strategies, Web design, creative services for online advertising (e.g., banners, rich media, interstitials), technical strategies, requirements specifications and programming.

Revenues are recognized on a percentage of completion basis. Provisions for any estimated losses on uncompleted projects are made in the period in which such losses are determinable. Most of the Company's revenues have been generated on a fixed fee or cap fee basis. The Company also provides ongoing services to certain customers.

While the Company considers the presentation of gross revenues to be appropriate, as a result of the Company assuming the economic risk related to reimbursable expenses, such as pass-through media costs, the Company has elected to present net revenues in its statement of operations, because they are representative of the Company's fee-based strategic and process consulting and development services, which are at the core of the current business model. Net revenues represent gross revenues, less reimbursable expenses, such as media pass-through costs. The Company's operating results discussed herein are not necessarily representative of future periods.

	THREE MONTHS ENDED JUNE 30, 2001 UNAUDITED	THREE MONTHS ENDED JUNE 30, 2000 UNAUDITED	SIX MONTHS JUNE 30 2001 UNAUDITED
Net revenues	100.0%	100.0%	100.0%
Direct salaries and costs	79.3%	118.5%	96.7%
Selling, general and administrative expenses	104.7%	118.5%	113.9%
Write-off of deferred issuance and transaction costs	52.3%	--	59.5%
Assets impairment	23.1%	--	12.2%
Depreciation	9.8%	13.3%	10.1%
Loss from operations before interest and other income, net and income taxes	(169.2%)	(150.3%)	(192.4%)
Interest and other income, net	(0.8%)	6.1%	1.1%
Provision for income taxes	(2.7%)	1.0%	(1.4%)
Net loss	(165.7%)	(145.2%)	(189.9%)

Revenues

Net revenues consist of gross revenues less pass-through expenses such as media placement costs. Net revenues for the three months ended June 30, 2001 increased by 48.5% compared to the same quarter in 2000. In the 2001 second quarter, net revenues were approximately $962,900 compared to $648,300 in the 2000 second quarter, or an increase of approximately $314,600. However, this increase in revenues was achieved despite the general economic slowdown that significantly reduced expenditures for IT and Internet professional services and delayed implementation of certain projects already underway. Furthermore, the second quarter 2000 was itself a weak quarter. Net revenues for the six months ended June 30, 2001 decreased by 14.4% compared to the same period in 2000. Net revenues for the six months ended June 30, 2001 were approximately $1,828,800 compared to approximately $2,137,200 for the six months ended June 30, 3000, or a decrease of approximately $308,400. During the three months ended June 30, 2001, the three largest net revenue-producing clients accounted for approximately 26%, 25% and 12%, respectively. During the six months ended June 30, 2001, the three largest net revenue-producing clients accounted for approximately 36%, 22% and 8%, respectively of the Company's net revenues. Accordingly, although the Company has increased its efforts to maintain and enhance client relationships, loss of major clients without comparable replacements could cause quarterly results to fluctuate and could have a material adverse effect on the Company's financial condition. See "Fluctuations in Quarterly Operating Results."

Direct Salaries and Costs

Direct salaries and costs include all direct labor costs and other direct costs related to project performance, such as independent contractors, supplies, and printing and equipment costs, less any reimbursed expenses. As a percentage of net revenues, direct salaries and costs decreased for the three months ended June 30, 2001 as compared to the same period in 2000. This was primarily due to increases in net revenues, as the actual direct costs were essentially unchanged. Direct salaries and costs decreased by approximately $4,100 to approximately $763,900 for the 2001 second quarter from approximately $768,000 for the 2000 second quarter. In the 2001 second quarter, direct salaries were the primary costs, as amounts paid to independent contractors was nil. In the 2000 second quarter, direct salaries and costs consisted primarily of approximately $655,000 paid as direct salary costs and approximately $46,000 paid as independent contractor costs. Gross profit, which is net revenues less direct salaries and costs, totaled $198,900 for the 2001 second quarter as compared to ($119,700) for the 2000 second quarter, resulting in a gross margin of 20.7% and (18.5%), respectively. The improved gross profit for the 2001 second quarter was due primarily to the increased net revenues recognized during the 2001 second quarter, compared to the second quarter 2000. Gross profit totaled approximately $59,600 for the first six months of 2001 compared to approximately $484,100 for the first six months of 2000, representing a gross profit margin of 3.3% and 22.7% respectively. The decline in gross profit margin was the result of increases in direct costs and decreased net revenues for 2001.

For the six months ended June 30, 2001 direct salaries and costs were approximately $1,769,100 compared to approximately

$1,653,100 for the six months ended June 30, 2000, and increase of 7.0%. The increase in costs were primarily related to direct labor costs incurred during the first quarter of 2001, as the second quarter costs were essentially unchanged from the prior year.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the three months ended June 30, 2001 and 2000 were approximately $1,007,800 and $768,500, respectively, and consisted primarily of labor costs, professional fees, occupancy costs, recruitment costs and communications costs. Selling, general and administrative expenses for the six months ended June 30, 2001 and 2000 were approximately $2,083,700 and $1,625,600, respectively. In the 2001 second quarter and first six months, the changes in selling, general and administrative costs were primarily due to increased occupancy costs, legal and professional expenses related to merger and acquisition activity and Fusion Capital, more fully explained under the heading "Subsequent Events" in note 9 to the consolidated financial statements.

Depreciation and Amortization

Depreciation and Amortization expense was approximately $93,900 and $86,100 for the three months ended June 30, 2001 and 2000, respectively. Depreciation and Amortization expense was approximately $184,400 and $165,500 for the six months ended June 30, 2001 and 2000, respectively, and related to depreciation of equipment, furniture and fixtures, and leasehold improvements. The Company's depreciation expenses in 2001 have increased as a result of purchases of additional computer and office equipment and the amortization of certain capitalized software development costs.

Operating Loss

The operating loss for the three months ended June 30, 2001 was approximately ($1,628,900) as compared to an operating loss of approximately ($974,200) for the three months ended June 30, 2000. Contributing to the operating loss for the three months ended June 30, 2001 were increases in direct labor and selling, general and administrative costs and expenses related to merger and acquisition activities as discussed above. The operating loss for the three months ended June 30, 2001 represented an increase of approximately $654,700 or 67.2% compared to the operating loss for the three months ended June 30, 2000. Included in these costs were the write-off of certain transaction costs and asset impairment costs. The operating loss for the six months ended June 30, 2001 was approximately ($3,519,000) as compared to an operating loss of approximately ($1,307,000) for the six months ended June 30, 2000. The first quarter ending March 31, 2001 included the write-off of certain deferred transaction costs totaling approximately $584,500.

Income Taxes

For the three months ended June 30, 2001, the Company had a loss before provision for income taxes of approximately ($1,621,400). Due to the operating loss discussed above, there were no provisions for income taxes in the second quarter of 2001. The provision for income taxes for the three months ended June 30, 2000 related to minimum statutory taxes and tax refunds due.

Net Loss

Net loss for the three months ended June 30, 2001 was approximately ($1,595,600) as compared to net loss of approximately ($941,500) for the three months ended June 30, 2000. Net loss for the six months ended June 30, 2001 was approximately ($3,473,300) as compared to net loss of approximately ($1,236,700) for the six months ended June 30, 2000.

Fluctuations in Quarterly Operating Results

Quarterly revenues and operating results have fluctuated and will fluctuate as a result of a variety of factors. These factors, some of which may be managed by the Company and some of which are beyond the Company's control, include the timing of the completion, material reduction, postponement or cancellation of major projects, the loss of a major customer or the termination of a relationship with a channel source, the timing of the receipt of new business, the timing of the hiring or loss of personnel, changes in the pricing strategies and business focus of the Company or its competitors, capital expenditures, operating expenses and other costs relating to the expansion of operations, general economic conditions and acceptance and use of the Internet.

Liquidity and Capital Resources

The Company's cash balance of $164,622 at June 30, 2001, decreased by $570,984 or 78% compared to the $735,606 cash balance at December 31, 2000. This decrease is primarily due to lower than anticipated revenues for the period, while operating expenses were not similarly reduced.

The Company is dependent on its current cash and investment securities, together with cash generated by operations, for working capital in order to be competitive, to meet the increasing demands of service, quality and pricing and for the expansion of its business. The Company's current cash position, even when combined with cash expected to be generated by operations, will not be sufficient to finance its continued operations unless the Company is immediately able to obtain additional financing. Unless the Company is successful in negotiating and consummating a financing within the next few weeks, a liquidation or bankruptcy filing is almost certain to occur. At this time, the Company's liabilities exceed its assets, such that it is highly unlikely that shareholders will receive any value in a liquidation, and any financing is likely to be so highly dilutive as to effectively eliminate current shareholder value. Although the Company is in advanced negotiations with respect to additional financing to satisfy its critical and immediate need for working capital, such financing may not ultimately be available or may be prohibitively expensive or may not be obtained in time to meet the Company's immediate and critical need for cash.

The Company's independent public accountants have added an explanatory paragraph to their audit opinion issued in connection with the 2000 financial statements which states that the Company's dependence on outside financing and losses since inception raise substantial doubt about its ability to continue as a going concern. The Company's independent public accountants also advised the Company that if there will be no change in the circumstances their opinion to be issued in connection with the 2001 financial statements of the Company will include an explanatory paragraph addressing the going concern uncertainty as well.

Recent Technical Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations ("FAS 141") and No. 142, Goodwill and Other Intangible Assets ("FAS 142"). FAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under FAS 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually (or more frequently if impairment indicators arise) for impairment. Separable intangible assets that are not deemed to have indefinite lives will continue to be amortized over their useful lives (but with no maximum life). The amortization provisions of FAS 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill and intangible assets acquired prior to July 1, 2001, the Company is required to adopt FAS 142 effective January 1, 2002. The Company believesthat the provisions of FAS 141 and FAS 142 will have a material effect on its results of operations and financial position.

PART II
OTHER INFORMATION

ITEM 2. Changes in Securities and Use of Proceeds.

On May 15, 2001, the Company issued 862,069 shares of common stock under the Fusion Facility in exchange for net proceeds of $250,000. The proceeds of this issuance were used for general working capital purposes.

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

(a) Exhibits:

3.1	Certificate of Incorporation of the Company*
3.1(a)	Amendment to Certificate of Incorporation of the Company*
3.1(b)	Amendment to Certificate of Incorporation of the Company**
3.2	By-laws of the Company*
3.2(b)	Amendment to By-laws of the Company*
4.1	Common Stock Certificate*
4.2	Warrant Certificate*
4.4	Warrant Agreement by and between Continental Stock Transfer & Trust Company and the Company*

4.5 Voting Agreement among Messrs. Centner, de Ganon, Cleek and Szollose*

* Incorporated by reference from the Registrant's Registration Statement on Form SB-2, No. 333-4319.

** Incorporated by reference from the Registrant's Form 10-KSB for its fiscal year ended 12/31/00

(b) Reports on Form 8-K:

None.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

K2 DIGITAL, INC.

Date: August 20, 2001

By: /s/ LYNN FANTOM

Lynn Fantom
Chief Executive Officer and
President

By: /s/ GARY BROWN

Gary Brown
Chief Operating Officer
(Principal Financial and
Accounting Officer)

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