TERAFORCE TECHNOLOGY CORP
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TERAFORCE TECHNOLOGY CORPORATION

31,636,607 Shares of Common Stock

This prospectus relates to 31,636,607 shares of common stock of TeraForce Technology Corporation to be sold from time to time by the selling stockholders named in this prospectus. We are not selling any shares under this prospectus, and we will not receive any of the proceeds from the sale of the shares of common stock by the selling stockholders. In July and August, 2003, we completed the sale and issuance of an aggregate of $3,010,000 in principal amount of our 12% Convertible Subordinated Notes. The Notes are convertible into an aggregate of 25,265,000 shares of common stock. As of June 30, 2004, $400,000 in principal amount of the notes, plus accrued interest, had been converted into 2,671,473 shares of common stock. Each purchaser of Notes was also issued a warrant for the purchase of our common stock. The warrants are exercisable for an aggregate of 2,037,500 shares of common stock. In connection with the sale of the Notes we issued warrants for the purchase of 1,834,375 shares of common stock to Odyssey Capital, LLC, the placement agent for the Notes. We would receive total proceeds of $619,500 if all warrant holders elected to exercise their warrants by paying cash. Any proceeds from these purchases will be used for working capital. As of June 30, 2004, warrants for the purchase of 759,984 shares of common stock had been exercised on a cashless basis, resulting in the issuance of 365,168 shares of common stock. We are also registering 2,800,000 shares of the Company s common stock issued to a private investor in October 2003 in exchange for the cancellation of approximately $700,000 of indebtedness owed by the Company to the investor.

The selling stockholders may sell the shares of common stock covered by this prospectus in a number of different ways and at varying prices. We provide more information about how the selling stockholders may sell their shares in a section entitled Plan of Distribution on page 23. You should read this prospectus and any supplement carefully before you invest.

Our common stock is traded on the OTC Bulletin Board under the symbol TERA. On June 30, 2004, the last reported sale price of our common stock on the OTC Bulletin Board was $0.173 per share.

We currently have a concurrent offering of our shares of common stock that will have a dilutive effect on any purchaser of shares under this prospectus and the registration statement of which it forms a part. A registration statement on Form S-2 (SEC File Number 333-102746) covers resales by various private investors and other persons of shares of our common stock issued in equity financing and other transactions that occurred during 2002 and 2003, including shares issuable upon the exercise of warrants to purchase common stock issued in connection with those transactions. The shares registered for resale in the concurrent offering are not covered by this prospectus or the registration statement of which it is a part.

You should read the section entitled Risk Factors beginning on page 2 for a discussion of factors you should consider before buying our common stock.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is July 1, 2004

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PROSPECTUS SUMMARY

We use the terms we, us, and our to refer to TeraForce Technology Corporation, a Delaware corporation, and its subsidiaries unless the context indicates otherwise. This summary is qualified in its entirety by the more detailed information appearing in other places in this prospectus and in documents we incorporate by reference into this prospectus. Unless we indicate otherwise, all information with regard to our capital stock in this prospectus, including share and per share information, assumes that our outstanding options, warrants and conversion rights have not been exercised.

The Company

We design, develop, produce and sell high-density embedded computing platforms and digital signal processing products, primarily for applications in the defense electronics industry. The Company is also involved, through our subsidiaries or joint venture arrangements, in the design and sale of optical networking equipment and the design of Internet infrastructure equipment. We were incorporated in Delaware on May 23, 1995. Our principal executive offices are located at 1240 E. Campbell Road, Richardson, Texas 75081 and our telephone number at that address is (469) 330-4960.

The Offering

Common stock offered by us	None
Common stock offered by the selling stockholders	A maximum of 31,636,607 shares
Common stock outstanding as of June 30, 2004	133,561,526 shares
Offering price	Determined at the time of sale
Use of proceeds	We will receive no proceeds from the sale of our common stock by the selling stockholders. Any proceeds we receive upon the exercise of the warrants outstanding will be used for general corporate purposes.
OTC Bulletin Board Symbol	TERA

The Selling Stockholders

On July 3, 2003, referred to in this prospectus as the Initial Closing, we completed the sale of $750,000 of 12% Convertible Subordinated Notes, or Notes, to sixteen accredited investors pursuant to a Note Agreement. On August 4, 2003, referred to in this prospectus as the Second Closing, we completed a private placement of an additional $2,160,000 principal amount of the Notes. We have issued a total of $3,010,000 principal amount of Notes. On August 26, 2003, we converted into Notes two loans, totaling $250,000, that had been made to the Company, and the two individual lenders became parties to the Note Agreement. The Notes are convertible into an aggregate of 25,265,000 shares of Common Stock, assuming the outstanding principal and accrued interest for 24 months is converted into common stock. As of June 30, 2004, $400,000 in principal amount of the notes, plus accrued interest, had been converted into 2,671,473 shares of common stock.

We also issued to each purchaser of the Notes a four-year warrant for the purchase of Common Stock. Warrants to purchase an aggregate of 2,037,500 shares of our Common Stock were issued to the purchasers of the Notes. The number of shares issuable upon exercise of the Warrants are subject to customary anti-dilution provisions and therefore may be adjusted from time to time. The exercise price is $0.16 per share, but is subject to customary anti-dilution provisions and therefore may be adjusted from time to time upon the occurrence of certain events. The Warrants expire four years from the their issue date, and may be exercised at the option of the holder at any time prior to their expiration.

In connection with the sale of the Notes, we issued warrants for the purchase of 1,834,375 shares of common stock to Odyssey Capital, LLC, who acted as placement agent for the Notes. An aggregate of 1,349,591 of these warrants were subsequently assigned and transferred to various parties. As of June 30, 2004, warrants for the purchase of 759,984 shares of common stock had been exercised on a cashless basis, resulting in the issuance of 365,168 shares of common stock.

We agreed to provide registration rights to each of these investors in connection with the 25,265,000 shares of common stock underlying the Notes purchased by investors and the 3,871,875 shares of common stock to be issued upon the exercise of the Warrants. This prospectus and the registration statement of which this prospectus forms a part have been prepared and filed in satisfaction of this agreement.

In October 2003, Oscar S. Wyatt received 2,800,000 shares of common stock, and the extension of the maturity date of common stock warrants previously issued to Mr. Wyatt, in exchange for the cancellation of a note payable to Mr. Wyatt of approximately $700,000. We also agreed to provide registration rights to Mr. Wyatt for these 2,800,000 shares of common stock.

RISK FACTORS

Before you invest in our common stock, you should be aware that there are various risks, including those described below.

Disclosure Regarding Forward-Looking Statements

The statements in this prospectus regarding our future financial and operating performance and results, and other statements that are not historical facts, are forward-looking statements, as defined in Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended. We use the words may, expect, anticipate, believe, continue, estimate, project, intend, designed or other expressions to identify forward looking statements. You should read statements that contain such words carefully because they discuss future expectations, contain projections of results of operations or of our financial condition, and/or state other forward-looking information. These statements also involve risks and uncertainties, including, but not limited to:

- events, conditions and financial trends that may affect our future plans and business strategy,
- results of expectations and estimates as to prospective events, and
- circumstances about which we can give no firm assurance.

Examples of types of forward-looking statements include statements on future levels of net revenue and cash flow, new product development, strategic plans and financing. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Factors that might cause a difference include, but are not limited to:

general economic conditions in the markets we operate in;

success in the development and market acceptance of new and existing products;

dependence on suppliers, third party manufacturers and channels of distribution;

customer and product concentration;

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fluctuations in customer demand;

the ability to obtain and maintain access to external sources of capital;

the ability to control costs;

overall management of our expansion; and

other risk factors detailed from time to time in our filings with the Securities and Exchange Commission.

We believe it is important to communicate our expectations of future performance to our investors. However, events may occur in the future that we are unable to accurately predict, or over which we have no control. Any forward-looking statement speaks only as of the date the statement was made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date the statement was made. Because it is not possible to predict every new factor that may emerge, forward-looking statements should not be relied upon as a prediction of actual future financial condition or results. When considering our forward-looking statements, keep in mind the risk factors and other cautionary statements in this prospectus. The risk factors noted in this section and other factors noted throughout this prospectus provide examples of risks, uncertainties and events that may cause our actual results to differ materially from those contained in any forward-looking statement. If one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect, actual outcomes may vary materially from those forward-looking statements included in this prospectus.

Risk Factors Relating to Our Business

A Number of Factors Could Cause Operating Results to Fluctuate Significantly.

Our revenues and operating results in any reporting period may fluctuate significantly due to a variety of factors, including:

changes in the price or availability of components for our products;

the mix of products sold to the defense electronics markets and other markets;

our ability to introduce new technologies and features ahead of competitors;

the timing and size of orders we receive from customers;

fluctuations in demand for our products;

delays in testing and evaluation by customers;

production delays due to quality problems with or availability of components;

changes in our pricing policies or the pricing policies of our competitors;

changes in customers   requirements, including changes or cancellations of orders from customers;

manufacturing and shipment delays and deferrals;

our ability to efficiently produce and ship orders promptly on a price-competitive basis;

announcements or introductions of new products by our competitors;

changes in U.S. government budget, procurement and contracting trends; and

changes in general economic conditions as well as those specific to the defense electronics industry.

Current economic conditions have made it more difficult to make reliable estimates of future revenues. Fluctuations in our revenue can lead to greater fluctuations in our operating profits. In addition, we expect to incur significant research and development expenses as we develop products to serve our markets, all of which are subject to rapidly changing technology, frequent product performance improvements and evolving industry standards. The ability to deliver superior technological performance on a timely and cost effective basis is a critical factor in securing design wins for future generations of defense electronics systems. Significant research and development spending by the Company does not ensure that our products will be designed into a customer s system. Because future production orders are usually contingent upon

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securing a design win, our operating results may fluctuate if we obtain or fail to obtain design wins for significant customer systems.

We Have Incurred Significant Losses in the Past.

In 2003, 2002 and 2001 we have incurred net losses of $8,559,000, $4,350,000 and $21,549,000, respectively. These losses have been funded from borrowings under credit facilities, sales of debt and equity securities and proceeds from the settlement of a lawsuit. It is not certain when we will become profitable. The ability to become profitable will depend, in part, on our ability to increase net revenue from sales of defense electronics products. If our need for capital exceeds available resources, there can be no assurance that additional capital will be available through public or private equity or debt financing.

Debt Service Obligations May Adversely Affect Our Cash Flow and We May Be Unable to Repay the Debt On Time.

We have approximately $7,400,000 of debt outstanding. Of this amount, approximately $700,000 is due by December 31, 2004 and the balance is due by June 30, 2005. We may not be able to generate sufficient cash flow from operations to repay all of this debt when it comes due. Approximately $2,860,000 of this debt is convertible into common stock at the option of the holders at a rate of $0.16 per share, which is less than prices at which our stock has recently traded. Therefore, this debt may be converted into common stock before its maturity. We intend to restructure or refinance any balance of the debt if we are not able to repay it when it comes due. However, there is no assurance that the convertible debt will be converted into common stock or that we will be able to restructure or refinance the remaining debt in a timely manner. Even if we are able to refinance or restructure this debt, we may still be subject to substantial interest and principal repayment obligations.

Our Auditors Have Expressed Doubt as to Our Ability to Continue as a Going Concern.

Our independent certified public accountants have added an explanatory paragraph to their audit opinion issued in connection with our consolidated financial statements. The opinion states that our ability to continue as a going concern is uncertain due to our history of operating losses and difficulty in generating operating cash flows. Our consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. These adjustments might include changes in the possible future recoverability and classification of assets or the amounts and classification of liabilities that might result from the outcome of this uncertainty.

We May Not Be Able to Successfully Complete Development and Achieve Customer Acceptance of New Defense Electronics Products.

We must continually enhance our products and develop new products on a timely and cost effective basis. Certain enhancements to our products are in the development phase and are not yet ready for commercial manufacturing or deployment. The successful development and deployment of these products is subject to substantial risk. The development of these products, from laboratory prototype to customer trial, and subsequently to general availability, involves a number of steps including the following:

- completion of product development;

the qualification and multiple sourcing of critical components;

validation of manufacturing methods and processes;

extensive quality assurance and reliability testing, and staffing of testing infrastructure;

validation of embedded software; and

establishment of systems integration and systems test validation requirements.

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Each of these steps in turn presents serious risks of failure, rework or delay. Any one of these setbacks could decrease the speed and scope of product introduction and marketplace acceptance of the product. In addition, unexpected intellectual property disputes, failure of critical design elements, and other setbacks may delay or even prevent the introduction of these products. A lack of working capital may also negatively impact our ability to enhance our products in a timely manner.

Additionally, the markets for our new products may be undeveloped. The commercial acceptance of these types of products is uncertain. We cannot assure you that our sales and marketing efforts for these products will be successful.

We are a Party to Lawsuits and May Be Subject to Other Contingent Liabilities.

We are a named party in a lawsuit and may be subject to significant other contingent liabilities. Defending these matters may require a substantial amount of our resources, and any judgments may materially affect our financial condition and results of operations.

Our Failure to Quickly Adapt to Rapidly Changing Competitive and Economic Conditions Could Have a Material Adverse Effect on Our Business and Results of Operations.

We operate in a rapidly changing and competitive and economic environment. Our future success will depend, in part, on our ability to enhance our current products and to develop new products on a timely and cost-effective basis that respond to technological developments and changing customer needs. The markets for sophisticated technology are constantly undergoing rapid competitive and economic changes. The full scope and nature of these changes are difficult to predict. The defense electronics market, in particular, demands constant technological improvements as a means of gaining military advantage. We believe that technological change will continue to attract new entrants to our market. Industry consolidation among competitors may increase their financial resources, which may allow our competitors to reduce their prices. This would require us to reduce the prices of our products or risk losing market share.

We Have a Limited Customer Base.

We are dependent on a small number of customers for a large portion of our revenues. In 2003, four customers accounted for approximately 64% of our net revenues. Customers in the defense electronics market purchase our products in connection with government programs that may have limited duration, leading to fluctuating sales to any particular customer in the defense electronics market from year to year. A significant decrease in our sales to any of our major customers, or the loss of any of our major customers, would have a material adverse effect on our business, financial condition and results of operations. In addition, our revenues are largely dependent upon the ability of our customers to develop and sell products and systems that incorporate our products. There is no assurance that our customers will not experience financial or other difficulties that could adversely affect our operations and, in turn, our results of operations.

We May Not Be Successful if We Do Not Attract New Customers.

Our future success will depend on our attracting additional customers. The growth of our customer base could be adversely affected by:

customer unwillingness to implement our defense electronics technology;

any delays or difficulties that we may incur in completing the development, introduction and production manufacturing of our planned products or product enhancements;

new product introductions by our competitors;

any failure of our products to perform as expected;

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- any difficulty we may incur in meeting customers delivery, installation or performance requirements; or

- customer concerns over our financial condition.

We Must Attract, Retain and Motivate Key Technical and Management Personnel in a Competitive Market in Order to Sustain and Grow Our Business.

Our success depends to a significant extent upon key technical and management employees. Competition for highly qualified employees can be intense and the process of locating key technical and management personnel with the required combination of skills and attributes can be lengthy and expensive. There can be no assurance that we will be successful in retaining our existing key personnel or in attracting and retaining the additional employees we may require. We must continue to recruit, train, assimilate, motivate, and retain qualified managers and employees to manage our operations effectively. If we do not successfully recruit, hire and retain key employees, we may be unable to execute our business plan effectively and our results of operations could be significantly adversely affected.

Our Agreement with VISTA Controls, Inc. May Not Produce the Expected Benefits.

In November 2003, we entered into a Technology License and Marketing Agreement with VISTA Controls, Inc., or Vista, a subsidiary of Curtiss-Wright Corporation. Pursuant to this agreement, and certain ancillary agreements, we have licensed to Vista technology related to our VQG4 and Eagle I products. Vista and we have agreed to jointly develop and market variations of these products, which will be designed to meet the requirements of harsh operating environments, also know as rugged products. Vista will produce the rugged versions of the VQG4 and Eagle I products. We expect that our relationship with Vista will have a positive effect on our business because of new products we expect to have as a result of the relationship and access to Vista s market channels. There is no assurance that these benefits will materialize. The joint development of the new products and customer acceptance of those products is subject to the same risks and uncertainties as we have described above. Even if we are able to utilize Vista s market channels, there is no assurance that this will result in material increased net revenues or that the margins generated from any such increase will be significant. The agreement with Vista could prevent us from pursuing other opportunities.

We May Be Unable to Secure Necessary Components and Support Because We Depend Upon a Limited Number of Third-Party Manufacturers and Support Organizations.

We depend on a limited number of suppliers for components of our products, as well as for equipment used to design and test our products. Certain components used in our products are only available from a single source or limited number of vendors. If these suppliers were to limit or reduce the sale of such components to the Company, or if these suppliers were to experience financial difficulties or other problems that prevented them from supplying the Company with the necessary components, such events could have a material adverse effect on the Company s business, financial condition and results of operations. These single source and other suppliers are each subject to quality and performance issues, materials shortages, excess demand, reduction in capacity and other factors that may disrupt the flow of goods to the Company or its customers; thereby adversely affecting the Company s business and customer relationships. Some of the sole source and limited source vendors are companies who, from time to time, allocate parts to equipment manufacturers due to market demand for components and equipment. The Company has no guaranteed supply arrangements with its suppliers and there can be no assurance that its suppliers will continue to meet the Company s requirements. Many of our competitors are much larger and may be able to obtain priority allocations from these shared vendors, thereby limiting or making our sources of supply unreliable for these components. If the Company s supply arrangements are interrupted, there can be no assurance that the Company would be able to find another supplier on a timely or satisfactory basis. Any delay in component availability for any of our products could result in delays in deployment of these products and in our ability to recognize revenues. Suppliers may be concerned regarding our financial condition and therefore may be unwilling to sell components to us, or to grant trade credit to us.

If we are unable to obtain a sufficient supply of components from alternative sources, reduced supplies and higher prices of components will significantly limit our ability to meet scheduled product deliveries to customers. A delay in receiving certain components or the inability to receive certain components could harm our customer relationships and our results of operations.

Failures of components affect the reliability and performance of our products, can reduce customer confidence in our products, and may adversely affect our financial performance. From time to time, we have experienced delays in receipt of components and have received components that do not perform according to their specifications. Any future difficulty in obtaining sufficient and timely delivery of components could result in delays or reductions in product shipments that could harm our business. In addition, a consolidation among suppliers of these components or adverse developments in their businesses that affect their ability to meet our supply demands could adversely impact the availability of components that we depend on. Delayed deliveries from these sources could adversely affect our business.

Our defense electronics products are manufactured by a limited number of third-party manufacturers. If we were required to find alternative third-party manufacturers, we may be forced to incur significant costs and risks. There is no assurance that the alternative manufacturers could produce our products with quality or costs comparable to the existing manufacturers. In addition, the transfer of the manufacturing process to an alternative provider could result in significant delays that could cause us to miss deadlines imposed by our customers.

The Defense Electronics Products Business Is Subject to Special Risks.

We expect that the majority of our net revenues in the future will come from the sale of our defense electronics products. We supply products to sub-contractors and prime contractors whose ultimate customer is often an agency of the United States government. The funding of U.S. government programs is subject to congressional appropriations. Although multiple-year contracts may be planned in connection with major procurements, Congress generally appropriates funds on a fiscal year basis even though a program may continue for several years. Consequently, programs are often only partially funded initially, and additional funds are committed only as Congress makes further appropriations and prime contracts receive such funding. The U.S. government could reduce or terminate a prime contract under which we are a subcontractor or team member irrespective of the quality of our products or services. The reduction in funding or termination of a government program we are involved in would result in a loss of anticipated future revenues attributable to that program and contracts or orders received by us. The termination of a program or the reduction in or failure to commit additional funds to a program we are involved in could increase our overall costs of doing business and have a material adverse effect on our financial condition and results of operations. The contracts with the United States government are subject to special risks including the following: delays or cancellations of funding for programs; ability of the government to unilaterally cancel the contract; reduction or modification as a result of budgetary restraints or political changes; and other factors not under the control of us or the prime contractor. In addition, changes in government administration, and changes in national and international priorities including developments in the geo-political environment such as the current War on Terrorism, Operation Enduring Freedom, Operation Iraqi Freedom, and nuclear proliferation in North Korea, could have a significant impact on defense spending priorities and the efficient handling of routine contractual matters. These changes could have either a positive or negative impact on our business, financial condition or results from operations in the future.

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The Failure to Develop and Introduce New Products That Meet Changing Customer Requirements and Address Technological Advances Would Limit Our Ability to Sell Our Products and Services.

New product development often requires long-term forecasting of market trends, and development and implementation of new technologies. If we fail or are late to respond to new technological developments, market acceptance of our products may be significantly reduced or delayed. The markets we participate in are characterized by rapidly changing technology, evolving industry standards, changes in end user requirements, and frequent new product introductions and enhancements. The introduction of products embodying new technologies or the emergence of new industry standards can render our existing products obsolete or unmarketable. There can be no assurance that we will be able to develop and introduce new products ahead of our competitors, or that our products will not be rendered obsolete. If we fail to invest sufficiently in research and development, our products could become less attractive to potential customers, and our business and financial condition could be materially adversely affected.

We May Not Be Able to Secure an Adequate Number of Design Wins.

Before buying our products, a customer will evaluate our products, and those of our competitors, as a part of designing a larger system. When a product is selected by a customer to be utilized in its system we refer to it as a design win. The design-win process is typically lengthy and expensive, and there can be no assurance that we will be able to continue to meet the product specifications of our customers in a timely and adequate manner. In the defense electronics market, military planners have historically funded significantly more design projects than actual deployments of new equipment. There can be no assurance that we will secure an adequate number of design wins. Failure to secure future design wins could have a material adverse effect on our business, financial condition and results of operations.

Product Performance Problems Could Limit Sales Prospects.

The production of new products with high technology content involves occasional problems while the technology and manufacturing methods mature. If significant reliability or quality problems develop, including those due to faulty components, a number of negative effects on our business could result, including:

- costs associated with reworking the manufacturing processes;
- high service and warranty expenses;
- high inventory obsolescence expense;
- high levels of product returns;
- delays in collecting accounts receivable;
- reduced orders from existing customers; and
- declining interest from potential customers.

Although we maintain accruals for product warranties, actual costs could exceed these amounts. From time to time, there will be interruptions or delays in the activation of products at a customer s site. These interruptions or delays may result from product performance problems or from aspects of the installation and activation activities, some of which are outside our control. If we experience significant interruptions or delays that cannot be promptly resolved, confidence in our products could be undermined, which could have a material adverse effect on operations.

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Failure to Protect Our Intellectual Property Will Adversely Affect Our Ability to Compete in the Industry and Our Profitability.

We rely on a combination of patents, copyright, trademark and trade secret laws, and restrictions on disclosure to protect our intellectual property. We also enter into confidentiality or license agreements with our employees, consultants and corporate partners and control access to and distribution of our software, documentation and other proprietary information. These intellectual property protection measures may not be sufficient to prevent wrongful misappropriation of our technology. In addition, these measures will not prevent competitors from independently developing technologies that are substantially equivalent or superior to our technology. The laws of many foreign countries do not protect intellectual property rights to the same extent as the laws of the United States. Failure to protect proprietary information could result in, among other things, loss of competitive advantage, loss of customer orders and decreased revenues. Monitoring the unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. If competitors are able to use our technology, our ability to compete effectively could be impaired. This litigation could result in substantial costs and diversion of resources and may not ultimately be successful.

We May Be Subject to Intellectual Property Infringement Claims That Are Costly to Defend and Could Limit Our Ability to Use Some Technologies in the Future.

Like other participants in our industry, we may be subject to infringement claims and other intellectual property disputes as competition in the marketplace continues to intensify. In the future, we may be subject to litigation and may be required to defend against claimed infringements of the rights of others or to determine the scope and validity of the proprietary rights of others. Any such litigation could be costly and divert management s attention from operations. In addition, adverse determinations in such litigation could:

- result in the loss of our proprietary rights to use the technology;
- subject us to significant liabilities;
- require us to seek licenses from third parties;
- require us to redesign the products that use the technology; or
- prevent manufacturing or sale of our products that employ the technology.

If we are forced to take any of the foregoing actions, our business may be seriously harmed.

We May Be Unable to License Third-Party Technology at a Reasonable Cost.

From time to time we may be required to license technology from third parties to develop new products or product enhancements. We cannot ensure that third-party licenses will be available to us on commercially reasonable terms. The inability to obtain any third-party license required to develop new products and product enhancements could require us to obtain substitute technology of lower quality or performance standards, or to license such technology at a greater cost. Both licensing inferior technology at a reasonable cost and licensing necessary technology at a higher cost could seriously harm the competitiveness of our products.

Our Products Are Subject to Government Regulation.

The export of our products and related technology may be subject at times to regulation and restriction by the Department of Commerce. Because our products are utilized in defense and intelligence gathering related applications, in some cases the export of our products and related technology may be subject to further regulation and restriction by the Department of State. Sales to foreign countries have not been material to date, but export controls could limit our ability to sell our products outside the United States

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or could delay such sales in the future. We also may be required to spend substantial time and resources in order to comply with the regulations and restrictions. We could be subject to fines if we fail to properly comply with these regulations.

In addition, our business and operating results may also be adversely affected by the imposition of certain tariffs, duties and other import restrictions on components that we obtain from non-domestic suppliers or by the imposition of export restrictions on products that we sell internationally. We do not believe we have material exposure to environmental laws. Changes in current or future laws or regulations, in the United States or elsewhere, could materially and adversely affect our business and results of operations.

Risk Factors Related to the Securities Market

Our Common Stock Is Subject to Price Volatility.

The price of our common stock is volatile. Fluctuations in operating results, such as revenues or operating results being below the expectations of public market analysts and investors, may cause additional volatility in the price of the common stock. In such event, the market price of our common stock could decline significantly. A significant decline in the market price of the common stock could result in litigation that could also result in increased costs and a diversion of management s attention and resources from operations.

There May Not Be a Liquid Market for our Common Stock.

Our common stock currently is traded on the OTC Bulletin Board operated by Nasdaq. This market generally has less liquidity than most other markets and certain institutional investors are precluded from buying stock in this market. There can be no assurance that our investors will be able to sell our common stock at prices and times that are desirable.

Additional Capital May Dilute Current Stockholders.

In order to provide capital for the operation of our business we may enter into additional financing arrangements. These arrangements may involve the issuance of new common stock, preferred stock that is convertible into common stock, debt securities that are convertible into common stock or warrants for the purchase of common stock. Any of these items could result in a material increase in the number of shares of common stock outstanding which would in turn result in a dilution of the ownership interest of existing common shareholders. In addition these new securities could contain provisions, such as priorities on distributions and voting rights, which could affect the value of our existing common stock.

Shares Issuable Upon the Exercise of Options, Warrants and Convertible Debentures or under Anti-Dilution Provisions in Certain Agreements Could Dilute Stock Holdings and Adversely Affect our Stock Price.

We have issued options and warrants to acquire common stock to our employees, to holders of our 12% convertible subordinated notes and to certain other persons at various prices, some of which are, or may in the future have, exercise prices at or below the market price of our stock. As of June 30, 2004, we have outstanding options to purchase a total of 17,222,466 shares and warrants to purchase a total of 29,718,559 shares of our common stock. Of these options and warrants, 17,975,968 have exercise prices above the recent market price of $0.173 per share (as of

June 30, 2004), and 25,965,059 have exercise prices at or below this recent market price. If exercised, these options and warrants will cause immediate and possibly substantial dilution to our stockholders.

On March 3, 2004 our board of directors approved an amendment to our stock incentive plan, subject to stockholder approval, to increase the maximum number of shares that may be issued under the plan from 9,500,000 to the greater of (a) 21,000,000 and (b) a number of shares equal to 12% of the number of fully diluted shares outstanding from time to time, subject to adjustment and substitution as set forth in the plan. Our stockholders approved this amendment at our 2004 annual meeting of stockholders held on May 19, 2004. As of June 30, 2004, we had an aggregate of 180,300,083 fully diluted shares, as calculated pursuant to the plan. Twelve percent of this number would equal 21,636,010 shares authorized for issuance under the plan. As of June 30, 2004, options to purchase a total of 17,222,466 shares of our common stock were outstanding under the Plan. Any further increase in the number of shares authorized for issuance under our stock incentive plan may result in further dilution to our stockholders.

The holders of our 12% convertible subordinated notes have the option of converting outstanding principal plus accrued interest on the notes into shares of our common stock at $0.16 per share. The 12% convertible subordinated notes are convertible into 22,707,500 shares of common stock, assuming the outstanding principal and accrued interest for 24 months is converted into common stock. As of June 30, 2004, $400,000 in principal amount of the notes, plus accrued interest, had been converted into 2,671,473 shares of common stock. Additional conversions of the notes will have a dilutive effect on our stockholders.

Issuance of shares pursuant to the exercise of options, warrants, anti-dilution provisions, or the conversion of our 12% convertible subordinated notes could lead to subsequent sales of the shares in the public market, which could depress the market price of our stock by creating an excess in supply of shares for sale. Issuance of these shares and sale of these shares in the public market could also impair our ability to raise capital by selling equity securities.

A Large Number of Shares will be Eligible for Future Sale and May Depress our Stock Price

As of June 30, 2004, we had outstanding 133,561,526 shares of common stock of which approximately 40,000,000 shares were restricted securities as that term is defined under Rule 144 promulgated under the Securities Act. These restricted shares are eligible for sale under Rule 144 at various time. We have entered into registration rights agreements requiring us to register the resale of approximately 88,189,943 shares of common stock, including shares of common stock issuable upon the exercise of warrants and the conversion of our 12% convertible subordinated notes and including the shares of common stock covered by this prospectus. No prediction can be made as to the effect, if any, that sales of shares of common stock or the availability of such shares for sale will have on the market prices prevailing from time to time. Nevertheless, the possibility that substantial amounts of our common stock may be sold in the public market may adversely affect prevailing market prices for the common stock and could impair our ability to raise capital through the sale of our equity securities.

We May Propose a Reverse-Split of Our Common Stock.

In order to reduce the number of shares outstanding, increase the trading price of our common stock, qualify for listing on an exchange and possibly attract additional groups of investors we may at some time in the future propose a reverse-split of our common stock. Such a proposal would require the approval of the majority of the outstanding shares of voting stock to be implemented. There can be no assurance that a reverse split would have the intended effect and therefore it could dilute the value of our common stock.

USE OF PROCEEDS

We will not receive any proceeds from any sale of shares of common stock by the selling stockholders (other than the exercise price payable upon the exercise of any warrants issued to the selling stockholders). Assuming all of the warrants held by the selling stockholders for an aggregate of 3,871,875 shares of common stock were exercised through a cash exercise, we would receive an aggregate of $619,500 of proceeds. As of June 30, 2004, warrants for the purchase of 759,984 shares of common stock had been exercised on a cashless basis, resulting in the issuance of 365,168 shares of common stock. The shares of common stock underlying the warrants are being registered for resale in this registration statement. We anticipate that we will use any proceeds from the exercise of the warrants for general corporate purposes in the execution of our business strategy.

SELLING STOCKHOLDERS

General. This prospectus covers offers and sales from time to time of our common stock by the following selling stockholders:

Robert E. Sternenberg, an individual residing in Texas;

Kirk E. Kanady, M.D., an individual residing in Texas;

Russell H. Schlattman, II, an individual residing in Texas;

Duane K. Rossmann, an individual residing in Texas;

Bruce K. Smith, an individual residing in Texas;

Wanda Hicks Carmichael, an individual residing in Texas;

Daniel Stroud, an individual residing in Texas;

Henry L. Bethea, an individual residing in Texas, beneficial owner of shares purchased by Bayou Anesthetic and Pain MPP & Trust, a Texas trust, Northwest Anesthesiology Pension Plan and Money Purchase Plan, a Texas trust, and Northwest Anesthesiology Salary Deferral, a Texas trust;

Betty Jo Edwards, M.D., an individual residing in Texas;

Phillip G. Sutton, M.D., an individual residing in Texas, as beneficial owner of shares purchased by Phillip G. Sutton, M.D., P.A. Money Purchase Plan, a Texas trust;

Jack Matt, Jr., an individual residing in Texas, as beneficial owner of shares purchased by Jack Matt, Jr. Charles Schwab & Co. Inc. Customer IRA Rollover, a Texas trust;

Paul Song, an individual residing in Texas;

Kevin McMullen, M.D., an individual residing in Oklahoma, as beneficial owner of shares purchased by Surgical Specialists of Oklahoma, PC Profit Sharing Plan, an Oklahoma trust;

Sigmond and Mary Jo Palowski, individuals residing in Texas;

Phillip L. Legget, M.D., an individual residing in Texas;

Manuel B. Gonzalez, an individual residing in Texas;

Kranthi Reddy, an individual residing in Texas;

Vasu Reddy, an individual residing in Texas, as beneficial owner of shares purchased by GVR Family Limited Partnership, a Texas family limited partnership, Trust of Rishi N. Reddy, a Texas trust, and Trust of Reva N. Reddy, a Texas trust;

Charles F. Gainennie, Jr., an individual residing in Texas;

John C. Bowen, III, an individual residing in Louisiana;

Jean Neustadt, Jr., an individual residing in Texas, as beneficial owner of shares purchased by Jean Neustradt, Jr. Sole and Separate Property, an individual residing in Texas;

Robert Ted Lyons, an individual residing in Texas;

Keith F. Konan, an individual residing in Texas;

Mitchell P. Derden, an individual residing in Texas;

Rodney D. Houston, an individual residing in Texas;

Gary D. Jones, an individual residing in Texas;

Gary Emmott, an individual residing in Texas;

Matthew M. Sokany, an individual residing in Texas;

Jeffery C. Lambert, an individual residing in Texas;

Jeff L. Hegan, an individual residing in Texas;

Corbin J. Robertson, III, an individual residing in Texas;

Corbin J. Robertson, III, an individual residing in Texas, as beneficial owner of shares purchased by Lion Fund L.P., a Texas limited partnership, and Spring Street Partners, a Texas partnership;

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Joseph Perlman, M.D., an individual residing in Texas;

Tom L. Pettiette, an individual residing in Texas;

Robert Lubin, an individual residing in Texas;

Riyad Tarazi, an individual residing in Texas;

Timothy M. Havens, an individual residing in Texas;

Michael A. Hillman, an individual residing in Texas;

Ken Reed, an individual residing in Texas, as beneficial owner of shares purchased by K&D Reed Investments Limited Partnership, a Texas limited partnership;

Terry C. Hicks, M.C., an individual residing in Texas;

Alan B. Springer, an individual residing in Texas, and Edward Gainennie, an individual residing in Texas, as beneficial owners of shares purchased by S&G Associates, L.L.C., a Texas limited liability company;

Robert P. Capps, an individual residing in Texas;

Anton von zu Liechtenstein, an individual residing in Liechtenstein;

Odyssey Capital, L.L.C., a Texas limited liability company;

Oscar S. Wyatt, an individual residing in Texas;

Brewer & Pritchard, PC, a Texas professional corporation;

Edward Gainennie, an individual residing in Texas;

Alan Springer, an individual residing in Texas; and

Denise Morvant, an individual residing in Texas.

On July 3, 2003, the Initial Closing, we completed the sale of $750,000 of 12% Convertible Subordinated Notes, or Notes, to sixteen accredited investors pursuant to a Note Agreement. On August 4, 2003, the Second Closing, we completed a private placement of $2,160,000 principal amount of the Notes to thirty accredited investors. We have issued a total of $3,010,000 principal amount of the Notes.

The Notes are our subordinated unsecured obligations and are subordinated to the rights of holders of all existing and future senior indebtedness. The terms of the Note Agreement limit our ability to incur additional senior indebtedness. Pursuant to the Note Agreement, we may not directly or indirectly create, incur or suffer to exist any indebtedness senior to the Notes, or Senior Indebtedness, in an aggregate principal amount exceeding at any time the sum of $1 million without the prior written consent of the holders of at least 51% of the aggregate principal amount of the Notes outstanding at the time the transaction is authorized by our board of directors. For purposes of calculating the limitation on incurring Senior Indebtedness, the following indebtedness will not be included in calculating the aggregate amount of Senior Indebtedness:

- Bank One, N.A. in the amount of $4.2 million;
- O.S. Wyatt Jr. in the amount of $650,000;
- FirstCapital Bank, SSB in the amount of $1,000,000; and
- any restructuring or refinancing of the above-described Senior Indebtedness.

We will pay all outstanding principal balances on the Notes at maturity, which is June 30, 2005. Interest on the Notes will accrue at a rate of 12% per annum, computed on the basis of a 360-day year of twelve 30-day months. Interest will be due annually on June 15 and at maturity on June 30, 2005. We may redeem all or any portion of the outstanding Notes at any time beginning 120 days after the final closing of this offering. Each Note to be redeemed shall be redeemed against payment of an amount in cash equal to:

- 110% of the outstanding principal balance of the Note, plus accrued interest, if redeemed after June 15, 2003 but on or before June 1, 2004; or
- 105% of the outstanding principal balance of the Note, plus accrued interest, if redeemed after June 1, 2004.

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A noteholder may convert at any time after the final closing of this offering any or all of the principal and accrued interest of his Notes into shares of our common stock. The number of shares of common stock issuable upon conversion of the Notes will be calculated by dividing the outstanding indebtedness and accrued interest to be converted by the conversion price in effect at the time of conversion. The initial conversion price of the Note was calculated as the lesser of:

the average closing price of our common stock for the thirty (30) trading days prior to the Initial Closing Date;

the average closing price of our common stock for the thirty (30) trading days prior to the Final Closing Date; and

$0.16.

We agreed to deliver written notice of the conversion price to each investor upon the final closing of the offering, which was $0.16 per share. The conversion price will be subject to anti-dilution provisions and, therefore, may be adjusted from time to time upon the occurrence of certain events. As of June 30, 2004, $400,000 in principal amount of the notes, plus accrued interest, had been converted into 2,671,473 shares of common stock.

We also issued to each purchaser of the Notes a four-year warrant for the purchase of common stock. The warrants entitle the noteholders to purchase shares of our common stock equal to 10% of the number of shares of common stock, not including any conversion shares resulting from accrued interest. The number of shares to be issued upon exercise of the warrants will be subject to anti-dilution provisions and, therefore, may be adjusted from time to time. The exercise price of the warrants was equal to the conversion price of the Notes upon the closing of this offering, or $0.16 per share. The exercise price will be subject to anti-dilution provisions and, therefore, may be adjusted from time to time upon the occurrence of certain events. The warrants may be exercised at the option of the holder at any time prior to their expiration. The warrants will expire four years after their issuance. The shares of common stock to be issued upon the exercise of the warrants are included in this registration statement covering shares of common stock underlying the Notes.

We entered into a registration rights agreement with each noteholder, and agreed to file a registration statement with the SEC under the Securities Act, registering the shares of common stock underlying the Notes and the warrants. This prospectus and the registration statement which includes this prospectus have been prepared and filed in satisfaction of these registration rights agreements. The Company and Noteholders each agreed with the other to indemnify the other for certain liabilities arising under the Securities Act.

The selling stockholders described below are offering shares of our common stock from time to time under this prospectus.

Robert E. Sternenberg purchased $25,000 in Notes at the Initial Closing, which are convertible into 193,750 shares of common stock. Mr. Sternenberg was also issued a warrant for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share. On August 4, 2003 (the Second Closing), Mr. Sternenberg purchased an additional $25,000 in Notes, which are convertible into 193,750 shares of common stock. Mr. Sternenberg also received a warrant for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share at the Second Closing.

Kirk E. Kanady, M.D. purchased $100,000 in Notes at the Initial Closing, which are convertible into 775,000 shares of common stock. Mr. Kanady was also issued a warrant for the purchase of 62,500 shares with an exercise price of $0.16 per share. At the Second Closing, Mr. Kanady purchased an additional $100,000 in Notes that are also convertible into 775,000 shares of common stock. Mr. Kanady was issued a second warrant for the purchase of 62,500 shares with an exercise price of $0.16 per share.

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Russell H. Schlattman, II, purchased $25,000 in Notes at the Initial Closing, which are convertible into 193,750 shares of common stock. Mr. Schlattman was also issued a warrant for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

Duane K. Rossmann purchased $50,000 in Notes at the Initial Closing, which are convertible into 387,500 shares of common stock. Mr. Rossman was also issued a warrant for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share.

Bruce K. Smith purchased $50,000 in Notes at the Initial Closing, which are convertible into 387,500 shares of common stock. Mr. Smith was also issued a warrant for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share.

Wanda Hicks Carmichael purchased $100,000 in Notes at the Initial Closing, which are convertible into 775,000 shares of common stock. Ms. Carmichael was also issued a warrant for the purchase of 62,500 shares with an exercise price of $0.16 per share at the Initial Closing. Ms. Carmichael purchased $300,000 in Notes at the Second Closing, which are convertible into 2,325,000 shares of common stock. Ms. Carmichael was also issued a warrant for the purchase of 187,500 shares with an exercise price of $0.16 per share at the Second Closing.

Daniel Stroud purchased $25,000 in Notes at the Initial Closing, which are convertible into 193,750 shares of common stock. Mr. Stroud was also issued a warrant for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

Bayou Anesthetic and Pain MPP & Trust purchased $30,000 at the Initial Closing, which are convertible into 232,500 shares of common stock. Bayou Anesthetic and Pain MPP & Trust was also issued a warrant for the purchase of 18,750 shares of common stock with an exercise price of $0.16 per share. Northwest Anesthesiology Pension Plan and Money Purchase Plan purchased $15,000 in Notes, which are convertible into 116,250 shares of common stock. Northwest Anesthesiology Pension Plan and Money Purchase Plan was also issued a warrant for the purchase of 9,375 shares with an exercise price of $0.16 per share. Northwest Anesthesiology Salary Deferral purchased $5,000 in Notes, which are convertible into 38,750 shares of common stock. Northwest Anesthesiology Salary Deferral was also issued a warrant for the purchase of 3,125 shares of common stock with an exercise price of $0.16 per share. Henry L. Bethea, a resident of Texas, is the beneficial owner of the Notes and warrants held by Bayou Anesthetic and Pain MPP & Trust, Northwest Anesthesiology Pension Plan and Money Purchase Plan and Northwest Anesthesiology Salary Deferral.

Betty Jo Edwards, M.D., purchased $25,000 in Notes at the Initial Closing, which are convertible into 193,750 shares of common stock. Ms. Edwards was also issued a warrant for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

The Phillip G. Sutton, MD, P.A. Money Purchase Plan purchased $100,000 in Notes at the Initial Closing, which are convertible into 775,000 shares of common stock. The Phillip G. Sutton, MD, P.A. Money Purchase Plan was also issued a warrant for the purchase of 62,500 shares of common stock with an exercise price of $0.16 per share. Phillip G. Sutton, MD is the beneficial owner of the Notes and warrants purchased by the Phillip G. Sutton, MD, P.A. Money Purchase Plan.

The Jack Matt Jr. Charles Schwab & Co. Inc. Customer IRA Rollover purchased $25,000 in Notes at the Initial Closing, which are convertible into 193,750 shares of common stock. The Jack Matt Jr. Charles Schwab & Co. Inc. Customer IRA Rollover was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share. Jack Matt, Jr. is the beneficial owner of the Notes and warrants held by the Jack Matt Jr. Charles Schwab & Co. Inc. Customer IRA Rollover.

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Paul Song purchased $100,000 in Notes at the Initial Closing, which are convertible into 775,000 shares of common stock. Mr. Song was also issued warrants for the purchase of 62,500 shares of common stock with an exercise price of $0.16 per share.

Surgical Specialists of Oklahoma, PC Profit Sharing Plan purchased $50,000 in Notes at the Initial Closing, which are convertible into 387,500 shares of common stock. Surgical Specialists of Oklahoma, PC Profit Sharing Plan was also issued warrants for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share. Surgical Specialists of Oklahoma, PC Profit Sharing Plan purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Surgical Specialists of Oklahoma, PC Profit Sharing Plan was also issued a warrant for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share. Kevin McMullen, MD is the beneficial owner of the Notes and warrants purchased by Surgical Specialists of Oklahoma, PC Profit Sharing Plan.

Sigmond and Mary Jo Palowski purchased $25,000 in Notes at the Initial Closing, which are convertible into 193,750 shares of common stock. Sigmond and Mary Jo Palowski were also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

Rick Richards purchased $280,000 in Notes at the Second Closing, which are convertible into 2,170,000 shares of common stock. Mr. Richards was also issued warrants for the purchase of 175,000 shares of common stock with an exercise price of $0.16 per share.

Phillip L. Legget, MD purchased $50,000 in Notes at the Second Closing, which are convertible into 387,500 shares of common stock. Mr. Legget was also issued warrants for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share.

Manuel B. Gonzalez purchased $70,000 in Notes at the Second Closing, which are convertible into 542,500 shares of common stock. Mr. Gonzalez was also issued warrants for the purchase of 43,750 shares of common stock with an exercise price of $0.16 per share.

Kranthi Reddy purchased $50,000 in Notes at the Second Closing, which are convertible into 387,500 shares of common stock. Ms. Reddy was also issued warrants for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share.

GVR Family Limited Partnership purchased $400,000 in Notes at the Second Closing, which are convertible into 3,100,000 shares of common stock. GVR Family Limited Partnership was also issued warrants for the purchase of 250,000 shares of common stock with an exercise price of $0.16 per share. Trust of Rishi N. Reddy purchased $10,000 in Notes at the Second Closing, which are convertible into 77,500 shares of common stock. Trust of Rishi N. Reddy was also issued warrants for the purchase of 6,250 shares of common stock with an exercise price of $0.16 per share. Trust of Reva N. Reddy purchased $10,000 in Notes at the Second Closing, which are convertible into 77,500 shares of common stock. Trust of Reva N. Reddy was also issued warrants for the purchase of 6,250 shares of common stock with an exercise price of $0.16 per share. Vasu Reddy is the beneficial owner of the Notes and warrants held by GVR Family Limited Partnership, Trust of Rishi N. Reddy and Trust of Reva N. Reddy.

Charles F. Gainennie, Jr. purchased $50,000 in Notes at the Second Closing, which are convertible into 387,500 shares of common stock. Mr. Gainennie was also issued warrants for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share.

John C. Bowen, III purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Mr. Bowen was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

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Jean Neustadt, Jr. Sole and Separate Property purchased $50,000 in Notes at the Second Closing, which are convertible into 387,500 shares of common stock. Jean Neustadt, Jr. Sole and Separate Property was also issued warrants for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share. Jean Neustadt, Jr. is the beneficial owner of Notes and warrants purchased by Jean Neustadt, Jr. Sole and Separate Property.

Robert Ted Lyons purchased $50,000 in Notes at the Second Closing, which are convertible into 387,500 shares of common stock. Mr. Lyons was also issued warrants for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share.

Keith F. Konen purchased $15,000 in Notes at the Second Closing, which are convertible into 116,250 shares of common stock. Mr. Konen was also issued warrants for the purchase of 9,375 shares of common stock with an exercise price of $0.16 per share.

Mitchell P. Derden purchased $5,000 in Notes at the Second Closing, which are convertible into 38,750 shares of common stock. Mr. Derden was also issued warrants for the purchase of 3,125 shares of common stock with an exercise price of $0.16 per share.

Rodney D. Houston purchased $5,000 in Notes at the Second Closing, which are convertible into 38,750 shares of common stock. Mr. Houston was also issued warrants for the purchase of 3,125 shares of common stock with an exercise price of $0.16 per share.

Gary D. Jones purchased $5,000 in Notes at the Second Closing, which are convertible into 38,750 shares of common stock. Mr. Jones was also issued warrants for the purchase of 3,125 shares of common stock with an exercise price of $0.16 per share.

Gary Emmott purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Mr. Emmott was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

Matthew M. Sokany purchased $50,000 in Notes at the Second Closing, which are convertible into 387,500 shares of common stock. Mr. Sokany was also issued warrants for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share.

Jeffery C. Lambert purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Mr. Lambert was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

Jeff L. Hegan purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Mr. Hegan was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

Corbin J. Robertson, III purchased $100,000 in Notes at the Second Closing, which are convertible into 775,000 shares of common stock. Mr. Robertson was also issued warrants for the purchase of 62,500 shares of common stock with an exercise price of $0.16 per share. Lion Fund LP purchased $100,000 in Notes at the Second Closing, which are convertible into 775,000 shares of common stock. Lion Fund LP was also issued warrants for the purchase of 62,500 shares of common stock with an exercise price of $0.16 per share. Spring Street Partners purchased $100,000 in Notes at the Second Closing, which are convertible into 775,000 shares of common stock. Spring Street Partners were also issued warrants for the purchase of 62,500 shares of common stock with an exercise price of $0.16 per share. Corbin J. Robertson, III is the beneficial owner of the Notes and warrants purchased by Lion Fund LP and by

Spring Street Partners.

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Joseph Perlman, MD purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Mr. Perlman was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

Tom L. Pettiette purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Mr. Pettiette was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

Robert Lubin purchased $10,000 in Notes at the Second Closing, which are convertible into 77,500 shares of common stock. Mr. Lubin was also issued warrants for the purchase of 6,250 shares of common stock with an exercise price of $0.16 per share.

Riyad Tarazi purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Mr. Tarazi was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

Timothy M. Havens purchased $100,000 in Notes at the Second Closing, which are convertible into 775,000 shares of common stock. Mr. Havens was also issued warrants for the purchase of 62,500 shares of common stock with an exercise price of $0.16 per share.

Michael A. Hillman purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Mr. Hillman was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

K&D Reed Investments Limited Partnership purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. K&D Reed Investments Limited Partnership was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share. Ken Reed is the beneficial owner of the Notes and warrants held by K&D Reed Investments Limited Partnership.

Terry C. Hicks, MD purchased $25,000 in Notes at the Second Closing, which are convertible into 193,750 shares of common stock. Mr. Hicks was also issued warrants for the purchase of 15,625 shares of common stock with an exercise price of $0.16 per share.

S&G Associates, LLC purchased $50,000 in Notes at the Second Closing, which are convertible into 387,500 shares of common stock. S&G Associates, LLC was also issued warrants for the purchase of 31,250 shares of common stock with an exercise price of $0.16 per share. Alan B. Springer and Edward Gainennie are beneficial owners of the Notes and warrants held by S&G Associates, LLC.

In connection with the offering and in addition to a cash fee of $146,750, we issued to Odyssey Capital, LLC, a fo