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USA TECHNOLOGIES INC
Form 8-K
July 29, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 8-K

Current Report Pursuant to Section 13 or 15(d) of
the Securities Act of 1934

Date of report (Date of earliest event reported): May 14, 2002

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

Pennsylvania (State or other jurisdiction of incorporation)	33-70992 (Commission File Number)	23-269963 (I.R.S. Employer Identification No.)
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200 Plant Avenue Wayne, Pennsylvania (Address of principal executive offices)	19087 (Zip Code)
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Registrant's telephone number, including area code: (610) 989-0340

Item 2. Acquisition of Stitch Networks Corporation

As previously reported, on May 14, 2002, USA Acquisition Corp., a wholly-owned subsidiary of USA Technologies, Inc. (the Company or Registrant), merged with and into Stitch Networks Corporation (Stitch) pursuant to an Agreement and Plan of Merger by and among the Company, USA Acquisition Corp., Stitch, and the stockholders of Stitch dated April 10, 2002. At the close of the transaction, Stitch became a wholly-owned subsidiary of the Company. The stockholders of Stitch were David H. Goodman, Pennsylvania Early Stage Partners, L.P., and Maytag Holdings, Inc. Stitch, located in Kennett Square Pennsylvania, is a provider of wireless remote monitoring, and cashless and mobile commerce

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solutions.

All of the outstanding shares of stock of Stitch were converted into the right to receive an aggregate of 22,762,341 shares of Common Stock of the Company and warrants to purchase up to 7,587,447 shares of Common Stock at \$.40 per share at any time through June 30, 2002. None of these warrants were exercised and these warrants have expired. Additionally, the Company assumed outstanding Stitch stock options which were converted into options to purchase an aggregate of 2,475,318 shares of Common Stock at \$.165 per share at any time prior to May 14, 2007 and warrants identical to those issued to the stockholders to purchase up to 412,553 shares of Common Stock. A total of 4,800,000 of the shares of Common Stock issued to the former stockholders of Stitch are being held in escrow in order to secure the former stockholders' indemnification obligations under the Agreement and Plan of Merger and are subject to cancellation.

Item 7. Financial Statements and Exhibits:

(a) Financial Statements of business acquired (Stitch Networks Corporation):

(1) Report of Independent Auditors.

Balance Sheets as of December 31, 2001 and 2000.

Statements of Operations for the years ended December 31, 2001 and 2000.

Statements of Stockholders' Equity for the years ended December 31, 2001 and 2000.

Statements of Cash Flows for the years ended December 31, 2001 and 2000.

Notes to Financial Statements.

(2) Unaudited Financial Statements:

Balance Sheets as of March 31, 2002 and 2001 (Unaudited).

Statements of Operations for the three months ended March 31, 2002 and 2001 (Unaudited).

Statements of Stockholders' Equity (Deficit) for the three months ended March 31, 2002 (Unaudited).

Statements of Cash Flows for the three months ended March 31, 2002 and 2001 (Unaudited).

Selected Notes to Financial Statements (Unaudited).

(b) Pro Forma Financial Information (Unaudited):

Pro Forma Consolidated Balance Sheet as of March 31, 2002 (Unaudited).

Pro Forma Consolidated Statement of Operations for the year ended June 30, 2001 (Unaudited).

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Pro Forma Consolidated Statement of Operations for the nine months ended March 31, 2002 (Unaudited).

Pro Forma Notes to Consolidated Financial Statements (Unaudited)

(c) Exhibits

- 2.1 Agreement and Plan of Merger dated April 10, 2002 by and among USA Technologies, Inc., USA Acquisition, Inc., Stitch Networks Corporation, David H. Goodman, PA Early Stage Partners, L.P., and Maytag Holdings, Inc. (Incorporated by reference to Exhibit 2.1 to the Company's Form 10-QSB for the quarter ended March 31, 2002).

Report of Independent Auditors

The Board of Directors
Stitch Networks Corporation

We have audited the accompanying balance sheets of Stitch Networks Corporation (formerly e-Vend.net Corporation) as of December 31, 2001 and 2000, and the related statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Stitch Networks Corporation at December 31, 2001 and 2000, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming Stitch Networks Corporation will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has never been profitable, continues to incur losses from operations, and anticipates that it will require additional debt or equity financing which may not be readily available. These matters raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that might result from the outcome of this uncertainty.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania

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June 28, 2002,
 except for paragraph 3 of Note 11,
 as to which the date is July 26, 2002

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Stitch Networks Corporation

Balance Sheets

	December 2001	
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,436,308	\$
Accounts receivable, net of allowance for doubtful accounts of \$3,600 at December 31, 2001 and 2000	132,160	
Inventory	235,000	
Other	88,604	
Total current assets	2,892,072	
Property and equipment, net	1,626,212	
Other assets	32,638	
Total assets	\$ 4,550,922	\$
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 724,117	\$
Accrued expenses	218,773	
Due to related party, net	5,888	
Current portion of long-term debt	2,386,506	
Total current liabilities	3,335,284	
Long-term debt, net of current portion	424,331	
Stockholders' equity:		
Series A convertible preferred stock, \$.01 par value; 3,114,637 shares authorized, issued and outstanding; liquidation value of \$2,383,476 at December 31, 2001	31,146	
Series B convertible preferred stock, \$.01 par value; 5,276,895 shares authorized, issued and outstanding; liquidation value of \$11,483,885 at December 31, 2001	52,769	
Common stock, \$.01 par value; 17,000,000 shares authorized at December 31, 2001 and 16,000,000 shares authorized at		

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December 31, 2000; 6,000,000 shares issued and outstanding	60,000	
Additional paid-in capital	14,619,244	
Accumulated deficit	(13,971,852)	

Total stockholders' equity	791,307	

Total liabilities and stockholders' equity	\$ 4,550,922	\$ -----
	=====	

See accompanying notes.

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Stitch Networks Corporation

Statements of Operations

		Year ended December 2001

Revenue	\$	1,003,241
		\$
Operating expenses:		
Cost of revenue		1,149,620
Compensation		3,085,946
General and administrative		730,811
Research and development		746,814
Sales and marketing		442,447
Depreciation and amortization		779,285

Total operating expenses		6,934,923

		(5,931,682)
Other income (expense):		
Interest income		191,703
Interest expense		(197,314)
Other, net		(5,328)

		(10,939)

Net loss	\$	(5,942,621)
		\$ -----
		=====

See accompanying notes.

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Stitch Networks Corporation
 Statements of Stockholders' Equity
 Years ended December 31, 2001 and 2000

	Preferred Stock						Addi Pai Cap
	Series A Convertible		Series B Convertible		Common Stock		
	Shares	Amount	Shares	Amount	Shares	Amount	
Balance, December 31, 1999	3,114,637	\$31,146	5,276,895	\$52,769	6,000,000	\$60,000	\$14,6
Compensation expense relating to options issued to nonemployees	-	-	-	-	-	-	-
Net loss	-	-	-	-	-	-	-
Balance, December 31, 2000	3,114,637	31,146	5,276,895	52,769	6,000,000	60,000	14,6
Compensation expense relating to options issued to nonemployees	-	-	-	-	-	-	-
Net loss	-	-	-	-	-	-	-
Balance, December 31, 2001	3,114,637	\$31,146	5,276,895	\$52,769	6,000,000	\$60,000	\$14,6

See accompanying notes.

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Stitch Networks Corporation
 Statements of Cash Flows

Year ended Dec
 2001

Cash flows from operating activities

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Net loss	\$	(5,942,621)	\$
Adjustments to reconcile net loss to cash used in operating activities:			
Depreciation and amortization		779,285	
Non-cash stock compensation expense		7,259	
Loss on disposal of property and equipment		127,859	
Changes in operating assets and liabilities:			
Accounts receivable		(121,673)	
Inventory		(185,468)	
Other current assets		43,319	
Accounts payable		541,339	
Accrued expenses		95,722	
Due to related party, net		(2,987)	
Other assets		(23,611)	

Net cash used in operating activities		(4,681,577)	
Cash flows from investing activities			
Purchase of property and equipment		(547,262)	

Net cash used in investing activities		(547,262)	
Cash flows from financing activities			
Borrowings of long-term debt		706,322	
Repayments of long-term debt		(120,572)	

Net cash provided by financing activities		585,750	

Net decrease in cash and cash equivalents		(4,643,089)	
Cash and cash equivalents at beginning of year		7,079,397	

Cash and cash equivalents at end of year	\$	2,436,308	\$
		=====	
Supplemental disclosures of cash flow information:			
Interest paid	\$	205,727	\$
		=====	

See accompanying notes.

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Stitch Networks Corporation

Notes to Financial Statements

December 31, 2001 and 2000

1. Description of Business

Stitch Networks Corporation (the Company), a Delaware corporation, was incorporated in February 1996 as Goodvest Corporation and, in March 1999, changed its name to e-Vend.net Corporation. In June 2001 the Company changed its name to Stitch Networks Corporation. The Company designs and employs embedded

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connectivity solutions that enable network servers to monitor and control vending machines and appliances over the internet. The Company's customers are principally located in the United States.

On December 31, 2000, the Company executed a Vending Placement, Supply and Distribution Agreement (the Agreement) with Eastman Kodak Company, Maytag Corporation and Dixie Narco, Inc., which formed a strategic alliance to market and execute a national vending program for the sale of one-time use camera and film products. The Agreement provides for an initial term of three years ending December 31, 2003, with additional provisions for early termination and extensions as defined. Furthermore, the Agreement also provides for exclusivity among the parties for the term of the Agreement relating to the sale of camera and film products from vending machines within the Continental United States. This agreement represented the majority of the Company's operations in 2001.

2. Summary of Significant Accounting Policies

Basis of Financial Statement Presentation

The financial statements of the Company have been prepared assuming the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction on liabilities in the normal course of business. Accordingly, the financial statements do not include any adjustments to recorded asset values that might be necessary should the Company be unable to continue in existence. The Company has never been profitable, has incurred net losses of \$5.9 million and \$4.1 million during the years ending December 31, 2001 and 2000, respectively, and cumulative losses from its inception through December 31, 2001 amounting to approximately \$14.0 million. Losses have continued through June 2002 and are expected to continue throughout 2002. The Company's ability to meet its future obligations is dependent upon the success of its products in the marketplace and its ability to raise capital, which may not be readily available, until the Company's products can generate sufficient operating revenues.

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2. Summary of Significant Accounting Policies (continued)

These factors raise substantial doubt about the Company's ability to continue as a going concern. Management believes that actions presently being taken will allow for the Company to continue as a going concern. Such actions include the generation of revenues from operations, a restructuring of the Company's cost structure which includes reductions in personnel and facility costs and additional financing activities.

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents includes all highly liquid investments purchased with

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an original maturity of three months or less.

Inventory

Inventory, which principally consists of finished goods, components, and packaging materials, is stated at the lower of cost (first in, first out basis) or market. The Company maintains a valuation reserve, which reflects the Company's estimate of the impact on inventory of potential obsolescence, excess quantities, and declines in market values. Such reserves approximated \$459,000 and \$0 at December 31, 2001 and 2000, respectively.

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2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are recorded at cost and are depreciated using the straight-line method over the estimated useful lives. Leasehold improvements are recorded at cost and are amortized on a straight-line basis over the shorter of the estimated useful life of the asset or the related lease term. The estimated useful lives are as follows:

Vending machines and related components	3 to 7 years
Computers and purchased software	3 years
Equipment and furniture	5 to 7 years
Leasehold improvements	3 years

Long-Lived Assets

In accordance with SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, the Company periodically evaluates the carrying value of long-lived assets when events and circumstances warrant such review. The carrying value of a long-lived asset is considered impaired when the anticipated undiscounted cash flow from such asset is separately identifiable and is less than the carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair market value of the long-lived asset. Fair market value is determined by using the anticipated cash flows discounted at a rate commensurate with the risk involved. Measurement of the impairment, if any, will be based upon the difference between carrying value and the fair value of the asset.

Financial Instruments

The Company's financial instruments principally consist of cash and cash equivalents, accounts receivable, and accounts payable and debt. Cash and cash equivalents, accounts receivable and accounts payable are carried at cost, which approximates fair value because of the short maturity of these instruments. The Company's debt is carried at cost, which approximates fair value, as the debt bears interest at rates approximating current market rates.

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2. Summary of Significant Accounting Policies (continued)

Revenue Recognition

Revenue from the sale of products from the Company's vending machines is recognized upon the sale of such products and acceptance by the customer. Monthly fees for the use of vending machines equipped with embedded Internet connectivity technology is recognized upon usage of the equipment.

Research and Development

The Company expenses research and development costs as incurred.

Income Taxes

The Company uses the liability method to account for income taxes. Accordingly, deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts reportable for income tax purposes.

Advertising Expenses

Advertising costs are expensed as incurred. Advertising expense for the years ended December 31, 2001 and 2000 was approximately \$155,000 and \$121,000, respectively.

Accounting for Stock Options

Financial Accounting Standards Board Statement ("SFAS") No. 123, Accounting for Stock Based Compensation, provides companies with a choice to follow the provisions of SFAS 123 in determination of stock-based compensation expense or to continue with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"). The Company has elected to follow the provisions of APB 25. Under APB 25, if the exercise price of the Company's stock options equals or exceeds the market price of the underlying Common Stock on the date of grant, no compensation expense is recognized. The effect of applying SFAS No. 123 to the Company's stock-based awards results in net loss that is not materially different from the reported net loss.

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2. Summary of Significant Accounting Policies (continued)

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New Accounting Pronouncements

The FASB recently issued Statement No. 144, Accounting for the Impairment of Disposal of Long-Lived Assets, that is applicable to financial statements issued for fiscal years beginning after December 15, 2001. The FASB's new rules on asset impairment supersede FASB Statement 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, and portions of APB Opinion 30, Reporting the Results of Operations. This Standard provides a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that would have to be met to classify an asset as held-for-sale. Classification as held-for-sale is an important distinction since such assets are not depreciated and are stated at the lower of fair value and carrying amount. This Standard also requires expected future operating losses from discontinued operations to be displayed in the period in which the losses are incurred, rather than as of the measurement date as presently required. The provisions of this Standard are not expected to have an effect on the Company's financial position or results of operations.

3. Property and Equipment

Property and equipment consist of the following:

	December 31	
	2001	2000
Vending machines and related components	\$ 1,034,099	\$ 774,503
Computers and purchased software	1,518,079	1,477,243
Equipment and furniture	453,218	477,332
Leasehold improvements and other	210,288	255,197
	3,215,684	2,984,275
Less accumulated depreciation and amortization	1,589,472	998,181
	\$ 1,626,212	\$ 1,986,094

4. Accrued Expenses

Accrued expenses consist of the following:

	December 31	
	2001	2000
Professional fees	\$ 63,373	\$ 56,000
Interest payable	10,519	18,932
Sales tax payable	26,686	3,826
Delivery costs	41,539	5,871
Other	76,656	38,422
	218,773	123,051
	\$ 218,773	\$ 123,051

5. Long-Term Debt

In July 1998, the Company obtained a \$425,000 Bank Loan (Loan) for working capital purposes. The Loan bore interest at 7.5% and was repayable in 36 equal monthly installments with a due date of June 1, 2002. The Loan was collateralized by substantially all of the Company's assets and was personally guaranteed by the Company's President and Chief Executive Officer.

In May 2000, the Company obtained a \$2,000,000 Equipment Line of Credit (Line of Credit) from a bank to fund the purchase of property and equipment. As of December 31, 2000, \$2,000,000 was outstanding under the Line of Credit. The Line of Credit bore interest at a variable rate based on the bank's prime rate and was due on May 1, 2002, with interest only due on a monthly basis in the interim. This loan was collateralized by substantially all of the Company's assets.

In May 2001, the \$2,000,000 outstanding principal on the Line of Credit and the \$165,042 outstanding balance on the Loan were restructured and combined into a single Loan (New Loan). The New Loan bears interest at a variable rate based on the bank's prime rate, and is due in full in June 2002, with interest payable monthly. The personal guarantee of the President was removed from any and all bank debt, and the collateral was replaced by an assignment of the Company's brokerage account containing the equivalent amount of cash and cash equivalents. The New Loan balance of \$2,165,042 was repaid in accordance with its terms in June 2002. In connection with this borrowing arrangement, the Company was also granted additional borrowing capacity in the form of a \$50,000 loan commitment. The \$50,000 commitment was utilized during February 2002 (see Note 11).

5. Long-Term Debt (continued)

In May 2001, the Company obtained from a separate bank a borrowing facility (the Facility) in the aggregate amount of approximately \$1,500,000 to fund the purchase of vending machines used for the distribution and sale of Kodak film products. Borrowings are made from time to time under the facility, with repayment schedules set at the time of each borrowing, including equal monthly payments over 36 months and an interest rate based upon an amount in excess of three year U.S. Treasury Notes. The outstanding principal balance under this facility was \$645,795 as of December 31, 2001. The Company has granted the bank a security interest in the specific film products vending machines. Repayment of principal is also insured by a Surety Bond issued by a third-party insurer in exchange for an initial fee paid by the Company. Subsequent to December 31, 2001 and through April 2002, the Company borrowed an additional \$779,111 under this facility.

Long-term debt consists of the following:

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	December 31	
	2001	2000

New loan	\$ 2,165,042	\$ -
Borrowing facility	645,795	-
Equipment line of credit	-	2,000,000
Bank loan	-	225,087

	2,810,837	2,225,087
Less current portion	(2,386,506)	(147,238)

	\$ 424,331	\$ 2,077,849
	=====	

6. Stockholders' Equity

Holdings of the Series A and Series B Preferred Stock have the option to convert such shares into shares of Common Stock on a one-to-one ratio, subject to certain exceptions. The conversion rate on a particular series of Preferred Stock is subject to an adjustment in the event that any additional Common Stock, or other shares convertible into Common Stock, are issued for a per-share price less than the particular series conversion price. The Series A and Series B Preferred Stockholders vote on an as-if-converted basis. Mandatory conversion occurs upon the closing of an initial public offering of the Company's Common Stock, as defined. The holders of the Series A and Series B also have demand and piggyback registration rights, as defined. The Series A and Series B rank paripassu in liquidation, and the holders of non-cumulative Series A and Series B are each entitled to receive an amount equal to their initial investment plus any declared but unpaid dividends and 7% of the initial investment amount compounded annually from the date of investment prior to distribution to the common shareholders.

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7. Income Taxes

At December 31, 2001, the Company has approximately \$10,900,000 (\$5,215,000 in 2000) and \$11,400,000 (\$5,615,000 in 2000) of net operating loss carryforwards for federal and state income tax purposes, respectively. The federal operating loss carryforwards will begin expiring in 2019, and the state operating loss carryforwards expire principally between 2005 and 2020. At December 31, 2001 and 2000, the Company recorded a deferred tax asset of approximately \$4,503,100 and \$2,122,200, respectively, which was reduced by a valuation allowance of the same amount, as the realization of the deferred tax asset is not certain.

Significant components of the Company's deferred tax asset is as follows:

	December 31	
	2001	2000

Deferred tax asset:		
Net operating loss carryforwards	\$ 4,460,700	\$ 2,120,700

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Other	42,400	1,500

	4,503,100	2,122,200
Valuation allowance	(4,503,100)	(2,122,200)

Net deferred tax asset	\$ -	\$ -
	=====	

The timing and extent in which the Company can utilize future tax deductions in any year may be limited by provisions of the Internal Revenue Code regarding changes in ownership of corporations.

8. Stock Option Plan

In March 1999, the Company adopted the 1999 Equity Compensation Plan (the Plan), which provides for the granting of stock options, restricted stock and stock appreciation rights (SARs) to employees, directors and consultants of the Company. Options granted under the Plan may be either Incentive Stock Options (ISOs) or Nonqualified Stock Options (NSOs). ISOs may be granted only to Company employees (including officers and directors who are also employees). NSOs may be granted to employees, directors and consultants. At December 31, 2001, the Company reserved 2,559,059 shares of common stock for issuance under the Plan. Options under the Plan are granted for periods of up to ten years and generally vest over four years. All options are subject in general to earlier termination if the optionee leaves the employ of the Company. To date, no restricted stock or SARs have been issued under the Plan.

The Company does not recognize compensation expense on the issuance of its stock options to employees and directors when the option terms are fixed and the exercise price equals the fair value of the underlying stock on the grant date. To date, all options issued to employees under the Plan have been ISOs and all are exercisable at a price not less than the fair value of the Common Stock at the date of the grant. Accordingly, no compensation expense has been recognized.

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8. Stock Option Plan (continued)

The following summarizes the activity of the Plan since its adoption:

	Common Shares Under Options Granted	Weighted Average Exercise Pr

Outstanding at December 31, 1999	769,000	\$ 0.6
Granted	428,000	1.8
Cancelled/forfeited	(12,109)	0.6

Outstanding at December 31, 2000	1,184,891	1.4
Granted	229,500	1.8
Cancelled/forfeited	(424,121)	1.7

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Outstanding at December 31, 2001

990,270

\$ 0.9

Information with respect to options outstanding under the Plan as of December 31, 2001 is as follows:

Options Outstanding			Options Exercisable		
Exercise Price Range	Number Outstanding at December 31 2001	Weighted- Average Remaining Contractual Life (Years)	Weighted- Average Exercise Price	Number Outstanding at December 31 2001	Weig Ave Exe Pr
\$.67	702,000	7.3	\$ 0.67	618,927	\$ 0
\$ 1.89	288,270	8.6	\$ 1.89	112,123	\$ 1
	----- 990,270 =====			----- 731,050 =====	

Included in the 2001 options outstanding at December 31, 2001 are 35,770 stock options granted to a nonemployee. The fair value of the options granted to the nonemployee is recognized as an expense over the period that the nonemployee provides services. The total expense for these options in each of the years ended December 31, 2001 and 2000 was \$7,259.

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9. Commitments and Contingencies

The Company leases various properties under operating leases expiring at various times through 2006. The aggregate minimum annual lease payments under the noncancelable operating leases as of December 31, 2001, are as follows:

2002	\$163,400
2003	146,400
2004	143,800
2005	38,600
2006	1,400

Total	\$493,600 =====

Total rental expense for 2001 and 2000 was approximately \$206,000 and \$224,000, respectively.

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

10. Related-Party Transactions

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During the years 2001 and 2000, the Company purchased vending machines from Dixie-Narco, Inc. (Dixie), a wholly-owned subsidiary of a shareholder of the Company. Total purchases from Dixie for the years ended December 31, 2001 and 2000 were \$661,000 and \$35,000, respectively. Amounts due to related party in the accompanying 2001 balance sheet represents the net amount owed to Dixie under the terms of the Dixie agreement.

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11. Subsequent Events

On May 14, 2002, USA Acquisition Corp., a wholly-owned subsidiary of USA Technologies merged with and into Stitch Networks Corporation (Stitch) pursuant to an Agreement and Plan of Merger by and among USA Technologies, Inc., USA Acquisition Corp., Stitch and the stockholders of Stitch dated April 10, 2002. At the close of the transaction, Stitch became a wholly owned subsidiary of USA Technologies, Inc.

All of the outstanding shares of stock of Stitch were converted into the right to receive an aggregate of 22,762,341 shares of Common Stock of USA Technologies, Inc. and warrants to purchase up to 7,587,447 shares of Common Stock of USA Technologies, Inc. at \$.40 per share at any time through June 30, 2002. Additionally, USA Technologies, Inc. assumed outstanding Stitch stock options which were converted into options to purchase an aggregate of 2,475,318 shares of Common Stock of USA Technologies, Inc. at \$.165 per share at any time prior to May 14, 2007 and warrants identical to those issued to the stockholders to purchase up to 412,553 shares of Common Stock of USA Technologies, Inc. A total of 4,800,000 of the shares of Common Stock issued to the former stockholders of Stitch are being held in escrow in order to secure the former stockholders' indemnification obligations under the Agreement and Plan of Merger and are subject to cancellation.

On January 9, 2002, the Company obtained a \$225,000 loan from a bank to fund working capital. The loan was payable to the bank on July 8, 2002. On February 26, 2002, the Company borrowed an additional \$50,000 from the same bank which was payable on demand. On July 26, 2002 the bank agreed to extend the due dates on the \$225,000 loan and \$50,000 loan to September 1, 2002, provided the Company pay the bank the July and August interest payments on such loans and a \$6,750 extension fee.

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Stitch Networks Corporation
Balance Sheets
(Unaudited)

	March 31	
	2002	2001
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,174,857	\$ 5,224
Accounts receivable, net of allowance for doubtful accounts of \$5,224 and \$11,818 at March 31, 2002 and 2001, respectively	113,927	
Inventory	227,966	
Due from related party, net	57,469	
Other	34,550	
Total current assets	2,608,769	6,016
Property and equipment, net	1,520,554	1,520,554
Other assets	32,638	
Total assets	\$ 4,161,961	\$ 8,036,558
Liabilities and stockholder's equity (deficit)		
Current liabilities:		
Accounts payable	\$ 650,525	\$ 650,525
Accrued expenses	300,791	
Current portion of long-term debt	2,706,088	
Total current liabilities	3,657,404	650,525
Long-term debt, net of current portion	629,910	2,706,088
Stockholder's equity (deficit):		
Series A convertible preferred stock, \$.01 par value; 3,114,637 shares authorized, issued and outstanding; liquidation value of \$2,425,186 (unaudited) at March 31, 2002	31,146	
Series B convertible preferred stock, \$.01 par value; 5,276,895		

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shares authorized, issued and outstanding; liquidation value of \$11,684,853 (unaudited) at March 31, 2002	52,769	
Common stock, \$.01 par value; 17,000,000 shares authorized; 6,000,000 shares issued and outstanding	60,000	14
Additional paid-in capital	14,626,505	(9)
Accumulated deficit	(14,895,773)	
	-----	-----
Total stockholders' equity (deficit)	(125,353)	5
	-----	-----
Total liabilities and stockholders' equity (deficit)	\$ 4,161,961	\$ 8
	=====	=====

See accompanying notes.

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Stitch Networks Corporation

Statements of Operations
(Unaudited)

	Three months ended M 2002	

Revenue	\$ 368,928	\$
Operating expenses:		
Cost of revenue	230,203	
Compensation	483,151	
General and administrative	156,396	
Research and development	136,622	
Sales and marketing	45,884	
Depreciation and amortization	199,628	

Total operating expenses	1,251,884	

	(882,956)	(
Other income (expense):		
Interest income	6,937	
Interest expense	(48,786)	
Other, net	884	

	(40,965)	

Net loss	\$ (923,921)	\$ (
	=====	

See accompanying notes.

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Stitch Networks Corporation

Statements of Stockholders' Equity (Deficit)

Three months ended March 31, 2002
(Unaudited)

	Preferred Stock						
	Series A Convertible		Series B Convertible		Common Stock		Additi Paid- Capit
	Shares	Amount	Shares	Amount	Shares	Amount	
Balance, December 31, 2001	3,114,637	\$31,146	5,276,895	\$52,769	6,000,000	\$60,000	\$14,6
Compensation expense relating to options issued to nonemployees	-	-	-	-	-	-	-
Net loss	-	-	-	-	-	-	-
Balance, March 31, 2002	<u>3,114,637</u>	<u>\$31,146</u>	<u>5,276,895</u>	<u>\$52,769</u>	<u>6,000,000</u>	<u>\$60,000</u>	<u>\$14,6</u>

See accompanying notes.

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Stitch Networks Corporation

Statements of Cash Flows
(Unaudited)

	Three months ended M 2002	
Cash flows from operating activities		
Net loss	\$	(923,921) \$
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization		199,628
Non-cash stock compensation expense		7,261
Loss on disposal of property and equipment		-
Changes in operating assets and liabilities:		
Accounts receivable		18,233
Inventory		7,034
Other assets		54,054
Accounts payable		(73,592)
Accrued expenses		82,018
Due to/from related party		(63,357)
Net cash used in operating activities		<u>(692,642)</u>

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Cash flows from investing activities		
Purchase of property and equipment		(93,970)
Net cash used in investing activities		(93,970)
Cash flows from financing activities		
Borrowings of long term debt		587,287
Repayments of long term debt		(62,126)
Net cash provided by (used in) financing activities		525,161
Net decrease in cash and cash equivalents		(261,451)
Cash and cash equivalents, beginning of period		2,436,308
Cash and cash equivalents, end of period	\$	2,174,857
		\$
Supplemental disclosures of cash flow information:		
Interest paid	\$	48,950
		\$

See accompanying notes.

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Stitch Networks Corporation

Selected Notes to Financial Statements

Three months ended March 31, 2002 and 2001
(Unaudited)

1. Description of Business

Stitch Networks Corporation (the Company), a Delaware corporation was incorporated in February 1996 as Goodvest Corporation and, in March 1999, changed its name to e-Vend.net Corporation. In June 2001 the Company changed its name to Stitch Networks Corporation. The Company designs and employs embedded connectivity solutions that enable network servers to monitor and control vending machines and appliances over the internet. The Company's customers are principally located in the United States.

On December 31, 2000, the Company executed a Vending Placement, Supply and Distribution Agreement (the Agreement) with Eastman Kodak Company, Maytag Corporation and Dixie Narco, Inc., in order to form a strategic alliance to market and execute a national vending program for the sale of one-time use camera and film products. The Agreement provides for an initial term of three years ending December 31, 2003, with additional provisions for early termination and extensions as defined. Furthermore, the Agreement also provides for exclusivity among the parties for the term of the Agreement relating to the sale of camera and film products from vending machines within the Continental United States. This agreement represents the majority of the Company's operations in 2001 and during the first quarter of 2002.

2. Summary of Significant Accounting Policies

Interim Financial Information

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The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary have been included. Operating results for the three month period ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002.

Use of Estimates

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

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2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents includes all highly liquid investments purchased with original maturity of three months or less.

Inventory

Inventory, which consists of finished goods, components, and packaging materials, is stated at the lower of cost (first in, first out basis) or market. The Company maintains a valuation reserve which reflects the Company's estimate of the impact on inventory of potential obsolescence, excess quantities, and declines in market values. Such reserves approximated \$459,000 and \$0 at March 31, 2002 and 2001, respectively.

Property and Equipment

Property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives. Leasehold improvements are recorded at cost and amortized on a straight-line basis over the shorter of the estimated useful life of the asset or the related lease term. The estimated useful lives are as follows:

Vending machines and related components	3 to 7 years
Computers and purchased software	3 years
Equipment and furniture	5 to 7 years
Leasehold improvements	3 years

Revenue Recognition

Revenue from the sale of products from the Company's vending machines is recognized upon the sale of such products and acceptance by the customer. Monthly fees for the use of vending machines equipped with embedded internet connectivity is recognized upon usage of the equipment.

Research and Development

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The Company expenses research and development costs as incurred.

3. Property and Equipment

Property and equipment consist of the following:

	March 31	
	2002	2001
Vending machines and related components	\$ 1,131,063	\$ 775,048
Computers and purchased software	1,518,079	1,501,760
Equipment and furniture	444,242	451,819
Leasehold improvements and other	207,748	199,854
	3,301,132	2,928,481
Less accumulated depreciation and amortization	1,780,578	1,146,176
	\$ 1,520,554	\$ 1,782,305

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4. Long-Term Debt

During the period from January 2002 to April 2002 the Company borrowed approximately \$779,000 under their borrowing facility to fund the purchase of vending machines used for the distribution and sale of Kodak film products. These borrowings are being repaid in accordance with the repayment schedules set at the time of each borrowing, including equal monthly payments over periods ranging from 31 to 36 months and an interest rate based upon an amount in excess of three year U.S. Treasury Notes.

On January 9, 2002, the Company obtained a \$225,000 loan from a bank to fund working capital. The loan was payable to the bank on July 8, 2002. On February 26, 2002, the Company borrowed an additional \$50,000 from the same bank which was payable on demand. On July 26, 2002 the bank agreed to extend the due dates on the \$225,000 loan and \$50,000 loan to September 1, 2002, provided the Company pay the bank the July and August interest payments on such loans and a \$6,750 extension fee.

5. Related-Party Transactions

During the three months ended March 31, 2002 and 2001, the Company purchased vending machines from Dixie-Narco, Inc. (Dixie), a wholly-owned subsidiary of a shareholder of the Company. Total purchases from Dixie for the quarter ended March 31, 2002 and 2001 were \$156,571 and \$1,321, respectively. Amounts due from related party in the accompanying balance sheet represents the net amount due from Dixie under the terms of the Dixie agreement.

6. Subsequent Events

On May 14, 2002, USA Acquisition Corp., a wholly-owned subsidiary of USA Technologies merged with and into Stitch Networks Corporation (Stitch) pursuant to an Agreement and Plan of Merger by and among USA Technologies, Inc., USA Acquisition Corp., Stitch and the stockholders of Stitch dated April 10, 2002.

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At the close of the transaction, Stitch became a wholly owned subsidiary of USA Technologies, Inc.

All of the outstanding shares of stock of Stitch were converted into the right to receive an aggregate of 22,762,341 shares of Common Stock of USA Technologies, Inc. and warrants to purchase up to 7,587,447 shares of Common Stock of USA Technologies, Inc. at \$.40 per share at any time through June 30, 2002. None of these warrants were exercised and these warrants have expired. Additionally, USA Technologies, Inc. assumed outstanding Stitch stock options which were converted into options to purchase an aggregate of 2,475,318 shares of Common Stock of USA Technologies, Inc. at \$.165 per share at any time prior to May 14, 2007 and warrants identical to those issued to the stockholders to purchase up to 412,553 shares Common Stock of USA Technologies, Inc. A total of 4,800,000 of the shares of the Common Stock issued to the former stockholders of Stitch are being held in escrow in order to secure the former stockholders' indemnification obligations under the Agreement and Plan of Merger and are subject to cancellation.

The management of USA Technologies, Inc. has taken measures to reduce costs at Stitch subsequent to the acquisition date. Head count has been significantly reduced and a consultant has been engaged to sublet the Stitch facility. Operating costs are also being reduced as the two operations integrate under one facility.

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USA Technologies Inc. Unaudited Pro Forma Consolidated Financial Statements Basis of Presentation

The Pro Forma Consolidated Balance Sheet as of March 31, 2002, the Pro Forma Consolidated Statement of Operations for the nine months ended March 31, 2002, and the Pro Forma Consolidated Statement of Operations for the year ended June 30, 2001, are based on the historical financial statements of USA Technologies, Inc. (USA) and Stitch Networks Corporation (Stitch). The acquisition of Stitch has been accounted for using the purchase method of accounting. The Pro Forma Consolidated Balance Sheet as of March 31, 2002 has been prepared assuming the Stitch acquisition was completed March 31, 2002. The Pro Forma Consolidated Statement of Operations for the nine months ended March 31, 2002 has been prepared assuming the Stitch acquisition was completed on July 1, 2001. The Pro Forma Consolidated Statement of Operations for the year ended June 30, 2001 has been prepared assuming that the Stitch acquisition was completed on July 1, 2000.

The Unaudited Pro Forma financial statement information is presented for informational purposes only. The Pro Forma Consolidated Balance Sheet and Statements of Operations do not purport to represent what USA's actual financial position or results of operations would have been had the acquisition of Stitch occurred as of such dates, or to project USA's financial position or results of operations for any period or date, nor does it give effect to any matters other than those described in the notes thereto. In addition, the allocations of purchase price to the assets and liabilities of Stitch are preliminary and the final allocations may differ from the amounts reflected herein. The Unaudited Pro Forma Consolidated Balance Sheet and Unaudited Pro Forma Statements of Operations should be read in conjunction with USA's financial statements and notes thereto, and the historical financial statements of Stitch which are

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included elsewhere on this current report on Form 8-K.

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USA Technologies Inc.
Pro Forma Consolidated Balance Sheet
March 31, 2002
(Unaudited)

	Stitch	USA	Acqui Adjus
	-----	-----	-----
Assets:			
Current assets:			
Cash and cash equivalents	\$2,174,857	\$1,328,455	
Accounts receivable, net	113,927	237,047	
Due from related party	57,469	-	
Inventory	227,966	876,765	
Subscriptions receivable	-	79,237	
Prepaid expenses and other current assets	34,550	899,214	
	-----	-----	
Total current assets	2,608,769	3,420,718	
Property and equipment, net	1,520,554	576,939	
Software development costs	-	5,326,186	
Goodwill	-	-	(1)
Intangible assets	-	-	(1)
Other assets	32,638	408,215	
	-----	-----	
Total assets	\$4,161,961	\$9,732,058	\$
	=====	=====	
Liabilities and shareholder's equity			
Current liabilities:			
Accounts payable	\$ 650,525	\$2,118,063	
Accrued expenses	300,791	1,346,017	
Equipment line of credit	-	34,632	
Current portion of long-term debt	2,706,088	58,113	
	-----	-----	
Total current liabilities	3,657,404	3,556,825	
Long-term debt, less current portion	629,910	4,605,370	
Convertible debentures, less current portion	-	51,667	
Shareholders' equity:			
Series A convertible preferred stock, no par value; 1,800,000 shares authorized; 540,789 issued and outstanding at March 31, 2002 (Unaudited)	83,915	3,830,628	(1)
Stitch Common Stock, \$.01 par value; 17,000,000 shares authorized; 6,000,000 shares issued and outstanding at March 31, 2002 (Unaudited)	60,000	-	(1)
USA Common Stock, no par value; 85,000,000 shares authorized; 39,787,136 issued and outstanding shares at March 31, 2002 (Unaudited)	14,626,505	45,252,955	(1) (1)
Deferred compensation	-	(25,750)	
Additional paid-in-capital	-	-	(1)
Accumulated deficit	(14,895,773)	(47,539,637)	(1) (1)
	-----	-----	
Total shareholders' equity (deficit)	(125,353)	1,518,196	

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Total liabilities and shareholders' equity	\$4,161,961	\$9,732,058	\$

See Notes to Unaudited Pro Forma Consolidated Financial Statements

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USA Technologies, Inc.
Pro Forma Consolidated Statement of Operations
For the year ended June 30, 2001
(Unaudited)

	Stitch -----	USA ---	Acquisiti Adjustmen -----
Revenues	\$ 502,248	\$ 1,451,002	
Operating expenses:			
Cost of sales	318,067	816,239	
General and administrative	1,298,648	4,666,636	
Compensation	3,009,020	2,966,776	
Research and development	761,078	961,378	
Depreciation and amortization	828,059	209,646	
Total operating expenses	6,214,872	9,620,675	(2) 326,8
	-----	-----	-----
	(5,712,624)	(8,169,673)	(326,8
Other income (expense):			
Interest income	410,968	60,034	
Interest expense	(199,495)	(1,122,505)	
Other, net	7,037	(40,100)	
	-----	-----	-----
Total other income (expense)	218,510	(1,102,571)	
Loss before cumulative effect of accounting change and extraordinary item	(5,494,114)	(9,272,244)	(2) (326,8
Cumulative effect of accounting change	-	(821,000)	
	-----	-----	-----
Loss before extraordinary item	(5,494,114)	(10,093,244)	(326,8
Extraordinary loss on exchange of debt	-	(863,000)	
	-----	-----	-----
Net loss	(5,494,114)	(10,956,244)	(326,8
Cumulative preferred dividends	-	(836,541)	
	-----	-----	-----
Loss applicable to common shares	\$ (5,494,114)	\$ (11,792,785)	\$ (326,8
	=====	=====	=====
Loss per common share (basic and diluted)		\$ (0.70)	
		=====	
Weighted average number of common shares outstanding (basic and diluted)		16,731,999	23,637,
		=====	=====

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USA Technologies, Inc.
 Pro Forma Consolidated Statement of Operations
 for the nine months ended March 31, 2002
 (Unaudited)

	Stitch -----	USA ----	Acquisiti Adjustmen -----
Revenue	\$ 1,005,394	\$ 1,118,271	
Operating expenses:			
Cost of sales	1,137,153	611,805	
General and administrative	731,398	3,665,611	
Compensation	1,988,871	3,155,986	
Research and development	477,879	642,438	
Depreciation and amortization	578,789	243,812	
Total operating expenses	4,914,090	8,319,652	(3) 245,1
	-----	-----	-----
	(3,908,696)	(7,201,381)	(245,1
Other income (expense):			
Interest income	6,937	10,464	
Interest expense	(150,123)	(991,578)	
Other, net	39,347	-	
	-----	-----	-----
Total other income (expense)	(103,839)	(981,114)	
Net loss	(4,012,535)	(8,182,495)	(3) (245,1
Cumulative preferred dividends	-	(822,561)	
	-----	-----	-----
Loss applicable to common shares	\$ (4,012,535)	\$ (9,005,056)	\$ (245,1
	=====	=====	=====
Loss per common share (basic and diluted)		\$ (0.30)	
		=====	
Weighted average number of common shares outstanding (basic and diluted)		30,186,045	23,637,
		=====	=====

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Notes to Unaudited Pro Forma Consolidated Financial Statements

- (1) To record the acquisition of Stitch at an assumed purchase price (calculated pursuant to the Merger Agreement dated May 14, 2002). The purchase price is assumed to be paid by the issuance of 22,762,341 shares of USA Technologies, Inc. Common Stock (\$7,511,573), the issuance of 8,000,000 Common Stock warrants (\$160,000), the issuance of 2,475,318 Common Stock options (\$569,323), and the issuance of 875,000 shares of Common Stock (\$288,750) to Technology Partners, LLC for payment of services rendered to the Company in connection with the acquisition. This adjustment also records the difference between the assumed purchase price

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of \$8,529,646 and the net assets of Stitch to: intangible assets (\$3,268,000) and goodwill (\$5,386,999).

- (2) To amortize the intangible assets recorded in connection with the Stitch acquisition over a 10 year estimated useful life as if the acquisition occurred on July 1, 2000.
- (3) To amortize the intangible assets recorded in connection with the Stitch acquisition over a 10 year estimated useful life as if the acquisition occurred on July 1, 2001.

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.

USA Technologies, Inc.

Dated: July 29, 2002

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

George R. Jensen, Jr.
Chief Executive Officer