ZOOM TECHNOLOGIES INC
Form 10-Q/A
August 08, 2002

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

FORM 10-Q/A

(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, 2002

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 Number 0-18672

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

Delaware	04-2621506
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
207 South Street, Boston, Massachusetts	02111
(Address of Principal Executive Offices in the U.S.)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (617) 423-1072

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 [ ]

The number of shares outstanding of the registrant's Common Stock, $.01 Par Value, as of May 10, 2002 was 7,860,866 shares.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
INDEX

PART I - FINANCIAL INFORMATION

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Balance Sheets

	March 31, 2002 (Unaudited)	December 31, (Audited
Assets		
Current assets:		
Cash	$ 7,139,232	$ 5,252,05
Accounts receivable, net of reserves for doubtful accounts, returns, and allowances of $2,086,282 at March 31, 2002 and $2,816,449 at December 31, 2001	5,040,767	5,652,03
Inventories, net	8,008,806	11,083,14
Prepaid expenses and other current assets	1,066,197	999,66
Total current assets	21,255,002	22,986,89
Property, plant and equipment, net	3,908,375	4,128,91

Net deferred tax assets	-	2,012,84
Other assets	26,666	56,66
Total assets	$ 25,190,043	$ 29,185,32
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 2,985,575	$ 2,750,17
Accrued expenses	1,474,755	1,879,56
Current portion of long-term debt	192,289	139,20
Total current liabilities	4,652,619	4,768,94
Long-term debt	5,653,567	5,745,36
Other non-current liabilities	-	255,28
Total liabilities	10,306,186	10,769,59
Stockholders' equity:		
Common stock, par value. Authorized 25,000,000 shares; issued and outstanding 7,860,866 shares at March 31, 2002 and at December 31, 2001	28,245,215	28,245,21
Retained earnings (accumulated deficit)	(13,126,260)	(9,634,69
Accumulated other comprehensive gain (loss)	(235,098)	(194,79
Total stockholders' equity	14,883,857	18,415,72
Total liabilities and stockholders' equity	$ 25,190,043	$ 29,185,32

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Statements of Operations
(Unaudited)

	Three Months Ending March 31,	
	2002	2001
Net sales	$ 8,973,517	$ 10,026,6
Costs of goods sold	7,183,327	9,874,7
Gross profit	1,790,190	151,9
Operating expenses:		
Selling	1,572,616	2,223,1
General and administrative	910,647	1,635,5
Research and development	1,075,934	1,479,0
Total operating expenses	3,559,197	5,337,8
Operating income (loss)	(1,769,007)	(5,185,8
Other income (expense):		
Interest income	31,529	77,3
Interest (expense)	(88,376)	(100,6

Equity in losses of affiliate	(30,000)	(69,7
Other, net	121,843	64,2
Total other income (expense), net	34,996	(28,7
Income (loss) before income tax expense and extraordinary item	(1,734,011)	(5,214,6
Income tax expense (benefit)	2,012,844	
Income (loss) before extraordinary item	(3,746,855)	(5,214,6
Extraordinary gain on elimination of negative goodwill	255,287	
Net income (loss)	$ (3,491,568)	$ (5,214,6
Earnings (loss) per common share before extraordinary item (basic and diluted)	$ (0.47)	$ (0.
Extraordinary gain on elimination of negative goodwill (basic and diluted)	$ 0.03	$
Earnings (loss) per common share (basic and diluted)	$ (0.44)	$ (0.
Weighted average common and common equivalent shares (basic and diluted)	7,860,866	7,860,8

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ending March 31, 2002	2001
Cash flows from operating activities:		
Net income (loss)	$ (3,491,568)	$ (5,214,63
Adjustments to reconcile net income (loss) to net cash provided by (used) in operating activities:		
Extraordinary (gain) loss on elimination of negative goodwill	(255,287)	
Depreciation and amortization	233,527	409,21
Amortization of restricted stock	-	24,96
Write-off of net deferred tax assets	2,012,844	
Equity in losses of affiliate	30,000	69,71
Changes in operating assets and liabilities:		
Accounts receivable, net	611,269	2,185,15
Inventories, net	3,074,336	4,624,52
Prepaid expenses and other assets	(66,534)	(434,68
Accounts payable and accrued expenses	(169,410)	(4,977,78
Net cash provided by (used in) operating activities	1,979,177	(3,313,54
Cash flows from investing activities:		
Sale of investment securities	-	5
Investment in affiliate	-	(74,99

Additions to property, plant and equipment	(12,986)	(269,80
Net cash provided by (used in) investing activities	(12,986)	(344,75
Cash flows from financing activities:		
Proceeds from the issuance of long-term debt	-	6,000,00
Principal payments on long-term debt	(38,714)	(23,69
Net cash provided by (used in) financing activities	(38,714)	5,976,30
Effect of exchange rate changes on cash	(40,303)	(148,78
Net increase (decrease) in cash	1,887,174	2,169,23
Cash beginning of period	5,252,058	2,906,27
Cash end of period	$ 7,139,232	$ 5,075,50
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	$ 88,376	$ 74,89
Income taxes	$ -	$

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements
(Unaudited)

(1) Basis of Presentation

The consolidated financial statements of Zoom Technologies, Inc. (the "Company") presented herein have been prepared pursuant to the rules of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include all of the information and footnote disclosures required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ending December 31, 2001 included in the Company's 2001 Annual Report on Form 10-K.

The consolidated balance sheet as of March 31, 2002, the consolidated statements of operations for the three months ending March 31, 2002 and 2001, and the consolidated statements of cash flows for the three months ending March 31, 2002 and 2001 are unaudited, but, in the opinion of management, include all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of results for these interim periods.

The results of operations for the periods presented are not necessarily indicative of the results to be expected for the entire year ending December 31, 2002.

(2) Liquidity

For the past three years, the Company has incurred negative cash flows from operations. In 2001, the Company's net cash used in operating activities was $2.6 million and net cash used in investing activities was $.8 million. In 2001, the Company obtained a mortgage on its corporate headquarters, which provided financing of $6 million. On December 31, 2001, Zoom had cash of approximately

$5.3 million. On March 31, 2002, Zoom had cash of approximately $7.1 million. Currently, the Company does not have a debt facility from which it can borrow, and it does not expect to obtain one on acceptable terms unless there is operating performance improvement.

To conserve cash and manage its liquidity, the Company has implemented expense reductions throughout 2001 and in the first quarter of 2002. The employee headcount was 313 at December 31, 2000, and since then has been reduced to 198 at March 31, 2002. The Company will continue to assess its cost structure as it relates to its revenues and cash position in 2002, and may make further reductions if these actions are deemed necessary.

In addition to expense reductions, the Company's liquidity in 2002 is expected to be enhanced by the utilization of approximately $3 million of "no charge" components, as a result of supply agreements entered in 2001. Under these arrangements, the Company is committed to purchase at least $8 million of components over the 30-month period commencing January 1, 2002, provided that those components are offered at competitive terms and prices. The utilization of "no-charge" components is expected to supplement the Company's cash flow in 2002, as it will be able to avoid the purchase and payment of an equivalent dollar amount of inventory. Management believes that in the first quarter of 2002, the Company had a favorable impact to its cash flow from this arrangement of approximately $1.0 million. The favorable impact to the Company's statement of operations will be recognized on a delayed basis as a purchase discount over the total number of components acquired through the supply agreement.

In 2000, the Company made a significant investment to build up its broadband access products, particularly cable modems. However, the Company was not able to penetrate the broadband modem and wireless local area network markets to the extent it had expected. This resulted in the write down of the inventory values by approximately $4.6 million in 2001 and $.2 million in the first quarter of 2002. On December 31, 2001 the Company had $4.1 million net inventory in excess broadband and wireless products and components. This inventory was paid for in 2000 and 2001. Sales of products in 2002 using any portion of this inventory is expected to enhance the Company's liquidity in 2002, as the Company will be able to avoid the purchase and payment of an equivalent dollar amount of new materials. The Company is currently selling cable modems and wireless products that consume a portion of this inventory and is aggressively pursuing additional orders in markets worldwide. Of the $4.1 million net broadband and wireless inventory on hand on December 31, 2001, the Company's remaining balance on March 31, 2002 was $2.9 million.

Additionally, during the past several years, the Company has experienced a declining demand for its dial-up modem products. Trends including the bundling by PC manufacturers of dial-up modems into computers and the increased popularity of broadband modems lower the total available market through the Company's sales channels. Because of this, the Company's dial-up modem sales are unlikely to grow unless the Company's market share grows, or the new V.92 and V.44 modem standards grow sales through the Company's channels. If the Company's dial-up modem sales do not grow, the Company's future success will depend in large part on its ability to successfully penetrate the broadband modem, networking, and dialer markets.

The Company's cash position at December 31, 2001 was $5.3 million and at March 31, 2002 was $7.1 million. Management believes it has sufficient resources to fund its planned operations over the next 12 months. However, if the Company is unable to increase its revenues, reduce its expenses, or raise capital, the Company's longer-term ability to continue as a going concern and achieve the Company's intended business objectives could be adversely affected.

(3) Earnings Per Share

The reconciliation of the numerators and denominators of the basic and diluted net loss per common share computations for the Company's reported net loss is as follows:

	Three Months Ending March 31, 2002	Three Months Ending March 31, 2001
Basic:		
Net income (loss)	$(3,491,568)	$(5,214,635)
Weighted average shares outstanding	7,860,866	7,860,866
Net income (loss) per share	$ (.44)	$ (.66)
Diluted:		
Net income (loss)	$(3,491,568)	$(5,214,635)
Weighted average shares outstanding	7,860,866	7,860,866
Net effect of dilutive stock options based on the treasury stock method using average market price	-	-
Weighted average shares outstanding	7,860,866	7,860,866
Net income (loss) per share	$ (.44)	$ (.66)

Potential common shares for which inclusion would have the effect of increasing diluted earnings per share (i.e., antidilutive) are excluded from the computation. Options to purchase 2,008 and 5,644 shares of common stock at March 31, 2002 and 2001, respectively, were outstanding, but not included in the computation of diluted earnings per share as their effect would be antidilutive.

(4) Inventories

Inventories consist of the following:	March 31, 2002	December 31, 2001
Raw materials	$ 4,569,297	$ 6,276,480
Work in process	1,496,810	462,389
Finished goods	1,942,699	4,344,274
	$ 8,008,806	$ 11,083,143

During the quarter ending March 31, 2002 the Company recorded lower of cost or market write-downs of $174,904 related to broadband and wireless inventory.

(5) Comprehensive Income

Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income" establishes rules for the reporting and display of comprehensive income and its components; however, it has no impact on the Company's net income (loss) or shareholders' equity. SFAS No. 130 requires all changes in equity from non-owner sources to be included in the determination of comprehensive income (loss).

The components of comprehensive loss, net of tax, are as follows:

	Three Months Ending March 31, 2002	2001
Net income (loss)	$(3,491,568)	$(5,214,635)
Foreign currency translation adjustment	(40,303)	(148,780)
Net unrealized holding gain (loss) on investment securities	-	53
Comprehensive income (loss)	$(3,531,871)	$(5,363,362)

(6) Mortgage

On January 10, 2001 the Company obtained a mortgage for $6 million on its real estate property located at 201 and 207 South Street, Boston, Massachusetts. This is a 20-year direct reduction mortgage. The interest rate is fixed for one year, based on the one-year Federal Home Loan Bank rate plus 2.5% per annum. The rate is adjusted on January 10th of each calendar year commencing on January 10, 2002. The current rate of interest as of March 31, 2002 was 4.97% and interest expense for the first quarter ending March 31, 2002 was $88,376.

(7) Income Taxes

At December 31, 2001, the Company's net deferred tax asset of $2.013 million was the result of the Company's specific tax planning strategy to sell its headquarters building in Boston. In the first quarter ending March 31, 2002, the Company recorded an income tax charge and valuation reserve of $2.013 million, which reduced its net deferred tax asset balance to zero. This additional reserve reflects the Company's decision to discontinue its specific tax planning strategy to sell its headquarters building in Boston in light of the less favorable market conditions for the sale of that building.

(8) Segment and Geographic Information

The Company's operations are classified into one reportable segment. The Company's domestic net sales and international sales for the three months ending March 31, 2002 and 2001, respectively, were comprised as follows:

	Three Months Ending March 31, 2002	% of Total	Three Months Ending March 31, 2001	% of Total
North America	$ 5,398,878	60%	$ 6,355,004	63%
International	3,574,639	40%	3,671,683	37%
Total	$ 8,973,517	100%	$10,026,687	100%

(9) Extraordinary Gain

On January 1, 2002, the Company recorded an extraordinary gain of $255,287, upon the adoption of SFAS No. 142 "Goodwill and Other Intangible Assets" (SFAS 142). The gain resulted from the elimination of the remaining negative goodwill on the Company's consolidated balance sheet related to a previous acquisition, and was recorded in accordance with the provisions of SFAS 142.

(10) New Accounting Pronouncements

In June 2001, the FASB issued SFAS No. 141 "Business Combinations" (SFAS

141) and SFAS No. 142 "Goodwill and Other Intangible Assets" (SFAS 142). SFAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under SFAS 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. The amortization provisions of SFAS 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 amortization and impairment provisions of SFAS 142 are effective upon the adoption of SFAS 142. The Company was required to adopt SFAS 142 at the beginning of 2002. The adoption of these accounting standards did not have any material effect on the Company's consolidated financial statements, other than the extraordinary gain recognized during the first quarter of 2002 related to the elimination of previously recognized negative goodwill (see note 9 to the consolidated financial statements).

In August 2001, the FASB issued SFAS No.144, "Accounting for the Impairment on Disposal of Long-Lived Assets" (SFAS 144), effective for fiscal years beginning after December 15, 2001. This statement addresses the financial accounting and reporting for the impairment and disposal of long-lived assets. It supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of" (SFAS 121). Under the new rules, the criteria required for classifying an asset as held-for-sale have been significantly changed. Assets held-for-sale are stated at the lower of their fair values or carrying amounts, and depreciation is no longer recognized. In addition, the expected future operating losses from discontinued operations will be displayed in discontinued operations in the period in which the losses are incurred rather than as of the measurement date. More dispositions will qualify for discontinued operations treatment in the statement of operations under the new rules. The adoption of this statement on January 1, 2002 did not have a material impact on the Company's operations or financial position.

FASB Emerging Issues Task Force Issue No. 00-14 "Accounting for Certain Sales Incentives" addresses the recognition, measurement, and income statement classification for certain types of sales incentives. The application of the guidance in Issue No. 00-14 resulted in a change in the manner in which the Company records certain types of discounts and sales and marketing incentives that are provided to its customers. The Company has historically recorded certain types of these incentives as marketing expenses. Under Issue No. 00-14, beginning on January 1, 2002, the Company records these discounts and incentives as reductions of revenue. In April 2001, the FASB Emerging Issues Task Force reached a consensus on Issue No. 00-25 "Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor's Products". Issue No. 00-25 addresses whether certain consideration offered by a vendor to a distributor, including slotting fees, cooperative advertising arrangements and "buy-down" programs, should be characterized as operating expenses or reductions of revenue. Issue No. 00-14 and 00-25 were implemented in the first quarter of 2002 and prior period reported amounts have reclassified to conform to the new presentation. First quarter 2001 results have been reclassified as follows:

	Three Months Ending March 31, 2001
Revenues:	
As previously reported...	$10,264,833
As reclassified......	10,026,687
Sales and Marketing expenses:	
As previously reported...	2,461,338
As reclassified.....	2,223,192

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

The following discussion and analysis should be read in conjunction with the safe harbor statement and the risk factors contained herein and set forth in our Annual Report on Form 10-K. Readers should also be cautioned that results of any reported period are often not indicative of results for any future period.

Critical Accounting Policies

The following is a discussion of what we view as our more significant accounting policies. These policies are also described in the notes to our audited consolidated financial statements included in our Annual Report on Form 10-K. As described below, management judgments and estimates must be made and used in connection with the preparation of our consolidated financial statements. Material differences could result in the amount and timing of our revenue and expenses for any period if we made different judgments or used different estimates.

Revenue Recognition. We sell hardware products to our customers. The products include dial-up modems, embedded modems, cable modems, PC cameras, ISDN and ADSL modems, telephone dialers, and wireless and wired networking equipment. We generally do not sell software or services. We earn a small amount of royalty revenue. We derive our revenue primarily from the sales of hardware products to three types of customers:

- computer peripherals retailers,
- computer product distributors, and
- original equipment manufacturers (OEMs).

We sell a very small amount of our hardware products to direct consumers and to customers via the Internet. We recognize revenue for all three types of our customers at the point when the customers take legal ownership of the delivered products. Legal ownership passes from Zoom to the customer based on the point specified in signed contracts and purchase orders, which are both used extensively. Many of our customer contracts or purchase orders specify that ownership passes to the customer at the destination. Since it would be impractical to verify ownership change for each individual delivery to the destination point, we estimate the day the customer receives delivery based on our ship date and the carrier's published delivery schedule specific to the freight class and location.

Our revenues are reduced by certain events which are characteristic of hardware sales to computer peripherals retailers. These events are product returns, price protection refunds, store rebates, and consumer mail-in rebates. Each of these is accounted for as a reduction of revenue based on careful management estimates, which are reconciled to actual customer or end-consumer refunds and credits on a monthly or quarterly basis. The estimates for product returns are based on recent historical trends plus estimates for returns prompted by events such as new product introductions, announced stock rotations, and announced customer store closings. We analyze historical returns, current economic trends, and changes in customer demand and acceptance of our products when evaluating the adequacy of sales return allowances. Our estimates for price protection refunds require a detailed understanding and tracking by customer and by sales program. Estimated price protection refunds are recorded in the same period as the announcement of a pricing change. Information from customer inventory-on-hand reports or from direct communications with the customers is used to estimate the refund, which is recorded as a reserve against accounts receivable and a reduction of current period revenue. Our estimates for consumer mail-in rebates are comprised of actual rebate claims processed by the rebate redemption centers plus an accrual for an estimated lag in processing. Our estimates for store rebates are comprised of actual credit requests from the eligible customers.

On January 1, 2002, we adopted FASB Emerging Issues Task Force Issue No. 00-14 "Accounting for Certain Sales Incentives" and Issue No. 00-25 "Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor's Products." The application of the guidance in Issue No. 00-14 and No. 00-25 resulted in a change in the manner in which we record certain types of discounts and sales and marketing incentives that are provided to our customers. We had historically recorded these incentives as selling expenses. Under Issue No. 00-14 and No. 00-25, we are now recording these incentives as reductions of revenue for the current and prior periods. This change reduced revenues, which, in turn, reduced gross margins. The offset was an equal reduction of selling expenses. There was not a change in net income (loss) for either the historical periods restated or the quarter ending March 31, 2002 (see note 10 to the consolidated financial statements). To ensure that the discounts and sales and marketing incentives are recorded in the proper period, we perform extensive tracking and documenting by customer, by period, and by type of marketing event. This tracking includes reconciliation to the accounts receivable records for deductions taken by our customers for these discounts and incentives.

Accounts Receivable Valuation. We establish accounts receivable reserves for product returns, store rebates, consumer mail-in rebates, price protection refunds, and bad debts. These reserves are drawn down as actual credits are issued to the customer's accounts. We purchase accounts receivable insurance on virtually all of our customer invoices. In recent years, if any customer receivable could not be insured and we determined that collection of a fee was not reasonably assured, we did not accept the customer's order. Our total year bad-debt write-offs for 2000 and 2001 were .3% and .2% of total revenue, respectively.

Inventory Valuation and Cost of Goods Sold. Inventory is valued on a standard cost basis where the material standards are periodically updated for current material pricing. Reserves for obsolete inventory are established by management based on usability reviews performed each quarter. Our reserves against this inventory range from 0% to 100%, based on management's estimate of the probability that the materials will not be consumed. At March 31, 2002, 52% of the cost value of the inventory that was excess to our projected five-month usage was covered by our obsolescence reserve. We follow a different process for our broadband and wireless inventory. We do not believe that at the present time we can reliably determine the usability of our broadband inventory because of the inherent unpredictability of securing orders with the large cable operators and telephone companies that currently represent the majority of our opportunities for broadband product sales. In the second half of 2000, when industry expectations were very high for expansion of the broadband and wireless markets, we purchased parts to support our aggressive forecast for a ramp-up of sales of cable modems, ADSL modems, and wireless networking products. This resulted in a significant inventory position of materials. During 2001, the market selling prices for the broadband and wireless products declined significantly because of an industry-wide oversupply. During 2001, and to a lesser extent in the first quarter of 2002 (see note 4 to the consolidated financial statements), the sales prices for some of the products dropped below our cost and accordingly, we then valued our inventory on a "lower of cost or market" basis. Our valuation process involves comparing our cost to the selling prices each quarter, and if the selling price of a product is less than the "if completed" cost of our inventory, we permanently write-down the inventory on a "lower of cost or market" basis.

We have entered into supply arrangements with suppliers of some components that include price and other concessions, including no-charge components, for meeting certain purchase requirements or commitments. Under these arrangements, we are committed to purchase at least $8.0 million of components over the 30-month period commencing on January 1, 2002, provided that those components are offered at competitive terms and prices. We are also required to purchase either a minimum percentage, as measured by unit purchases or dollar amount of components from a supplier over a two-year period commencing on January 1, 2002. In connection with these arrangements, we are entitled to receive at least $3.0 million of no-charge components, based upon the supplier's market price for the components, and other pricing concessions based upon our purchase volumes. We received $1.2 million of these no-charge components in the fourth quarter of 2001. At December 31, 2001, the gross inventory value of $1.2 million was offset by a $1.2 million reserve in inventory, yielding a net inventory value of zero. We have received an additional $1.8 million of no-charge components in the first quarter of 2002. At March 31, 2002, the gross inventory value of these no-charge components was $2.7 million, offset by a $2.9 million reserve in inventory, yielding a net inventory value of ($.2) million for inventory acquired under these arrangements. We expect that the remaining $2.7 million value of "no charge" components will be consumed in our manufacturing process and shipped in finished products to customers during the remainder of 2002. If this occurs, our cash flow in 2002 is expected to improve by $3.0 million, as we expect to avoid the purchase and payment of an equivalent dollar amount. In the first quarter of 2002, our purchases and payment of the components in question were approximately $1.0 million less than our previous run-rate. Our statement of operations will reflect the $3.0 million of favorability as we ship products containing the components acquired under these supply arrangements. In the quarter ending March 31, 2002 the favorable impact of this arrangement to our statement of operations was less than $.1 million.

Valuation and Impairment of Deferred Tax Assets. As part of the process of preparing our consolidated financial statements we are required to estimate the recoverability of our deferred tax assets. This process involves the estimation of our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations.

Significant management judgment is required in determining our provision for income taxes and any valuation allowance recorded against our net deferred tax assets in accordance with the provisions of the Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." In 2001, we recorded a $3.8 million income tax charge to reflect an additional increase in our deferred tax asset valuation allowance. This is equal to 100% of the tax benefits derived from our 2001 pre-tax losses and certain of our pre-tax losses incurred prior to 2001. Management's decision to record the valuation allowance was based on the uncertain recoverability of the deferred tax asset balance. At December 31, 2001, a portion of our net deferred tax asset was supported by our specific tax planning strategy to sell our appreciated headquarters building in Boston. The amount of the projected tax benefit from this sale was used to support the $2.013 million deferred tax asset remaining on our balance sheet as of December 31, 2001. In our first quarter ending March 31, 2002, we recorded an additional income tax charge and valuation reserve, which reduced our net deferred tax asset balance to zero. This additional reserve reflects our decision to discontinue our specific tax planning strategy to sell our headquarters building in Boston in light of the less favorable market conditions for the sale of such building.

Results of Operations

We recorded net sales of $9.0 million for our first quarter ending March 31, 2002, down 11% from $10.0 million in the first quarter of 2001. We reported an operating loss of $1.8 million for the first quarter of 2002, compared to an operating loss of $5.2 million in the first quarter of 2001. We reported a net loss of $3.5 million for our first quarter ending March 31, 2002 compared to a net loss of $5.2 million for the first quarter ending March 31, 2001. The net loss of $3.5 million for the first quarter of 2002 consisted of the operating loss of $1.8 million, a non-cash tax expense of $2.0 million, and a non-cash extraordinary gain of $.3 million. Loss per share improved as we reported a loss of $0.44 for the first quarter of 2002 compared to a loss of $0.66 for the first quarter of 2001.

In Q1 2002 unit volume and average selling price both declined in our primary revenue product category, dial-up modems, and revenues declined both inside and outside North America, reflecting continuing weakness in the dial-up modem market. Partially offsetting the decline in dial-up modems was an increase in sales of cable modems and other product categories in Q1 2002 compared to Q1 2001 and the recording of $.3 million in Q1 2002 of revenue for a retroactive royalty payment from an Internet Service Provider.

Our gross profit increased to $1.8 million in Q1 2002 from $.2 million in Q1 2001. This increase reflected an improvement in our gross profit percentage to 20% of net sales in Q1 2002 from 2% in Q1 2001. In the first quarter of 2001, our gross margins were adversely impacted by a $2.6 million write down of inventory, primarily relating to our broadband modems and wireless networking products. In the first quarter of 2002, we had an inventory write-down of $.2 million related to wireless networking products. Our gross margins in fiscal 2002 were positively impacted by reduced costs of materials due to more favorable supply contracts (as noted above under Critical Accounting Policies) and the retroactive royalty payment received as noted above. The improvements were partially offset by reduced sales pricing in Q1 2002, and generally higher revenue dilution for price protection, customer discounts, and sales rebates in Q1 2002 compared to Q1 2001.

Our operating expenses decreased by $1.8 million to $3.6 million in Q1 2002 from $5.3 million in Q1 2001. The decrease of $1.8 million was comprised of lower selling expenses of $.7 million, lower general and administrative expenses of $.7 million, and lower research and development expenses of $.4 million. We have reduced our worldwide staff from 289 employees on March 31, 2001 to 198 employees on March 31, 2002. We also continue to maintain a temporary wage freeze and controls on discretionary spending.

Selling expenses in Q1 2002 decreased to $1.6 million or 17.5% of net sales from $2.2 million or 22.2% of net sales in Q1 2001. Selling expenses were lower primarily because lower co-operative advertising expenses, lower personnel costs, and lower outbound freight costs.

General and administrative expenses were $0.9 million or 10.1% of net sales in Q1 2002 compared to $1.6 million or 16.3% of net sales in Q1 2001. General and administrative expenses were lower, primarily because of lower personnel costs, lower depreciation and amortization, and lower bank fees. Our general and administrative expenses in Q1 2001 included goodwill amortization of $.2 million, compared to no amortization in Q1 2002, as a result of the write-off of our goodwill assets in Q4 2001.

Research and development expenses decreased to $1.1 million or 12.0% of net sales in Q1 2002 from $1.5 million or 14.8% of net sales in Q1 2001. Research and development costs decreased primarily as a result of reduced personnel costs. Development and support continues on all of our product lines.

Other income (expense), net changed from expense of $.03 million in Q1 2001 to income of $.03 million in Q1 2002. Included in other income (expense) are interest income (expense), other income and non-interest income, and equity in losses of an affiliate.

- Interest Income. Interest income decreased to $.03 million in Q1 2002 from $.08 million in Q1 2001. The decrease was the result of our lower earned interest rate and a slightly higher average invested cash balance during Q1 2002 compared to Q1 2001. The average interest rate earned in 2002 was approximately 350 basis points lower in Q1 2002 than in Q1 2001.
- Interest expense. Interest expense decreased to $.09 million in Q1 2002 from $.1 million in Q1 2001. The interest expense decrease is due to a lower interest rate for the $6.0 million mortgage taken out in January 2001 on our headquarters building. This interest is adjusted annually in January of each year.
- Equity in losses of affiliate. Our affiliate equity losses were $.03 million in Q1 2002 compared to $.07 million in Q1 2001. Our investment balance in the affiliate has been reduced to $.027 million at March 31, 2002.
- Other Income, Net. Other income and non-interest income increased to $.12 million in Q1 2002 from $0.06 million in Q1 2001. The main reason for the increase was the reversal of a reserve for $0.1 million relating to a dispute involving a deposit that was resolved in March 2002. Other activity in this account includes foreign exchange losses which were $.05 million in Q1 2002 and a slightly lower rental income Q1 2002 compared to Q1 2001.

Income tax expense was $2.0 million in Q1 2002 compared to zero in Q1 2001. We recorded income tax expense of $2.0 million and a corresponding valuation reserve against our net deferred tax asset balance of $2.0 million at December 31, 2001. The net deferred tax asset balance at March 31, 2002 is zero. This reserve is discussed in further detail under the caption "Critical Accounting Policies" set forth herein.

Liquidity and Capital Resources

We ended the first quarter of 2002 with cash of $7.1 million and working capital of $16.6 million.

Operating activities generated $2.0 million in cash during the first quarter of 2002. Cash provided from operating activities included a reduction of inventory of $3.1 million, a reduction of our deferred income tax asset of $2.0 million, and a reduction of accounts receivable of $.6 million. Cash used in operating activities included our net loss of $3.5 million and a decrease of accounts payable and accrued expenses of $.2 million. The reduction of inventory was primarily attributable to reduced inventory purchases and sales of excess broadband and wireless inventory. The $2.0 million reduction in our deferred tax asset offsets the $2.0 million income tax expense recorded as part of our net loss for the quarter, comprising a non-cash accounting adjustment. Our decrease in accounts receivable reflects our lower sales volume.

Investing activities used $.01 million in cash for capital expenditures during the first quarter of 2002. We do not have any significant capital commitments and we anticipate that we will continue with modest investments in equipment and in improvements to our facilities during the year.

During the first quarter of 2002, we used cash for financing activities of $.04 million for three monthly principal payments on our $6.0 million mortgage on our headquarters facility. Principal on the loan is amortized on a 20-year basis. The interest rate is adjusted annually in January of each year based on the one-year Federal Home Loan Bank rate plus 2.5 % per annum. The interest rate for the current year is 4.97%.

Currently we do not have a debt facility from which we can borrow, and we do not expect to obtain one on acceptable terms unless there is operating performance improvement. However, we believe we would be able to obtain additional funds, if and when required, by factoring accounts receivable. We have engaged in preliminary negotiations with a financial organization, but we do not plan to put anything in place until and unless it is necessary since there would be an up-front cost to finalize the arrangement.

To conserve cash and manage our liquidity, we have reduced our worldwide staff from 289 employees on March 31, 2001 to 198 employees on March 31, 2002. We continue to maintain our temporary wage freeze and our controls on discretionary spending. We will continue to assess our cost structure as it relates to our revenues and cash position in the remainder 2002, and we may make further reductions if the actions are deemed necessary.

In addition to expense reductions, our liquidity in 2002 is expected to be enhanced by the utilization of approximately $3.0 million of "no charge" components as a result of supply agreements entered in 2001. Under these arrangements, we are committed to purchase at least $8.0 million of components over the 30-month period commencing January 1, 2002, provided that those components are offered at competitive terms and prices. The utilization of "no-charge" components is expected to supplement our cash flow in 2002, as we will be able to avoid the purchase and payment of an equivalent dollar amount of inventory. We believe that we have had a favorable impact to our cash flow in the first quarter of 2002 resulting from this arrangement of approximately $1.0 million.

On December 31, 2001, we had $4.1 million net inventory in broadband and wireless products and components. This inventory was paid for in 2000 and 2001. Sales of products in 2002 using any portion of this inventory will enhance our liquidity in 2002, as we will be able to avoid the purchase and payment of an equivalent dollar amount of new materials. We are currently selling cable modems and wireless products that consume a portion of this inventory and we are aggressively pursuing additional orders in markets worldwide. Of the $4.1 million net broadband and wireless inventory on hand on December 31, 2001, our remaining balance on March 31, 2002 was $2.9 million.

Our cash position at December 31, 2001 was $5.3 million, which improved to $7.1 million at March 31, 2002. We believe we have sufficient resources to fund our planned operations over the next 12 months. However, if we are unable to increase our revenues, reduce our expenses, or raise capital, our longer-term ability to continue as a going concern and achieve our intended business objectives could be adversely affected. See "Risk Factors" below, for further information with respect to events and uncertainties that could harm our business, operating results, and financial condition.

Commitments

During 2001, we entered into an agreement to purchase the ground lease for a manufacturing facility located at 27 Drydock Avenue in Boston, Massachusetts (the "Drydock Building"). In connection with the proposed purchase of the Drydock Building, we paid $513,500 which was held in escrow as a deposit pending the closing of the transaction. Of this deposit, $25,000 was nonrefundable. When Zoom was unable to obtain acceptable financing the Seller (the current leaseholder) retained the deposit pending resolution of some disputed facts concerning Zoom's withdrawal from the transaction under the terms of the Purchase and Sale Agreement. While we believed that we were entitled to a return of the $488,500 refundable portion of the deposit plus interest, the seller directed the escrow agent to hold the funds pending resolution of the dispute.

As an alternative to pursing legal remedies to obtain a return of the deposit, we pursued an arrangement to acquire the Drydock Building in partnership with the following individuals: Frank B. Manning, President and a director of Zoom; Peter R. Kramer, Executive Vice President and a director of Zoom; Bruce M. Kramer, Peter Kramer's brother; and a third party. Under this arrangement, these individuals, either directly or through entities controlled by them, joined together with us as of March 29, 2002 to form the Zoom Group LLC, a Massachusetts limited liability company ("Zoom Group") to purchase the Drydock Building. Zoom and each of the investors owns a 20% interest in the Zoom Group. The managers of the Zoom Group are Peter Kramer and the third party. There are no special allocations among the members of the Zoom Group, and each member is required to contribute his or its proportionate amount of capital in return for its 20% interest.

Effective as of March 29, 2002, we entered into a Reinstatement Agreement, Assignment Agreement and Second Amendment to Agreement of Purchase and Sale with the Zoom Group and the owner of the Drydock ground lease. Under this Reinstatement Agreement, the original purchase agreement for the Drydock Building was amended and reinstated, and we assigned our rights under the purchase agreement to the Zoom Group, together with rights to the $488,500 refundable portion of the deposit plus interest. In connection with this transaction, under a separate letter agreement, the other members of the Zoom Group paid us $390,800 ($97,700 each), representing their proportionate share of the deposit assigned to the Zoom Group. As a result, our remaining interest in the deposit is $97,700. As part of the reinstatement of the purchase agreement, the members of the Zoom Group agreed that an additional $25,000 of the $488,500 deposit would be nonrefundable, $5,000 of which has been allocated to each investor.

Under the Reinstatement Agreement, the Zoom Group agreed to purchase the Drydock Building, subject to financing and other contingencies, for a purchase price of $6.1 million, subject to adjustment. Under this arrangement, the Zoom Group is required to seek nonrecourse financing that meets specified criteria in the amount of at least $3.8 or $4.0 million, depending upon the purchase price. If the closing takes place, each member of the Zoom Group has initially agreed to contribute up to $540,000 to fund the cash portion of the purchase price plus initial working capital. These initial capital contributions include each member's share of the deposit. If the purchase does not close and the nonrefundable portion of the deposit is returned, each member will receive $92,700 plus interest. If the purchase does not close and the seller is permitted to retain the deposit, each member will lose the entire amount of its $97,700 deposit and we will have no obligation to reimburse the other members for any of the $390,800 paid to us to cover their share of the total deposit.

Under the Zoom Group Operating Agreement, following the closing of the purchase of the Drydock Building, we will have both the right to sell our interest in the Zoom Group to the other members of the Zoom Group, and the right to purchase the other members' entire interests in the Zoom Group. Our right of sale expires on January 5, 2003. Should we exercise our sale right, we would be entitled to recover the full amount of all refundable investments (the $92,700 refundable portion of the $97,700 deposit and any additional investment made in the Zoom Group.) For example, if Zoom contributed $540,000, including its deposit, toward the purchase of the Drydock Building and initial working capital, we would have the right to sell our interest to the other Zoom members for $535,000 (the $540,000 that Zoom contributed less the $5,000 nonrefundable portion of the deposit). If we exercise this right, the other members will be jointly and severally liable to pay this amount within ninety (90) days. Our right to purchase the interests of the other members of the Zoom Group expires on December 31, 2005. Under our right to purchase, we have the option to purchase all the interests of the other members of the Zoom Group for a purchase price determined in accordance with a prearranged formula based upon the initial purchase price of the Drydock Building plus 20% a year, prorated after the first year. We have no obligation to exercise either our purchase or sale right, and no member of the Zoom Group has any right to require us to do so. Any decision to exercise any of these rights will be made by the independent directors of

Zoom.

Recently Issued Accounting Standards

In June 2001, the FASB issued SFAS No. 141 "Business Combinations" (SFAS 141) and SFAS No. 142 "Goodwill and Other Intangible Assets" (SFAS 142). SFAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under SFAS 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 SFAS 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 amortization and impairment provisions of SFAS 142 are effective upon the adoption of SFAS 142. The Company was required to adopt SFAS 142 at the beginning of 2002. The adoption of these accounting standards did not have any material effect on the Company's consolidated financial statements, other than the extraordinary gain recognized during the first quarter of 2002 related to the elimination of previously recognized negative goodwill (see note 9 to the consolidated financial statements).

In August 2001, the FASB issued SFAS No.144, "Accounting for the Impairment on Disposal of Long-Lived Assets" (SFAS 144), effective for fiscal years beginning after December 15, 2001. This statement addresses the financial accounting and reporting for the impairment and disposal of long-lived assets. It supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of" (SFAS 121). Under the new rules, the criteria required for classifying an asset as held-for-sale have been significantly changed. Assets held-for-sale are stated at the lower of their fair values or carrying amounts, and depreciation is no longer recognized. In addition, the expected future operating losses from discontinued operations will be displayed in discontinued operations in the period in which the losses are incurred rather than as of the measurement date. More dispositions will qualify for discontinued operations treatment in the statement of operations under the new rules. The adoption of this statement on January 1, 2002 did not have a material impact on our operations or financial position.

FASB Emerging Issues Task Force Issue No. 00-14 "Accounting for Certain Sales Incentives" addresses the recognition, measurement, and income statement classification for certain types of sales incentives. The application of the guidance in Issue No. 00-14 resulted in a change in the manner in which the Company records certain types of discounts and sales and marketing incentives that are provided to its customers. The Company has historically recorded these incentives as selling expenses. Under Issue No. 00-14, beginning on January 1, 2002, the Company records these discounts and incentives as reductions of revenue. In April 2001, the FASB Emerging Issues Task Force reached a consensus on Issue No. 00-25 "Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor's Products". Issue No. 00-25 addresses whether certain consideration offered by a vendor to a distributor, including slotting fees, cooperative advertising arrangements and "buy-down" programs, should be characterized as operating expenses or reductions of revenue. Issue No. 00-14 and 00-25 were implemented in the first fiscal quarter of 2002 and prior period reported amounts have reclassified to conform to the new presentation (see note 10 to the consolidated financial statements).

RISK FACTORS

This report contains forward-looking statements that involve risks and uncertainties, such as statements of our objectives, expectations and intentions. The cautionary statements made in this report should be read as applicable to all forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences include those discussed below, as well as those discussed elsewhere in this report.

Our revenues have declined and we have incurred significant losses and used significant cash in operations over the last three years.

We incurred a net loss of $3.5 million in the first quarter of 2002 and net losses of approximately $18.3 million in fiscal 2001, $3.1 million in fiscal 2000, and $1.4 million in fiscal 1999. During 1999 through 2001, our revenue declined from $64.1 million in 1999 to $59.8 million in 2000 and $43.7 million in 2001. In the first quarter of 2002, our revenue was $9.0 million, an 11% decline from the prior year's first quarter. The cash used in operations during 1999 through 2001 was $2.6 million in 2001, $8.0 million in 2000, and $2.7 million in 1999. In the first quarter of 2002, our cash generated from operations increased by $2.0 million. As of March 31, 2002 we had net working capital of $16.6 million including cash of $7.1 million.

We attribute the decline of our business primarily to a decline in the retail dial-up modem market, and delays in our penetration of the broadband modem and wireless local area network markets. We anticipate that we will continue to incur significant expenses for the foreseeable future as we:

- continue to develop and seek appropriate approvals for our dial-up modem, broadband access, wireless local area network, Internet gateway, and dialer products; and
- continue to make efforts to expand our sales channels internationally, and into new channels appropriate to our new product areas.

Although we have reduced our operating expense levels significantly, our revenues must increase or we will continue to incur operating losses. We cannot guarantee that our expenditures will significantly increase or halt the decline in our revenues. Although we believe that we have sufficient resources to fund our planned operations over the next year, if we fail to increase our revenues, our longer-term ability to stay in business and to achieve our intended business objectives could be adversely effected. Our continuing losses and use of cash could also adversely affect our ability to fund the growth of our business should our strategies prove successful.

To stay in business we may require future additional funding which we may be unable to obtain on favorable terms, if at all.

Over the next twelve months, we may require additional financing for our operations either to fund losses beyond those we anticipate or to fund growth in our inventory and accounts receivable should growth occur. We currently do not have a debt facility from which we can borrow and we do not expect to obtain one on acceptable terms unless our operating performance improved. Additional financing may not be available to us on a timely basis if at all, or on terms acceptable to us. If we fail to obtain acceptable additional financing when needed, we may be required to further reduce planned expenditures or forego business opportunities, which could reduce our revenues, increase our losses, and harm our business. Moreover, additional equity financing could dilute the per share value of our common stock held by current shareholders, while additional debt financing could restrict our ability to make capital expenditures or incur additional indebtedness, all of which would impede our ability to succeed.

Our existing indebtedness could prevent us from obtaining additional financing and harm our liquidity.

In January 2001, we obtained a $6 million, 20 year direct reduction mortgage from a bank, secured by our owned real estate in Boston, Massachusetts.

Our outstanding indebtedness could adversely affect our ability to obtain additional financing for working capital, acquisitions, or other purposes. Our existing indebtedness could also make us more vulnerable to economic downturns and competitive pressures, make it more difficult to obtain additional debt financing, and adversely affect our liquidity. In the event of a cash shortfall, we could be forced to reduce other expenditures to meet our requirements with respect to our outstanding debt. Our ability to meet our obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations. Many of these factors are beyond our control. If we are unable to generate sufficient cash flow from operations in the future to service our debt, we may be required to refinance all or a portion of these obligations or obtain additional financing in order to stay in business.

Our revenues and operating results have been adversely affected because of a decline in average selling prices for our dial-up modems and because of the decline in the retail market for dial-up modems.

The dial-up modem industry has been characterized by declining average selling prices and a declining retail market. The decline in average selling prices is due to a number of factors, including technological change, lower component costs, and competition. The decline in the size of the retail market for dial-up modems is primarily due to the inclusion of dial-up modems as a standard feature contained in new PCs, and the advent of broadband products. As the market for cable and ADSL modems matures and competition between cable and ADSL service providers intensifies, it is likely that there will be increased retail distribution of cable and ADSL modems. While increased retail sale of broadband modems could increase our sales of these products, it could further reduce demand for our dial-up modems. Decreasing average selling prices and reduced demand for our dial-up modems would result in decreased revenue for dial-up modems. In addition, we have experienced and we may in the future experience substantial period to period fluctuations in operating results.

We believe that our future success will depend in large part on our ability to more successfully penetrate the broadband modem markets, which have been challenging markets, with significant barriers to entry.

With the shrinking of the dial-up modem market, we believe that our future success will depend in large part on our ability to more successfully penetrate the broadband, cable and ADSL, modem markets. These markets have been challenging markets, with significant barriers to entry, that have adversely affected our sales to these markets. Although some cable and ADSL modems are sold at retail, the high volume purchasers of these modems are concentrated in a relatively few large cable, telecommunications, and internet service providers which offer broadband modem services to their customers. These customers, particularly cable services providers, also have extensive and varied approval processes for modems to be approved for use on their network that can be expensive, time consuming, and continue to evolve. Successfully penetrating the broadband modem market therefore presents a number of challenges including:

- the current limited retail market for broadband modems;
- the relatively small number of cable, telecommunications and internet service provider customers that make up a substantial part of the market for broadband modems;
- the significant bargaining power of these large volume purchasers;
- the time consuming, expensive, uncertain and varied approval process of the various cable service providers; and
- the strong relationships with cable service providers enjoyed by incumbents cable equipment providers like Motorola and Scientific Atlanta.

Our initial sales of broadband products have been adversely affected by all of these factors. We cannot assure that we will be able to successfully penetrate these markets.

Continued fluctuations in our operating results could cause the market price of our common stock to fall.

Our operating results have fluctuated in the past and are likely to fluctuate in the future. It is possible that our revenues and operating results will be below the expectations of investors in future quarters. If we fail to meet or surpass the expectations of investors, the market price of our common stock will most likely fall. Factors that have affected and may in the future affect our operating results include:

- the overall demand for dial-up, cable and ADSL modems, wireless local area network products, Internet gateway products, dialers, and other communications products;
- the timing of new product announcements and releases by us and our competitors;
- successful testing, qualification and approval of our products, such as Cablelabs(R) qualification of cable modems, telephone company qualification of ADSL modems, approval by service providers for use on their networks, and governmental approvals;
- variations in the number and mix of products we sell;
- the timing of customer orders and adjustments of delivery schedules to accommodate our customers' programs;
- the availability of components, materials and labor necessary to produce our products;
- the timing and level of expenditures in anticipation of future sales;
- pricing and other competitive conditions; and
- seasonality.

Our customer base is concentrated and the loss of one or more of our customers could harm our business.

Relatively few customers have accounted for a significant portion of our net sales. In fiscal 2001, approximately 53% of our net sales were attributable to four customers, each of whom accounted for more than 10% of our net sales. In Q1 2002, approximately 52% of our net sales were attributable to four customers, each of whom accounted for 10% or more of our net sales. Because our customer base is concentrated, a loss of one or more of these significant customers or a reduction or delay in orders or a default in payment from any of our top customers could significantly reduce our sales which would materially harm our business, results of operations, and financial condition.

Our failure to meet changing customer requirements and emerging industry standards would adversely impact our ability to sell our products.

The market for PC communications products and high-speed broadband access products is characterized by aggressive pricing practices, continually changing customer demand patterns, rapid technological advances, emerging industry standards and short product life cycles. Some of our product developments and enhancements have taken longer than planned and have delayed the availability of our products, which adversely affected our sales and profitability in the past. Any significant delays in the future may adversely impact our ability to sell our products, and our results of operations and financial condition may be adversely affected. Our future success will depend in large part upon our ability to:

- identify and respond to emerging technological trends in the market;
- develop and maintain competitive products that meet changing customer demands;
- enhance our products by adding innovative features that differentiate our products from those of our competitors;

- o bring products to market on a timely basis;
- o introduce products that have competitive prices;
- o manage our product transitions, inventory levels and manufacturing processes efficiently;
- o respond effectively to new technological changes or new product announcements by others;

Our product cycles tend to be short, and we may incur significant non-recoverable expenses or devote significant resources to sales that do not occur when anticipated. In the rapidly changing technology environment in which we operate, product cycles tend to be short. Therefore, the resources we devote to product development, sales and marketing may not generate material revenues for us. In addition, short product cycles has resulted in and may in the future result in excess and obsolete inventory, which has had and may in the future have an adverse affect on our results of operations. In an effort to develop innovative products and technology, we have incurred and may in the future incur substantial development, sales, marketing, and inventory costs. If we are unable to recover these costs, our financial condition and operating results could be adversely affected. In addition, if we sell our products at reduced prices in anticipation of cost reductions and we still have higher cost products in inventory, our business would be harmed and our results of operations and financial condition would be adversely affected.

Our operating results have been adversely affected because of price protection programs.

Our operating results have been adversely affected by reductions in average selling prices because we gave credits to some of our customers as a result of contractual price protection guarantees. Specifically, when we reduce the price for a product, the customer receives a credit for the difference between the customer's most recent purchase price and our reduced price for the product, for all unsold product at the time of the price reduction. For fiscal 2001, we recorded a reduction of revenue of $.9 million for customer price protection. In Q1 2002, we recorded a reduction of revenue of $.1 million for price protection.

We may be subject to product returns resulting from defects, or from overstocking of our products. Product returns could result in the failure to attain market acceptance of our products, which would harm our business.

If our products contain undetected defects, errors, or failures, we could face:

- o delays in the development of our products;
- o numerous product returns; and
- o other losses to us or to our customers or end users.

Any of these occurrences could also result in the loss of or delay in market acceptance of our products, either of which would reduce our sales and harm our business. We are also exposed to the risk of product returns from our customers as a result of contractual stock rotation privileges and our practice of assisting some of our customers in balancing their inventories. Overstocking has in the past led and may in the future lead too higher than normal returns.

Our failure to effectively manage our inventory levels could materially and adversely affect our liquidity and harm our business.

During fiscal 2000, in anticipation of future sales of our recently introduced broadband access products, particularly cable modems, we significantly increased our inventory for these products. We also built up this inventory in response to shortages of components for these products earlier in that year. Since that time, most of these component shortages have been alleviated. We have also had difficulty in generating significant orders for some of our products, particularly broadband products, and as a result, we experienced a significant increase in our inventory, to $21.9 million on December 31, 2000 from $14.3 million on December 31, 1999. During fiscal 2001, we were able to reduce our inventory levels to $11.1 million as a result of sales, raw material returns to suppliers, and the write-down of value of some of our inventory. At March 31, 2002, our inventory level is $8.0 million, a reduction of $3.1 million from December 31, 2001 primarily attributable to reduced inventory purchases and sales of excess broadband and wireless inventory. Our failure to effectively manage our inventory may adversely affect our liquidity and increases the risk of inventory obsolescence, a decline in market value of the inventory, or losses from theft, fire, or other casualty.

We may be unable to produce sufficient quantities of our products because we depend on third party manufacturers. If these third party manufacturers fail to produce quality products in a timely manner, our ability to fulfill our customer orders would be adversely impacted.

We use contract manufacturers to partially manufacture our products. We use these third party manufacturers to help ensure low costs, rapid market entry, and reliability. Any manufacturing disruption could impair our ability to fulfill orders, and failure to fulfill orders would adversely affect our sales. Although we currently use four contract manufacturers for the bulk of our purchases, in some cases a given product is only provided by one of these companies. The loss of the services of our any of our significant third party manufacturers or a material adverse change in the business of or our relationships with any of these manufacturers could harm our business. Since third parties manufacture our products and we expect this to continue in the future, our success will depend, in part, on the ability of third parties to manufacture our products cost effectively and in sufficient quantities to meet our customer demand.

We are subject to the following risks because of our reliance on third party manufacturers:

- reduced management and control of component purchases;
- reduced control over delivery schedules;
- reduced control over quality assurance;
- reduced control over manufacturing yields;
- lack of adequate capacity during periods of excess demand;
- limited warranties on products supplied to us;
- potential increases in prices;
- interruption of supplies from assemblers as a result of a fire, natural calamity, strike or other significant event; and
- misappropriation of our intellectual property.

We may be unable to produce sufficient quantities of our products because we obtain key components from, and depend on, sole or limited source suppliers.

We obtain certain key parts, components, and equipment from sole or limited sources of supply. For example, we purchase dial-up and broadband modem chipsets from Conexant Systems (formerly Rockwell) and Agere Systems (formerly Lucent Technologies). Integrated circuit product areas covered by one or both companies include dial-up modems, ADSL modems, cable modems, networking, routers, and gateways. We also purchase ADSL chipsets from Globespan and we purchase chipsets for our wireless network interface cards from Intersil Corporation. In the past, we have experienced delays in receiving shipments of modem chipsets from our sole source suppliers. We may experience similar delays in the future. In addition, some products may have other components that are available from only one source. If we are unable to obtain a sufficient supply of components from our current sources, we could experience difficulties in obtaining alternative sources or in altering product designs to use alternative components. Resulting delays or reductions in product shipments could damage relationships with our customers and our customers could decide to purchase products from our competitors. Inability to meet our customers' demand or a decision by one or more of our customers to purchase products from our competitors could harm our operating results.

Our failure to satisfy minimum purchase requirements or commitments we have with our sole source suppliers could have an adverse affect on our results of operations.

We have entered into supply arrangements with suppliers of some components that include price and other concessions, including no-charge components, for meeting minimum purchase requirements or commitments. Our business and results of operations could be harmed if we fail to satisfy the minimum purchase requirements or commitments contained in our supply arrangements.

The market for high-speed communications products and services has many competing technologies and, as a result, the demand for our products and services is uncertain.

The market for high-speed communications products and services has a number of competing technologies. For instance, Internet access can be achieved by:

- using a standard telephone line and appropriate service for dial-up modems, ISDN modems, or ADSL modems, possibly in combination;
- using a cable modem with a cable TV line and cable modem service;
- using a router and some type of modem to service the computers connected to a local area network; or
- other approaches, including wireless links to the Internet.

Although we currently sell products that include these technologies, the market for high-speed communication products and services is fragmented and still in its development stage. The introduction of new products by competitors, market acceptance of products based on new or alternative technologies, or the emergence of new industry standards could render and have in the past rendered our products less competitive or obsolete. If any of these events occur, we may be unable to sustain or grow our business. In addition, if any of one or more of the alternative technologies gain market share at the expense of another technology, demand for our products may be reduced, and we may be unable to sustain or grow our business.

We face significant competition, which could result in decreased demand for our products or services.

We may be unable to compete successfully. A number of companies have developed, or are expected to develop, products that compete or will compete with our products. Furthermore, many of our current and potential competitors have significantly greater resources than we do. Intense competition, rapid technological change and evolving industry standards could decrease demand for our products or make our products obsolete. Our competitors by product group include the following:

- Dial-up modem competitors: Actiontec, Askey, Best Data, Creative Labs, GVC, Intel, SONICblue, and US Robotics.
- Cable modem competitors: Motorola, Samsung, Scientific Atlanta, Thomson, and Toshiba.
- ADSL modem competitors Siemens (formerly Efficient Networks) and Westell.
- Wireless Local Area Network competitors: 3Com, Agere, Buffalo Technologies, Cisco Systems, D-link, Intel, Linksys, Proxim, and SMC.

The principal competitive factors in our industry include the following:

- product performance, features and reliability;

- price;
- product availability and lead times;
- size and stability of operations;
- breadth of product line;
- sales and distribution capability;
- tailoring of product to local market needs, sometimes including packaging, documentation, software, and support in the local language;
- ease of use and technical support and service;
- relationships with providers of broadband access services; and
- compliance with industry standards.

Our business is dependent on the Internet and the development of the Internet infrastructure.

Our success will depend in large part on increased use of the Internet to increase the demand for high-speed communications products. Critical issues concerning the commercial use of the Internet remain largely unresolved and are likely to affect the development of the market for our products. These issues include security, reliability, cost, ease of access, and quality of service.

Our success also will depend on the continued growth of the use of the Internet by businesses, particularly for applications that utilize multimedia content and that require high bandwidth. The recent growth in the use of the Internet has caused frequent periods of performance degradation. This has required the upgrade of routers, telecommunications links and other components forming the infrastructure of the Internet by Internet service providers and other organizations with links to the Internet.

Any perceived degradation in the performance of the Internet as a whole could undermine the benefits of our products. Potentially increased performance provided by our products and the products of others ultimately is limited by and reliant upon the speed and reliability of the Internet backbone itself. Consequently, the emergence and growth of the market for our products will depend on improvements being made to the entire Internet infrastructure to alleviate overloading.

Changes in current or future laws or governmental regulations that negatively impact our products and technologies could harm our business.

The jurisdiction of the Federal Communications Commission, or the FCC, extends to the entire United States communications industry including our customers and their products and services that incorporate our products. Our products are also required to meet the regulatory requirements of other countries throughout the world where our products are sold. Obtaining government regulatory approvals is time-consuming and very costly. In the past, we have encountered delays in the introduction of our products, such as our cable modems, as a result of government certifications. We may face further delays if we are unable to comply with governmental regulations. Delays caused by the time it takes to comply with regulatory requirements may result in cancellations or postponements of product orders or purchases by our customers, which would harm our business.

Our international operations are subject to a number of risks inherent in international activities.

Our international sales accounted for approximately 29% of our revenues in fiscal 1999, 29% in fiscal 2000 and 38% in fiscal 2001. In Q1 2002 our international sales accounted for approximately 40% of our revenues. The revenues we received from international sales were significantly impacted by our Hayes European operation, which we began operating in March 1999. Currently our operations are significantly dependent on our international operations, and may be materially and adversely affected by many factors including:

- international regulatory and communications requirements and policy changes;
- favoritism towards local suppliers;
- local language and technical support requirements;
- difficulties in inventory management, accounts receivable collection and the management of distributors or representatives;
- difficulties in staffing and managing foreign operations;
- political and economic changes and disruptions;
- governmental currency controls;
- shipping costs;
- currency exchange rate fluctuations; and
- tariff regulations.

We anticipate that our international sales will continue to account for a significant percentage of our revenues. If foreign markets for our current and future products develop more slowly than currently expected, our future results of operations may be harmed.

Fluctuations in the foreign currency exchange rates in relation to the U.S. dollar could have a material adverse effect on our operating results.

Changes in currency exchange rates that increase the relative value of the U.S. dollar may make it more difficult for us to compete with foreign manufacturers on price, or may otherwise have a material adverse effect on our sales and operating results. A significant increase in our foreign currency denominated sales would increase our risk associated with foreign currency fluctuations.

Our future success will depend on the continued services of our executive officers and key research and development personnel with expertise in hardware and software development.

The loss of any of our executive officers or key research and development personnel, the inability to attract or retain qualified personnel in the future or delays in hiring skilled personnel could harm our business. Competition for skilled personnel is significant. We may be unable to attract and retain all the personnel necessary for the development of our business. In addition, the loss of Frank B. Manning, our president and chief executive officer, or Peter Kramer, our executive vice president, some other member of the management team, a key engineer, or other key contributors, could harm our relations with our customers, our ability to respond to technological change, and our business.

Our business may be harmed by acquisitions we may complete in the future.

We may pursue acquisitions of related businesses, technologies, product lines, or products. Our identification of suitable acquisition candidates involves risk inherent in assessing the values, strengths, weaknesses, risks and profitability of acquisition candidates, including the effects of the possible acquisition on our business, diversion of our management's attention, risk of increased leverage, shareholder dilution, risk associated with unanticipated problems; and risks associated with liabilities we assume.

We may have difficulty protecting our intellectual property.

Our ability to compete is heavily affected by our ability to protect our intellectual property. We rely primarily on trade secret laws, confidentiality procedures, patents, copyrights, trademarks, and licensing arrangements to protect our intellectual property. The steps we take to protect our technology may be inadequate. Existing trade secret, trademark and copyright laws offer only limited protection. Our patents could be invalidated or circumvented. We have more intellectual property assets in some countries than we do in others.

In addition, the laws of some foreign countries in which our products are or may be developed, manufactured or sold may not protect our products or intellectual property rights to the same extent as do the laws of the United States. This may make the possibility of piracy of our technology and products more likely We cannot assure that the steps that we have taken to protect our intellectual property will be adequate to prevent misappropriation of our technology.

We could infringe the intellectual property rights of others.

Particular aspects of our technology could be found to infringe on the intellectual property rights or patents of others. Other companies may hold or obtain patents on inventions or may otherwise claim proprietary rights to technology necessary to our business. We cannot predict the extent to which we may be required to seek licenses. We cannot assure that the terms of any licenses we may be required to seek will be reasonable. We are often indemnified by our suppliers relative to certain intellectual property rights; but these indemnifications do not cover all possible suits, and there is no guarantee that a relevant indemnification will be honored by the indemnifying company.

Our executive officers and directors may control certain matters to be voted on by the shareholders. These officers and directors may vote in a manner that is not in your best interests.

Based upon information provided to us, our executive officers and directors beneficially own, in the aggregate as of March 31, 2002, approximately 22.3% of our outstanding common stock. As a result, these shareholders could significantly influence certain matters to be voted on by the shareholders. These matters include the election of directors, amendments to our certificate of incorporation and approval of significant corporate transactions. These executive officers and directors may vote as shareholders in a manner that is not in your best interests.

The volatility of our stock price could adversely affect an investment in our common stock.

The market price of our common stock has been and may continue to be highly volatile. We believe that a variety of factors have caused and could in the future cause the stock price of our common stock to fluctuate, including:

- announcements of developments related to our business, including announcements of certification by the FCC or other regulatory authorities of our products or our competitors products;
- quarterly fluctuations in our actual or anticipated operating results, assets, liabilities, and order levels;
- general conditions in the US and worldwide economies;
- announcements of technological innovations;
- new products or product enhancements introduced by us or our competitors;
- developments in patents or other intellectual property rights and litigation; and
- developments in our relationships with our customers and suppliers.

In addition, in recent years the stock market in general and the markets for shares of small capitalization and "high-tech" companies in particular, have experienced extreme price fluctuations which have often been unrelated to the operating performance of affected companies. Any fluctuations in the future could adversely affect the market price of our common stock and the market price of our common stock may decline.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

The Company owns financial instruments that are sensitive to market risks as part of its investment portfolio. The investment portfolio is used to preserve the Company's capital until it is required to fund operations, including the Company's research and development activities. None of these market-risk sensitive instruments are held for trading purposes. The Company does not own derivative financial instruments in its investment portfolio. The investment portfolio contains instruments that are subject to the risk of a decline in interest rates.

Investment Rate Risk - The Company's investment portfolio consists entirely of money market funds, which are subject to interest rate risk. Due to the short duration and conservative nature of these instruments, the Company does not believe that it has a material exposure to interest rate risk. The 20 year mortgage of our headquarters building is a variable rate loan with the interest rate adjusted annually. A 1% change in the interest rate would result in a decrease or increase of approximately $60,000 of interest expense per year.

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995

This report contains forward-looking information relating to Zoom's plans, expectations and intentions, including statements relating to Zoom's dial-up modem, cable modem, DSL modem, wireless networking, and dialer sales and development activities, the anticipated growth of sales resulting from the V92 service rollout, the anticipated development of Zoom's markets and sales channels, the anticipated level of demand for Zoom's products, the anticipated impact of Zoom's cost-cutting initiatives, and Zoom's financial condition or results of operations. Actual results may be materially different than those expectations as a result of known and unknown risks, including: Zoom's continuing losses; Zoom's ability to obtain additional financing for working capital and other purposes; Zoom's ability to effectively manage its inventory; uncertainty of new product development and introduction, including budget overruns, project delays and the risk that newly introduced products may contain undetected errors or defects or otherwise not perform as anticipated, and other delays in shipments of products; the early stage of development of the cable and DSL data communications markets, the uncertainty of market growth of those markets, and Zoom's ability to more successfully penetrate those markets, which have been challenging markets with significant barriers to entry; Zoom's dependence on one or a limited number of suppliers for certain key components; rapid technological change; competition; and other risks set forth in herein and in Zoom's other filings with the Securities and Exchange Commission. Zoom cautions readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. Zoom expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any such statements to reflect any change in the Zoom's expectations or any change in events, conditions or circumstance on which any such statement is based.

PART II - OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

At a special meeting of the shareholders of the Company held on February 15, 2002, the shareholders approved a special resolution pursuant to which the Company was authorized to take actions to change its jurisdiction of incorporation from Canada to the State of Delaware through a process called a continuance in Canada and a domestication in Delaware. The transaction and special resolution voted upon are described in detail in the Company's Proxy Statement/Prospectus dated December 28, 2001 contained in the Company's Registration Statement on Form S-4 (Registration No. 333-74266). The special resolution was approved by shareholders of the Company as follows:

Votes For	Votes Against	Abstentions or Broker Non-Votes

3,497,233	16,136	26,524

On February 28, 2002, the Company completed the change in its jurisdiction of incorporation from Canada to the State of Delaware and changed its name from Zoom Telephonics, Inc. to Zoom Technologies, Inc.

ITEM 6 - Exhibits and reports on Form 8-K

(a) Exhibits	Description	Page
10.1	Operating Agreement, Zoom Group LLC dated as of March 29, 2002.	26-57
10.2	Agreement between Zoom Telephonics, Inc. and Members of the Zoom Group dated as of March 22, 2002.	58-60
10.3	Reinstatement Agreement, Assignment Agreement and Second amendment of Purchase and Sale dated as of March 29, 2002.	61-68
99.1	Certification, Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	69

(b) No reports on Form 8-K were filed by the Company during the quarter ending March 31, 2002.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY

SIGNATURES

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

ZOOM TECHNOLOGIES, INC.

Date: May 14, 2002 By: /s/ Frank B. Manning

Frank B. Manning, President

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Date: May 14, 2002                By:    /s/ Robert Crist
                                  -------------------------------------------
                                      Robert Crist, Vice President of Finance
                                        and Chief Financial Officer (Principal
                                        Financial and Accounting Officer)
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to mean any corporation of which at least a majority of the outstanding voting stock is owned by us, or by us and one or more Subsidiaries, or by one or more Subsidiaries. EVENTS OF DEFAULT, WAIVER AND NOTICE The indentures provide that the following events will be events of default with respect to the debt securities of a series: - we default in the payment of any interest on the debt securities of that series for 30 days or more; - we default in the payment of any principal or premium on the debt securities of that series on the date that payment was due; - we default in making any sinking fund payment on the debt securities of that series on the date that payment was due; - we breach any of the other covenants applicable to that series of debt securities and that breach continues for 90 days or more after we receive notice from the trustee or the holders of at least 25% of the aggregate principal amount of debt securities of that series; - we commence bankruptcy or insolvency proceedings or consent to any bankruptcy relief sought against us; or - we become involved in involuntary bankruptcy or insolvency proceedings and an order for relief is entered against us, if that order remains in effect for more than 60 consecutive days. The prospectus supplement may specify additional events of default that may be applicable to debt securities of a series. The trustee or the holders of 25% of the aggregate principal amount of debt securities of a series may declare all of the debt securities of that series to be due and payable immediately if an event of default with respect to a payment occurs. The trustee or the holders of 25% of the aggregate principal amount of debt securities of each affected series voting as one class may declare all of the debt securities of each affected series due and payable immediately if an event of default with respect to a breach of a covenant occurs. The trustee or the holders of 25% of the aggregate principal amount of debt securities outstanding under the applicable indenture voting as one class may declare all of the debt securities outstanding under that indenture due and payable immediately if a bankruptcy event of default occurs. The holders of a majority of the aggregate principal amount of the debt securities of the applicable series or number of series may annul a 11 declaration or waive a past default with respect to that series except for a continuing payment default and only if all other events of default with respect to that series have been cured or waived. If any of the affected debt securities are original issue discount securities, by principal amount we mean the amount that the holders would be entitled to receive by the terms of that debt security if the debt security were declared immediately due and payable. The holders of a majority in principal amount of the debt securities of any or all series affected and then outstanding will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the applicable trustee under the indentures. Notwithstanding the foregoing, a trustee will not have to follow any direction unless the holders of the debt securities offer to reimburse the trustee for the costs, expenses and liabilities which the trustee might incur in compliance with the request. If we have placed funds on deposit with the trustee to avoid having to comply with the restrictive covenants in the senior debt indenture and the debt securities are declared due and payable because of an event of default, the funds on deposit will be sufficient to pay amounts due on the debt securities at the time of their stated maturity, but may not be sufficient to pay amounts due on the debt securities at the time the debt securities are declared due and payable. In that case, we would remain liable for any deficiency. Each indenture requires that we file a certificate each year with the applicable trustee stating that there are no defaults under the indenture. Each indenture permits the applicable trustee to withhold notice to holders of debt securities of any default other than a payment default if the trustee considers it in the best interests of the holders. MODIFICATION OF INDENTURES We can enter into a supplemental indenture with the applicable trustee to modify any provision of the applicable indenture or any series of debt securities without obtaining the consent of the holders of any debt securities if the modification does not adversely affect the holders in any material respect. In addition, we can generally enter into a supplemental indenture with the applicable trustee to modify any provision of the indenture or any series of debt securities if we obtain the consent of the holders of a majority of the aggregate principal amount of outstanding debt securities of each affected series voting as one class. However, we need the consent of each affected holder in order to: - change the date on which any payment of principal or interest on any debt security is due; - reduce the amount of any principal, interest or premium due on any debt security; - change the currency or location of any payment; - impair the right of any holder to bring suit for any payment after its due date; or - reduce the percentage in principal amount of debt securities required to consent to any modification or waiver of any provision of the indenture or the debt securities. FORM OF DEBT SECURITIES Each debt security will be represented either by a certificate issued in definitive form to a particular investor or by one or more global securities representing the entire series of securities issued at one time. Certificated securities in definitive form and global securities will be issued in registered form. Definitive securities name you or your nominee as the owner of the security and, in order to transfer or exchange these securities or to receive payments other than interest or other interim payments, you or your nominee must physically deliver the securities to the trustee, registrar, paying agent or other agent, as applicable. Global securities name a depositary or its 12 nominee as the owner of the debt securities represented by the global securities. The depositary maintains a computerized system that will reflect the beneficial ownership of the securities through accounts maintained by broker/dealers, banks, trust companies or other representatives, as we explain more fully below under "--Global Securities." GLOBAL SECURITIES We may issue the debt securities of any series in the form of one or more fully registered global securities that will be deposited with a depositary or with a nominee for a depositary identified in the prospectus supplement relating to that series and registered in the name of the depositary or its nominee. Unless we specify a different depositary in a prospectus supplement, the depositary for any global securities we issue will be The Depository Trust Company, or DTC, New York, New York. In that case, one or more global securities will be issued in a denomination or aggregate denominations equal to the portion of the aggregate principal or face amount of outstanding registered securities of the series to be represented by the global securities. Unless and until the depositary exchanges a global security in whole or in part for securities in definitive registered form, the global security may not be transferred except in whole or in part by the depositary to a nominee of the depositary or by a nominee of the depositary to the depositary or another nominee of the depositary or by the depositary or any of its nominees to a successor of the depositary or a nominee of that successor. If not described below, any specific terms of the depositary arrangement with respect to any portion of a series of securities to be represented by a global security will be described in the prospectus supplement relating to that series. We anticipate that the following provisions will apply to all depositary arrangements. Ownership of beneficial interests in a global security will be limited to persons that have accounts with the depositary for that global security, which we call "participants", or persons that may hold interests through participants. Upon the issuance of a global security, the depositary for the global security will credit, on its book-entry registration and transfer system, the participants' accounts with the respective principal or face amounts of the securities represented by the global security beneficially owned by those participants. The accounts to be credited will be designated by any dealers, underwriters or agents participating in the distribution of the securities. Ownership of beneficial interests in the global security will be shown on, and the transfer of those ownership interests will be effected only through, records maintained by the depositary for the global security, with respect to interests of participants, and on the records of participants, with respect to interests of persons holding through participants. The laws of some states may require that some purchasers of securities take physical delivery of their securities in definitive form. Those laws may impair the ability to own, transfer or pledge beneficial interests in global securities. So long as the depositary for a global security, or its nominee, is the registered owner of the global security, the depositary or its nominee, as the case may be, will be considered the sole owner or holder of the debt securities represented by the global security for all purposes under the applicable indenture. Except as described below, owners of beneficial interests in a global security will not be entitled to have the securities represented by a global security registered in their names, will not receive or be entitled to receive physical delivery of their securities in definitive form and will not be considered the owners or holders of the securities under the applicable indenture. Accordingly, each person owning a beneficial interest in a global security must rely on the procedures of the depositary for that global security and, if that person is not a participant, on the procedures of the participant through which that person owns its interest, to exercise any rights of a holder under the applicable indenture. We understand that under existing industry practices, if we 13 request any action of holders or if an owner of a beneficial interest in a global security desires to give or take any action which a holder is entitled to give or take under the applicable indenture, the depositary for that global security would authorize the participants holding the relevant beneficial interests to give or take that action, and those participants would authorize beneficial owners owning through those participants to give or take that action or would otherwise act upon the instructions of beneficial owners holding through them. Payments of principal, premium, if any, and interest, if any, on debt securities represented by a global security registered in the name of a depositary or its nominee will be made to the depositary or its nominee, as the case may be, as the registered owner of the global security. We and the trustees or any of our or their agents will not have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the global security or for maintaining, supervising or reviewing any records relating to those beneficial ownership interests. We expect that the depositary for any debt securities represented by a global security, upon receipt of any payment of principal, premium, interest or other distribution of underlying securities or commodities to holders in respect of the global security, will immediately credit participants' accounts in amounts proportionate to their respective beneficial interests in the global security as shown on the records of the depositary. We also expect that payments by participants to owners of beneficial interests in the global security held through those participants will be governed by standing customer instructions and customary practices, as is now the case with the securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of those participants. DTC has advised us that DTC is a limited purpose trust company organized under the laws of the State of New York, a "banking organization" within the meaning of the New York banking law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered under Section 17A of the Securities Exchange Act of 1934. DTC was created to hold securities of its participants and to facilitate the clearance and settlement of securities transactions among its participants through electronic book-entry changes in accounts of the participants, thereby eliminating the need for physical movement of securities certificates. DTC's participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations, some of which (and/or representatives of which) are also owners of DTC. Access to DTC's book-entry systems is also available to others, such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a participant, either directly or indirectly. If the depositary for any debt securities represented by a global security is at any time unwilling or unable to continue as depositary or ceases to be a clearing agency registered under the Exchange Act, and we do not appoint a successor depositary registered as a clearing agency under the Exchange Act within 90 days, we will issue the debt securities in definitive form in exchange for that global security. We will also issue debt securities of any series in definitive form in exchange for the global securities representing the securities of that series if any event occurs and is continuing which, after notice or lapse of time, or both, would become an event of default with respect to the securities of that series. In addition, we may at any time and in our sole discretion determine not to have any of the debt securities of a series represented by one or more global securities and, in that event, will issue debt securities of that series in definitive form in exchange for all of the global security or securities representing those debt securities. Any securities issued in definitive form in exchange for a global security will be registered in such name or names as the depositary will instruct the relevant trustee. We expect that those instructions will be based upon directions received by the depositary from participants with respect to ownership of beneficial interests in the global security. 14 DESCRIPTION OF PREFERRED STOCK AND PREFERENCE STOCK The following description of the material terms of our preferred stock and preference stock is based on the provisions of our restated certificate of incorporation, as amended. For more information as to how you can obtain a current copy of our restated certificate of incorporation, see "Where You Can Find More Information." Our restated certificate of incorporation, as amended, authorizes the issuance of 600,000 shares of cumulative preferred stock, par value $50.00 per share, 5,000,000 shares of preference stock, without par value, and 480,000,000 shares of common stock, par value $1.00 per share. PREFERRED STOCK We may issue preferred stock from time to time in one or more series, without stockholder approval. Subject to limitations prescribed by law, our board of directors is authorized to determine the voting powers, if any, designations and powers, preferences and rights, and the qualifications, limitations or restrictions, for each series of preferred stock that may be issued and to fix the number of shares of each series. At August 31, 2001, there were 488 shares of our 4% Convertible Cumulative Preferred Stock outstanding. Each share of our outstanding 4% preferred stock is entitled to cumulative dividends at the rate of $2 per year, can be redeemed at our option, in whole or in part at any time, at a price of $50 per share, plus dividends accrued to the redemption date, and is convertible into 24.24 shares of our common stock, subject to anti-dilution adjustment. DIVIDENDS. Holders of preferred shares of each series will be entitled to receive, when and as declared by our board of directors out of funds legally available for the payment of dividends, cumulative dividends at the rate determined by our board of directors for that series, and no more. Dividends on the preferred shares will accrue from the date fixed by our board of directors for that series. Unless we have declared and paid in full all dividends payable on all of our outstanding preferred shares for the current period and all prior periods, we will not be allowed to make any dividend payments on any class of stock that is subordinate to our preferred shares and we will not be allowed to redeem or otherwise repurchase any shares of any class of stock which ranks equally with or subordinate to our preferred shares. Accrued and unpaid dividends on the preferred shares will not bear interest. REDEMPTION. The terms, if any, on which preferred shares of any series may be redeemed will be described in a prospectus supplement. If we decide to redeem fewer than all of the outstanding preferred shares of any series, we will determine the method of selecting which shares to redeem. CONVERSION OR EXCHANGE RIGHTS. The prospectus supplement relating to any series of preferred stock that is convertible or exchangeable will state the terms on which shares of that series are convertible into or exchangeable for shares of common or preference stock or another series of preferred stock of Pitney Bowes or securities of any third party. LIQUIDATION. In the event of our voluntary or involuntary liquidation, before any distribution of assets will be made to the holders of any class of shares ranking subordinate to the preferred shares as to assets, the holders of the preferred shares of each series will be entitled to receive out of our assets available for distribution to our shareholders the sum of the par value for that series and all accrued and unpaid dividends on those shares. In the event of a voluntary liquidation, the holders of preferred shares also will receive the premium, if any, assigned to that series. The holders of all series of preferred shares are entitled to share ratably, in accordance with the 15 respective amounts payable on their shares, in any distribution upon liquidation which is not sufficient to pay in full the aggregate amounts payable on all of those shares. After payment in full of the liquidation price of the preferred shares, the holders of those shares will not be entitled to any further participation in any distribution of our assets. Neither the consolidation or merger of Pitney Bowes with or into any other corporation or corporations, nor the merger or consolidation of any other corporation into and with Pitney Bowes, will be deemed to be a voluntary or involuntary liquidation if the transaction is consented to by the holders of 66 2/3% of the outstanding preferred shares. However, the sale, exchange or transfer of all or substantially all of the assets of Pitney Bowes will be deemed a voluntary liquidation of Pitney Bowes for purposes of payment of the liquidation price of the preferred shares. VOTING. The preferred shares of a series will not be entitled to vote, except as provided below or in the applicable prospectus supplement unless required by applicable law. Unless otherwise indicated in the prospectus supplement relating to a series of preferred shares, each share of a series will be entitled to one vote on matters on which holders of that series are entitled to vote. However, we may not alter certain rights and preferences of the preferred shares without the affirmative vote of the holders of at least two-thirds of the affected outstanding preferred shares, voting as a class. In addition, whenever dividends on the preferred shares are in arrears in an aggregate amount equal to six quarterly dividend periods or we fail to retire or repurchase any shares of preferred stock that we are obligated to retire or repurchase, then the holders of all series of outstanding preferred shares, voting as a class, will be entitled to elect one-third of the total number of directors, but not less than three directors. We may not increase the amount of preferred shares or authorize or create any shares of any other class of stock ranking equal to the preferred shares as to dividends or assets or otherwise without the consent of the holders of at least a majority of all the outstanding preferred shares, voting as a class. PREFERENCE STOCK We may issue preference stock from time to time in one or more series, without stockholder approval. The preference shares rank as to dividends and assets junior to the preferred shares but senior to the common stock and to any other capital stock of Pitney Bowes that we may authorize in the future, other than capital stock that ranks senior or equal to the preference shares and that is authorized as described below under "Voting". Each series of preference shares will rank equally to each other series of preference shares as to dividends and assets, unless the prospectus supplement relating to a particular series of preference shares states that the shares of that series rank junior to the other series of preference shares as to dividends or assets or both. Subject to the limitations prescribed by law, our board of directors is authorized to determine the voting powers, if any, designations and powers, preferences and rights, and the qualifications, limitations or restrictions for each series of preference stock that may be issued and to fix the number of shares of each series. At August 31, 2001, there were 59,774 shares of $2.12 Convertible Preference Stock outstanding. Each share of our outstanding $2.12 preference stock is entitled to cumulative dividends at the rate of $2.12 per year, can be redeemed at our option, in whole or in part at any time, at a price of $28 per share, plus dividends accrued to the redemption date, and is convertible into 16 shares of our common stock, subject to anti-dilution adjustment. DIVIDENDS. Holders of preference shares of each series will be entitled to receive, when and as declared by our board of directors out of funds legally available for the payment of dividends, cumulative dividends at the rate determined by our board of directors for that series, and no more. Dividends on the preference shares will accrue from the date fixed by our board of directors for that series. Because the preference shares rank junior to the preferred shares, unless we have declared 16 and paid in full all dividends payable on all of our outstanding preferred shares for the current period and all prior periods, we will not be allowed to make any dividend payments on the preference shares and we will not be able to redeem or repurchase any preference shares. We will also not be allowed to make any dividend payment on any series of preference shares unless at the same time we pay dividends, in the same proportion to the preferential dividend rates, for each other series of preference shares ranking equally with that series. In addition, unless we have paid in full all dividends payable on all of our outstanding preference shares for the current period and all prior periods, we will not be allowed to make any dividend payments on any class of stock that is subordinate to our preference shares and we will not be allowed to redeem or otherwise repurchase any shares of any class of stock which ranks equally with or subordinate to our preference shares. REDEMPTION. The terms, if any, on which preference shares of any series may be redeemed will be described in a prospectus supplement. If we decide to redeem fewer than all of the outstanding preference shares of any series, we will determine the method of selecting which shares to redeem. CONVERSION OR EXCHANGE RIGHTS. The prospectus supplement relating to any series of preference stock that is convertible or exchangeable will state the terms on which shares of that series are convertible into or exchangeable for shares of common stock or another series of preference stock of Pitney Bowes or securities of any third party. LIQUIDATION. In the event of our voluntary or involuntary liquidation, before any distribution of assets is made to the holders of any class of shares ranking as to assets subordinate to the preference shares, the holders of the preference shares of each series will be entitled to receive out of our assets available for distribution to our shareholders the preferential amount, in cash, that will be determined by our board of directors for that series when that series is established and all accrued and unpaid dividends on those shares, but the holders of the preference shares will not be entitled to receive the liquidation price of their shares until the liquidation price of the preferred shares outstanding at the time has been paid in full. The holders of all series of preference shares are entitled to share ratably, in accordance with the respective amounts payable on their shares, in any distribution upon liquidation which is not sufficient to pay in full the aggregate amounts payable on those shares, except to the extent that the prospectus supplement relating to a particular series of preference shares states that the shares of that series rank junior to the other series of preference shares as to dividends or assets. After payment in full of the liquidation price of the preference shares, the holders of those shares will not be entitled to any further participation in any distribution of our assets. VOTING. The preference shares of a series will not be entitled to vote, except as provided below or in the applicable prospectus supplement and as required by applicable law. Unless otherwise indicated in the prospectus supplement relating to a series of preference shares, each share of a series will be entitled to one vote on matters on which holders of that series are entitled to vote. Notwithstanding the foregoing, we may not create, authorize or increase the authorized amount of any class of stock having preference or priority as to dividends or assets over the preference shares without the affirmative vote of the holders of at least two-thirds of the preference shares, irrespective of series. We may not increase the authorized amount of preference stock or of any previously authorized class of stock ranking equally with the preference stock as to dividends or assets, or authorize or create any class of stock ranking equally with the preference stock as to dividends or assets, without the consent of the holders of a majority of the outstanding preference shares, irrespective of series. Whenever dividends on the preference shares are in arrears in an aggregate amount equal to six quarterly dividend periods, then the holders of preference shares, voting as a class, will be entitled to elect two directors. 17 DESCRIPTION OF COMMON STOCK The following description of the material terms of our common stock is based on the provisions of our restated certificate of incorporation, as amended. For more information as to how you can obtain a current copy of our restated certificate of incorporation, see "Where You Can Find More Information". We do not intend to offer common stock directly with this prospectus. We may issue debt securities or preferred or preference stock under this prospectus that are convertible into Pitney Bowes' common stock. If a series of securities is convertible into common stock, the prospectus supplement will state the initial conversion price per share at which the securities may be converted. Subject to the rights of the holders of any of our preferred stock or preference stock then outstanding, holders of common stock are entitled to one vote per share on matters to be voted on by our stockholders and to receive dividends, if any, when declared from time to time by our board of directors in its discretion out of legally available funds. Upon our liquidation or dissolution, holders of common stock are entitled to receive proportionately all assets remaining after payment of all liabilities and liquidation preference on any shares of preferred stock or preference stock outstanding at the time. Holders of common stock have no preemptive or other subscription rights other than the rights described below under "--Stockholder Rights Agreement", and there are no conversion rights or redemption or sinking fund provisions with respect to common stock. As of August 31, 2001, there were approximately 244,829,461 shares of our common stock outstanding, net of 78,508,451 shares of treasury stock, and approximately 18,772,315 shares reserved for issuance upon exercise of outstanding stock options and conversion of our 4% preferred shares and $2.12 preference shares. All of our outstanding common stock is fully paid and non-assessable, which means that the holders have paid their purchase price in full and we may not ask them for additional funds, and all of the shares of common stock that may be offered with this prospectus will be fully paid and non-assessable when issued. The transfer agent and registrar for our common stock is First Chicago Trust Company of New York, a division of Equiserve LP. Our common stock is listed on the New York Stock Exchange under the ticker symbol "PBI". STOCKHOLDER RIGHTS AGREEMENT On December 11, 1995, we entered into a stockholder rights agreement. The material provisions of that rights agreement are summarized below. However, since the terms of our rights agreement are complex, this summary may not contain all of the information that is important to you. For more information, you should read the agreement, which is filed as an exhibit with the SEC. See "Where You Can Find More Information" for information on how to obtain a copy. Our rights agreement currently provides that each share of our outstanding common stock has one right to purchase one-two-hundredth of a share of our Series A Junior Participating Preference Stock. The purchase price per one-two-hundredth of a share of preference stock under the stockholder rights agreement is $97.50. The rights are not exercisable until they separate from the common stock, as described below. Initially, the rights under our rights agreement are attached to outstanding certificates representing our common stock, but the rights will be represented by separate certificates on the day 10 days after someone acquires at least 20% of our common stock, or approximately 10 days after someone commences a tender offer for at least 20% of our outstanding common stock. 18 After the rights separate from our common stock, certificates representing the rights will be mailed to record holders of the common stock. Once distributed, the rights certificates alone will represent the rights. All shares of our common stock issued prior to the date the rights separate from the common stock have been and will be issued with the rights attached. Until the rights separate from the common stock, each right will be transferable only with the related share of common stock. The rights will expire on February 20, 2006 unless we redeem or exchange them earlier. If an acquiring person obtains or has the right to obtain at least 20% of our common stock and none of the events described in the next paragraph have occurred, then each right will entitle the holder to purchase for $97.50 a number of shares of our common stock having a then current market value of $195.00. If an acquiring person obtains or has the right to obtain at least 20% of our common stock, then each right will entitle the holder to purchase for $97.50 a number of shares of common stock of the acquiring person having a then current market value of $195.00 if any of the following occurs: - we merge into another entity; - an acquiring entity merges into us; or - we sell 50% or more of our assets or earning power. Under our rights agreement, any rights that are or were owned by an acquiring person of more than 20% of our outstanding common stock will be null and void. Our rights agreement contains exchange provisions which provide that after an acquiring person obtains 20% or more, but less than 50%, of our outstanding common stock, our board of directors may, at its option, exchange all or part of the then outstanding and exercisable rights for shares of our common stock, at an exchange ratio of one share of common stock or one two-hundredth of a share of Series A Junior Participating Preference Stock per right. Our board of directors may, at its option, redeem all of the outstanding rights at a redemption price of $0.005 per right, subject to adjustment, prior to the earlier of (1) the time that an acquiring person obtains 20% or more of our outstanding common stock, or (2) the final expiration date of the rights agreement. The ability to exercise the rights will terminate upon the action of our board of directors ordering the redemption of the rights, and the only right of the holders of the rights will be to receive the redemption price. Holders of rights will have no rights as stockholders, such as the right to vote or receive dividends, simply by virtue of holding the rights. The rights agreement includes anti-dilution provisions designed to prevent efforts to diminish the effectiveness of the rights. For so long as the rights are redeemable, we may amend the rights agreement in any respect. At any time when the rights are no longer redeemable, we may amend the rights in any respect that does not adversely affect the holders of rights. Our rights agreement contains provisions that have anti-takeover effects. The rights may cause substantial dilution to a person or group that attempts to acquire us without conditioning the offer on a substantial number of rights being acquired, redeemed or declared invalid. Accordingly, the existence of the rights may deter acquirors from making takeover proposals or tender offers. However, the rights are not intended to prevent a takeover, but rather are designed to enhance the ability of our board of directors to negotiate with an acquiror on behalf of all of the stockholders. 19 LIMITATION OF LIABILITY AND INDEMNIFICATION MATTERS Our certificate of incorporation provides that a director of Pitney Bowes will not be liable to Pitney Bowes or its stockholders for monetary damages for breach of fiduciary duty as a director, except in certain cases where liability is mandated by the Delaware General Corporation Law. Our certificate of incorporation also provides for indemnification, to the fullest extent permitted by the Delaware General Corporation Law, of any person made or threatened to be made a party to any action, suit or proceeding by reason of the fact that the person is or was a director or officer of Pitney Bowes, or, at the request of Pitney Bowes, serves or served as a director, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise, against all expense, liability and loss (including attorneys' fees, judgments, fines, Employee Retirement Income Security Act excise taxes or penalties and amounts paid or to be paid in settlement) reasonably incurred or suffered by that person in connection with the action, suit or proceeding. Our certificate of incorporation also provides that, to the extent authorized from time to time by our board of directors, Pitney Bowes may provide to employees and other agents of Pitney Bowes rights of indemnification and to receive payment or reimbursement of expenses, including attorneys' fees, that are similar to the rights conferred by the certificate of incorporation on directors and officers of Pitney Bowes or persons serving at the request of Pitney Bowes as directors, officers, employees or agents of any other enterprise. SECTION 203 OF THE DELAWARE GENERAL CORPORATION LAW Section 203 of the Delaware General Corporation Law applies to Pitney Bowes. In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a "business combination" with an "interested stockholder", as defined in Section 203, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. A "business combination" includes a merger, asset sale or a transaction resulting in a financial benefit to the interested stockholder. An "interested stockholder", as defined in Section 203, is a person who, together with affiliates and associates, owns (or, in certain cases, within the preceding three years, did own) 15% or more of the corporation's outstanding voting stock. Under Section 203, a business combination between Pitney Bowes and an interested stockholder is prohibited unless it satisfies one of the following conditions: - before the stockholder became an interested stockholder, the board of directors of Pitney Bowes must have approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder; - upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of Pitney Bowes outstanding at the time the transaction commenced, excluding, for purposes of determining the number of shares outstanding, shares owned by persons who are directors and officers; or - the business combination is approved by the board of directors of Pitney Bowes and authorized at an annual or special meeting of the stockholders by the affirmative vote of at least 66 2/3% of the outstanding voting stock which is not owned by the interested stockholder. See also "--Certain Anti-Takeover Matters--Vote Required for Certain Business Combinations" below for information about provisions in our certificate of incorporation that impose requirements similar to those of Section 203. 20 CERTAIN ANTI-TAKEOVER MATTERS Our certificate of incorporation and by-laws include a number of provisions that may have the effect of encouraging persons considering unsolicited tender offers or other unilateral takeover proposals to negotiate with our board of directors rather than pursue non-negotiated takeover attempts. These provisions include: VOTE REQUIRED FOR CERTAIN BUSINESS COMBINATIONS. Our certificate of incorporation generally requires the affirmative vote of the holders of at least 80% of the voting power of the then outstanding shares of capital stock of Pitney Bowes entitled to vote generally in the election of directors, which we call "voting stock", voting together as a single class, in addition to any other affirmative vote required by law or the certificate of incorporation, to approve: - any merger or consolidation of Pitney Bowes or any of its subsidiaries with an "interested stockholder", as defined in the certificate of incorporation and described below, or any other corporation which is, or after the merger or consolidation would be, an affiliate of an interested stockholder; - any sale, lease, exchange, mortgage, pledge, transfer or other disposition to or with any interested stockholder or any affiliate of any interested stockholder of any assets of Pitney Bowes or any of its subsidiaries having an aggregate fair market value of $50,000,000 or more; - the issuance or transfer by Pitney Bowes or any of its subsidiaries of any securities of Pitney Bowes or any of its subsidiaries to any interested stockholder or any affiliate of any interested stockholder in exchange for cash, securities or other property having an aggregate fair market value of $50,000,000 or more; - the adoption of any plan or proposal for the liquidation or dissolution of Pitney Bowes proposed by or on behalf of an interested stockholder or any affiliate of any interested stockholder; or - any reclassification of securities or recapitalization of Pitney Bowes, or any merger or consolidation of Pitney Bowes with any of its subsidiaries or any other transaction which has the effect of increasing the proportionate share of the outstanding shares of any class of equity or convertible securities of Pitney Bowes or any of its subsidiaries which is directly or indirectly owned by any interested stockholder or any affiliate of any interested stockholder. An "interested stockholder" means any person, other than Pitney Bowes or any of its subsidiaries, who or which: - beneficially owns, directly or indirectly, more than 20% of the voting power of the outstanding shares of voting stock; - is an affiliate of Pitney Bowes and at any time within the two-year period immediately before the date in question beneficially owned, directly or indirectly, 20% or more of the voting power of the then outstanding voting stock; or - is the assignee of any shares of voting stock which were at any time within the two-year period immediately before the date in question beneficially owned by an interested stockholder, if the assignment of those shares occurred in the course of a transaction or series of transactions not involving a public offering within the meaning of the Securities Act of 1933. 21 - The special voting requirement described above will not apply to a transaction of any of the kinds described above, and that transaction will require only any affirmative vote that is required by law and any other provisions of our certificate of incorporation, if either: - a majority of our "disinterested directors" approve the transaction; "disinterested director" means any director who is unaffiliated with the interested stockholder and was a member of the board of directors before the interested stockholder became an interested stockholder, and any successor of a disinterested director who is unaffiliated with the interested stockholder and is recommended to succeed the disinterested director by a majority of disinterested directors then on the board; or - all of the following conditions are met: -- the aggregate amount of the cash and the fair market value as of the date of consummation of the transaction of consideration other than cash to be received per share by holders of common stock in the transaction is at least equal to the higher of the following: (a) the highest per share price paid by the interested stockholder for any shares of common stock acquired by it within the two-year period immediately before the first public announcement of the proposal of the transaction, which we call the "announcement date", or in the transaction in which it became an interested stockholder, whichever is higher, and (b) the fair market value per share of common stock on the announcement date or the date on which the interested stockholder became an interested stockholder, whichever is higher; -- the aggregate amount of the cash and the fair market value as of the date of consummation of the transaction of consideration other than cash to be received per share by holders of shares of any other class of outstanding voting stock is at least equal to the highest of the following: (a) the highest per share price paid by the interested stockholder for any shares of that class of voting stock acquired by it within the two-year period immediately before the announcement date or in the transaction in which it became an interested stockholder, whichever is higher; (b) the highest preferential amount per share to which the holders of shares of that class of voting stock are entitled upon any voluntary or involuntary liquidation, dissolution or winding up of Pitney Bowes; and (c) the fair market value per share of that class of voting stock on the announcement date or the date on which the interested stockholder became an interested stockholder, whichever is higher; -- the consideration to be received by holders of a particular class of outstanding voting stock will be in cash or in the same form as the interested stockholder has previously paid for shares of that class of voting stock; if the interested stockholder has paid for shares of any class of voting stock with varying forms of consideration, the consideration for that class will be either cash or the form used to acquire the largest number of shares of that class previously acquired by it; -- after the interested stockholder has become an interested stockholder and before the consummation of the transaction: (a) except as approved by a majority of the disinterested directors, Pitney Bowes has not failed to declare and pay at the regular date any full quarterly dividends on the outstanding preferred stock or preference stock; (b) except as approved by a majority of the disinterested directors, Pitney Bowes has not reduced the annual rate of dividends on the common stock or failed to increase that rate to reflect any reclassification of the outstanding shares of common stock, including any reverse stock split; (c) the interested stockholder has not become the beneficial owner of any additional shares of voting stock except as part of the 22 transaction which results in the interested stockholder becoming an interested stockholder; -- after the interested stockholder has become an interested stockholder, the interested stockholder has not received the benefit, except proportionately as a stockholder, of any loans, advances, guarantees, pledges or other financial assistance or any tax credits or other tax advantages provided by Pitney Bowes; and -- a proxy or information statement describing the proposed transaction and complying with the requirements of the Exchange Act and the rules and regulations under that Act has been mailed to public stockholders of Pitney Bowes at least 30 days before the consummation of the transaction, whether or not the proxy or information statement is required to be mailed under that Act. CLASSIFIED BOARD OF DIRECTORS. Our certificate of incorporation provides for a board of directors divided into three classes, with one class to be elected each year to serve for a three-year term. As a result, at least two annual meetings of stockholders may be required for the stockholders to change a majority of our board of directors. In addition, the stockholders of Pitney Bowes can only remove directors, with or without cause, by the affirmative vote of the holders of at least 80% of the outstanding shares of voting stock, voting together as a single class. Except to the extent that the holders of preferred stock and preference stock have the right to fill vacancies on the board of directors in some circumstances, vacancies on our board of directors may be filled only by our board of directors. The classification of directors and the inability of stockholders to remove directors without the vote of at least 80% of the outstanding shares of voting stock or to fill vacancies on the board of directors make it more difficult to change the composition of our board of directors, but promote a continuity of existing management. ADVANCE NOTICE REQUIREMENTS. Our by-laws establish advance notice procedures with regard to stockholder proposals relating to the nomination of candidates for election as directors or other business to be brought before meetings of stockholders of Pitney Bowes. These procedures provide that notice of stockholder proposals of these kinds must be timely given in writing to the Secretary of Pitney Bowes before the meeting at which the action is to be taken. Generally, to be timely, notice of stockholder proposals other than nomination of director candidates must be received at the principal executive offices of Pitney Bowes not less than 90 days before an annual meeting at which the proposals are to be presented, and notice of stockholder nominations of director candidates to be presented at an annual or special meeting must be received not later than (1) 90 days before the annual meeting or (2) the close of business on the seventh day following the date on which notice of the special meeting is first given to stockholders, as applicable. The notice must contain certain information specified in the by-laws. NO ABILITY OF STOCKHOLDERS TO CALL SPECIAL MEETINGS. Our certificate of incorporation and by-laws deny stockholders the right to call a special meeting of stockholders, except to the extent that holders of preferred stock or preference stock have the right to call a special meeting in some circumstances. Our certificate of incorporation and by-laws provide that, except to that extent, only the board of directors may call special meetings of the stockholders. NO WRITTEN CONSENT OF STOCKHOLDERS. Our certificate of incorporation requires all stockholder actions to be taken by a vote of the stockholders at an annual or special meeting, and does not permit our stockholders to act by written consent without a meeting. AMENDMENT OF BY-LAWS AND CERTIFICATE OF INCORPORATION. Our certificate of incorporation requires the approval of not less than 80% of the voting power of all outstanding shares of voting stock, voting as a single class, to amend any of the provisions of the certificate of incorporation and 23 by-laws described in this section. Those provisions make it more difficult to dilute the anti-takeover effects of our by-laws and our certificate of incorporation. BLANK CHECK PREFERRED AND PREFERENCE STOCK. Our certificate of incorporation provides for 600,000 authorized shares of preferred stock and 5,000,000 authorized shares of preference stock. The existence of authorized but unissued shares of preferred and preference stock may enable the board of directors to render more difficult or to discourage an attempt to obtain control of Pitney Bowes by means of a merger, tender offer, proxy contest or otherwise. For example, if in the due exercise of its fiduciary obligations, the board of directors were to determine that a takeover proposal is not in the best interests of Pitney Bowes, the board of directors could cause shares of preferred or preference stock to be issued without stockholder approval in one or more private offerings or other transactions that might dilute the voting or other rights of the proposed acquiror or insurgent stockholder or stockholder group. In this regard, the certificate of incorporation grants our board of directors broad power to establish the rights and preferences of authorized and unissued shares of preferred and preference stock. The issuance of shares of preferred or preference stock could decrease the amount of earnings and assets available for distribution to holders of shares of common stock. The issuance may also adversely affect the rights and powers, including voting rights, of those holders and may have the effect of delaying, deterring or preventing a change in control of Pitney Bowes. 24 DESCRIPTION OF DEPOSITARY SHARES We may, at our option, elect to offer fractional shares of preferred stock or preference stock, rather than full shares of preferred stock or preference stock. If we exercise this option, we will issue to the public receipts for depositary shares, and each of these depositary shares will represent a fraction (to be set forth in the applicable prospectus supplement) of a share of a particular series of preferred stock or preference stock. The shares of any series of preferred stock or preference stock underlying the depositary shares will be deposited under a deposit agreement between us and a bank or trust company selected by us.

The depositary will have its principal office in the United States and a combined capital and surplus of at least $50,000,000. Subject to the terms of the deposit agreement, each owner of a depositary share will be entitled, in proportion to the applicable fraction of a share of preferred stock or preference stock underlying the depositary share, to all the rights and preferences of the preferred stock or preference stock underlying that depositary share. Those rights may include dividend, voting, redemption, conversion and liquidation rights. The depositary shares will be evidenced by depositary receipts issued under a deposit agreement. Depositary receipts will be distributed to those persons purchasing the fractional shares of preferred stock or preference stock underlying the depositary shares, in accordance with the terms of the offering. The following description of the material terms of the deposit agreement, the depositary shares and the depositary receipts is only a summary and you should refer to the forms of the deposit agreement and depositary receipts that will be filed with the SEC in connection with the offering of the specific depositary shares. Pending the preparation of definitive engraved depositary receipts, the depositary may, upon our written order, issue temporary depositary receipts substantially identical to the definitive depositary receipts but not in definitive form. These temporary depositary receipts entitle their holders to all the rights of definitive depositary receipts. Temporary depositary receipts will then be exchangeable for definitive depositary receipts at our expense. DIVIDENDS AND OTHER DISTRIBUTIONS. The depositary will distribute all cash dividends or other cash distributions received with respect to the underlying stock to the record holders of depositary shares in proportion to the number of depositary shares owned by those holders. If there is a distribution other than in cash, the depositary will distribute property received by it to the record holders of depositary shares that are entitled to receive the distribution, unless the depositary determines that it is not feasible to make the distribution. If this occurs, the depositary may, with our approval, sell the property and distribute the net proceeds from the sale to the applicable holders. WITHDRAWAL OF UNDERLYING PREFERRED OR PREFERENCE STOCK. Unless we say otherwise in a prospectus supplement, holders may surrender depositary receipts at the principal office of the depositary and, upon payment of any unpaid amount due to the depositary, be entitled to receive the number of whole shares of underlying preferred or preference stock and all money and other property represented by the related depositary shares. We will not issue any partial shares of preferred or preference stock. If the holder delivers depositary receipts evidencing a number of depositary shares that represent more than a whole number of shares of preferred or preference stock, the depositary will issue a new depositary receipt evidencing the excess number of depositary shares to that holder. REDEMPTION OF DEPOSITARY SHARES. If a series of preferred stock or preference stock represented by depositary shares is subject to redemption, the depositary shares will be redeemed from the proceeds received by the depositary resulting from the redemption, in whole or in part, of 25 that series of underlying stock held by the depositary. The redemption price per depositary share will be equal to the applicable fraction of the redemption price per share payable with respect to that series of underlying stock. Whenever we redeem shares of underlying stock that are held by the depositary, the depositary will redeem, as of the same redemption date, the number of depositary shares representing the shares of underlying stock so redeemed. If fewer than all the depositary shares are to be redeemed, the depositary shares to be redeemed will be selected by lot or proportionately, as may be determined by the depositary. VOTING. Upon receipt of notice of any meeting at which the holders of the underlying stock are entitled to vote, the depositary will mail the information contained in the notice to the record holders of the depositary shares underlying the preferred stock or preference stock. Each record holder of the depositary shares on the record date (which will be the same date as the record date for the underlying stock) will be entitled to instruct the depositary as to the exercise of the voting rights pertaining to the amount of the underlying stock represented by that holder=s depositary shares. The depositary will then try, as far as practicable, to vote the number of shares of preferred stock or preference stock underlying those depositary shares in accordance with those instructions, and we will agree to take all actions which may be deemed necessary by the depositary to enable the depositary to do so. The depositary will not vote the underlying shares to the extent it does not receive specific instructions from the holders of depositary shares underlying the preferred stock or preference stock. CONVERSION OF PREFERRED OR PREFERENCE STOCK. If the prospectus supplement relating to the depositary shares says that the deposited preferred or preference stock is convertible into or exchangeable for common stock or preferred or preference stock of another series of Pitney Bowes or securities of any third party, the following will apply. The depositary shares, as such, will not be convertible into or exchangeable for any securities of Pitney Bowes or any third party. Rather, any holder of the depositary shares may surrender the related depositary receipts to the depositary with written instructions to instruct us to cause conversion or exchange of the preferred or preference stock represented by the depositary shares into or for whole shares of common stock or shares of another series of preferred or preference stock of Pitney Bowes or securities of the relevant third party, as applicable. Upon receipt of those instructions and any amounts payable by the holder in connection with the conversion or exchange, we will cause the conversion or exchange using the same procedures as those provided for conversion or exchange of the deposited preferred or preference stock. If only some of the depositary shares are to be converted or exchanged, a new depositary receipt or receipts will be issued for any depositary shares not to be converted or exchanged. AMENDMENT AND TERMINATION OF THE DEPOSITARY AGREEMENT. The form of depositary receipt evidencing the depositary shares and any provision of the deposit agreement may at any time be amended by agreement between us and the depositary. However, any amendment which materially and adversely alters the rights of the holders of depositary shares will not be effective unless the amendment has been approved by the holders of at least a majority of the depositary shares then outstanding. The deposit agreement may be terminated by us or by the depositary only if (a) all outstanding depositary shares have been redeemed or converted or exchanged for any other securities into which the underlying preferred or preference stock is convertible or exchangeable or (b) there has been a final distribution of the underlying stock in connection with our liquidation, dissolution or winding up and the underlying stock has been distributed to the holders of depositary receipts. CHARGES OF DEPOSITARY. We will pay all transfer and other taxes and governmental charges arising solely from the existence of the depositary arrangements. We will also pay charges of the depositary in connection with the initial deposit of the underlying stock and any redemption of the 26 underlying stock. Holders of depositary receipts will pay other transfer and other taxes and governmental charges and those other charges, including a fee for any permitted withdrawal of shares of underlying stock upon surrender of depositary receipts, as are expressly provided in the deposit agreement to be for their accounts. REPORTS. The depositary will forward to holders of depositary receipts all reports and communications from us that we deliver to the depositary and that we are required to furnish to the holders of the underlying stock. LIMITATION ON LIABILITY. Neither we nor the depositary will be liable if either of us is prevented or delayed by law or any circumstance beyond our control in performing our respective obligations under the deposit agreement. Our obligations and those of the depositary will be limited to performance in good faith of our respective duties under the deposit agreement. Neither we nor the depositary will be obligated to prosecute or defend any legal proceeding in respect of any depositary shares or underlying stock unless satisfactory indemnity is furnished. We and the depositary may rely upon written advice of counsel or accountants, or upon information provided by persons presenting underlying stock for deposit, holders of depositary receipts or other persons believed to be competent and on documents believed to be genuine. RESIGNATION AND REMOVAL OF DEPOSITARY. The depositary may resign at any time by delivering notice to us of its election to resign. We may remove the depositary at any time. Any resignation or removal will take effect upon the appointment of a successor depositary and its acceptance of the appointment. The successor depositary must be appointed within 60 days after delivery of the notice of resignation or removal and must be a bank or trust company having its principal office in the United States and having a combined capital and surplus of at least $50,000,000. 27 PLAN OF DISTRIBUTION We may sell the securities being offered by this prospectus in four ways: - directly to purchasers; - through agents; - through underwriters; and - through dealers. We may directly solicit offers to purchase our securities or we may designate agents to solicit offers to purchase those securities. We will, in the prospectus supplement relating to an offering, name any agent that could be viewed as an underwriter under the Securities Act of 1933 and describe any commissions we must pay. Any agent will be acting on a best efforts basis for the period of its appointment or, if indicated in the applicable prospectus supplement, on a firm commitment basis. Agents, dealers and underwriters may be customers of, engage in transactions with, or perform services for us in the ordinary course of business. As one of the means of direct issuance of securities, we may utilize the services of any available electronic auction system to conduct an electronic "dutch auction" of the offered securities among potential purchasers who are eligible to participate in the auction of those offered securities, if so described in the prospectus supplement. If any underwriters are utilized in the sale of the securities in respect of which this prospectus is delivered, we will enter into an underwriting agreement with them at the time of sale to them and we will set forth in the prospectus supplement relating to that offering their names and the terms of our agreement with them. If a dealer is utilized in the sale of the securities in respect of which the prospectus is delivered, we will sell those securities to the dealer, as principal. The dealer may then resell those securities to the public at varying prices to be determined by such dealer at the time of resale. Remarketing firms, agents, underwriters and dealers may be entitled under agreements which they may enter into with us to indemnification by us against some types of civil liabilities or to contribution in respect of those liabilities, including liabilities under the Securities Act of 1933. Remarketing firms, agents, underwriters and dealers may be customers of or engage in transactions with or perform services for us in the ordinary course of business. If we so indicate in the prospectus supplement, we will authorize agents, underwriters or dealers to solicit offers by the types of purchasers specified in the prospectus supplement to purchase offered securities from us at the public offering price set forth in the prospectus supplement under delayed delivery contracts providing for payment and delivery on a specified date in the future. These contracts will be subject to only those conditions described in the prospectus supplement, and the prospectus supplement will set forth the commission payable for solicitation of those offers. Any underwriter, agent or dealer utilized in the initial offering of securities will not confirm sales to accounts over which it exercises discretionary authority without the prior specific written approval of its customer. VALIDITY OF THE SECURITIES Unless otherwise specified in a prospectus supplement, the validity of the securities in respect of which this prospectus is being delivered will be passed on for us by Sara E. Moss, Esq., Senior Vice President and General Counsel of Pitney Bowes, and by Davis Polk & Wardwell, 450 Lexington Avenue, New York, New York 10017, and, for the underwriters or agents by Sullivan & Cromwell, 125 Broad Street, New York, New York 10004. 28 EXPERTS The financial statements incorporated in this prospectus by reference to the Annual Report on Form 10-K of Pitney Bowes Inc. for the year ended December 31, 2000, have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting. WHERE YOU CAN FIND MORE INFORMATION We have filed this prospectus as part of a registration statement on Form S-3 with the SEC. The registration statement contains exhibits and other information that are not contained in this prospectus. In particular, the registration statement includes as exhibits copies of the forms of our senior and subordinated indentures. Our descriptions in this prospectus of the provisions of documents filed as exhibits to the registration statement or otherwise filed with the SEC are only summaries of the documents' material terms. If you want to review any of these documents, you should obtain the documents by following the procedures described in the paragraph below. We file annual, quarterly and special reports and other information with the SEC. You may read and copy any document we file at the SEC's Public Reference Room located at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. You may also read our SEC filings, including the complete registration statement and all of the exhibits to it, through the SEC's web site at http://www.sec.gov. The SEC allows us to "incorporate by reference" much of the information we file with them, which means that we can disclose important information to you by referring you directly to those publicly available documents. The information incorporated by reference is considered to be part of this prospectus. In addition, information we file with the SEC in the future will automatically update and supersede information contained in this prospectus and the accompanying prospectus supplement. We incorporate by reference the documents listed below and any filings made with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of the initial registration statement and before the effectiveness of the registration statement and after the effectiveness of the registration statement until we sell all of the securities we are offering with this prospectus: - Our Annual Report on Form 10-K for the year ended December 31, 2000 (which incorporates by reference portions of our proxy statement dated March 23, 2001). - Our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2001 and June 30, 2001. - Our Current Reports on Form 8-K filed February 1, 2001, February 8, 2001, April 13, 2001, April 18, 2001, April 19, 2001 (two reports), May 17, 2001, June 5, 2001 (two reports), June 15, 2001, July 2, 2001, July 3, 2001, July 19, 2001 and October 23, 2001. - Our Form 8-A filed February 16, 1996 and Form 8-A/A filed January 16, 1998. You may obtain free copies of any of these documents by writing or telephoning us at Pitney Bowes Inc., World Headquarters, One Elmcroft Road, Stamford, Connecticut, 06926-0700, telephone (203) 356-5000. 29 PRINCIPAL OFFICE OF THE ISSUER PITNEY BOWES INC. World Headquarters One Elmcroft Road Stamford, Connecticut 06926-0700 ------------------------ TRUSTEE, PRINCIPAL PAYING AGENT AND SECURITY REGISTRAR SUNTRUST BANK 25 Park Place 24th Floor Atlanta, Georgia 30303 ------------------------ LUXEMBOURG LISTING AGENT, PAYING AGENT AND TRANSFER AGENT DEXIA BANQUE INTERNATIONALE A LUXEMBOURG S.A. 69, route d' Esch L-1470 Luxembourg ------------------------ LEGAL ADVISORS TO PITNEY BOWES AS TO TO THE UNDERWRITERS AS TO MATTERS OF UNITED STATES LAW MATTERS OF UNITED STATES LAW DAVIS POLK & WARDWELL SULLIVAN & CROMWELL 450 Lexington Avenue 125 Broad Street New York, New York 10017 New York, New York 10004 ------------------------ AUDITORS TO PITNEY BOWES PRICEWATERHOUSECOOPERS LLP 300 Atlantic Street Stamford, Connecticut 06901 --

-- No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus. You must not rely on any unauthorized information or representations. This prospectus is an offer to sell only the notes offered hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this prospectus is current only as of its date. ------------------------ TABLE OF CONTENTS E250,000,000 PITNEY BOWES INC. % Notes due ------------------ [LOGO] ------------------ GOLDMAN SACHS INTERNATIONAL DEUTSCHE BANK ABN AMRO JPMORGAN --
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