ARC WIRELESS SOLUTIONS INC
Form 10QSB
August 13, 2002

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

FORM 10 - QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended June 30, 2002.

ARC Wireless Solutions, Inc.
(Exact name of small business issuer as specified in its charter)

Utah
(State or other jurisdiction of incorporation)

000-18122	87-0454148
(Commission File Number)	(IRS Employer Identification Number)

4860 Robb Street, Suite 101
Wheat Ridge, Colorado, 80033-2163
(Address of principal executive offices including zip code)

(303) 421-4063
(Small Business Issuer telephone number, including area code)

Not Applicable
(Former Name or Former Address, if Changed Since Last Report)

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X No

As of August 1, 2002, the Registrant had 153,312,274 shares outstanding of its $.0005 par value common stock.

Transitional Small Business Disclosure Format (Check One):
Yes No X

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ARC Wireless Solutions, Inc.

Quarterly Report on FORM 10-QSB For The Period Ended

June 30, 2002

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

ARC Wireless Solutions, Inc.
Consolidated Balance Sheets

	June 30, 2002 (unaudited)	December 31, 2001 *
Assets		
Current assets:		
Cash	$ 108,000	$ 345,000
Accounts receivable - customers, net	4,630,000	4,687,000
Accounts receivable - vendors, net	1,663,000	1,214,000
Inventory, net	6,549,000	5,938,000
Other current assets	257,000	117,000
Total current assets	13,207,000	12,301,000
Property and equipment, net	630,000	729,000
Other assets:		
Intangible assets including goodwill, net	10,931,000	10,907,000
Deposits	65,000	64,000
Total assets	$ 24,833,000	$ 24,001,000
Liabilities and stockholders' equity		
Current liabilities:		
Bank line of credit	$ 3,865,000	$ 925,000
Accounts payable	5,242,000	5,273,000
Current portion of capital lease obligations	9,000	11,000
Accrued expenses	367,000	503,000
Total current liabilities	9,483,000	6,712,000
Capital lease obligations, less current portion	17,000	21,000
Bank line of credit, less current portion	--	2,621,000
Total liabilities	9,500,000	9,354,000
Commitments		
Stockholders' equity:		
Common stock	78,000	77,000
Preferred stock	--	--
Treasury stock	(1,192,000)	(1,117,000)
Additional paid-in capital	21,677,000	21,522,000
Accumulated deficit	(5,230,000)	(5,835,000)
Total stockholders' equity	15,333,000	14,647,000
Total liabilities and stockholders' equity	$ 24,833,000	$ 24,001,000

* These numbers were derived from the audited financial statements for the year ended December 31, 2001.

See accompanying notes.

ARC Wireless Solutions, Inc.
Consolidated Statements of Operations

	Three months ended June 30, 2002	Three months ended June 30, 2001	Six Months June 3[0,] 2002
	(unaudited)		(unaudi[ted])
Sales, net	$ 7,951,000	$ 7,968,000	$ 15,957,000
Cost of sales	6,352,000	6,394,000	12,556,000
Gross profit	1,599,000	1,574,000	3,401,000
Operating expenses:			
Selling, general and administrative expenses	1,445,000	1,369,000	2,899,000
Amortization of purchased intangibles	--	248,000	--
Total operating expenses	1,445,000	1,617,000	2,899,000
Income (loss) from operations	154,000	(43,000)	502,000
Other income (expense):			
Interest expense, net	(53,000)	(59,000)	(101,000)
Gain from debt cancellation	48,000	--	226,000
Other income	11,000	22,000	17,000
Total other income (expense)	6,000	(37,000)	142,000
Income (loss) before income taxes	160,000	(80,000)	644,000
Provision for income taxes	(19,000)	(4,000)	(39,000)
Net Income (loss)	$ 141,000	$ (84,000)	605,000
Net loss per share (basic and diluted)	--	$ (.001)	--
Net income (loss) per share - basic	$ .001	--	$ .004
Net income (loss) per share - diluted	$ .001	--	$ .004

See accompanying notes.

ARC Wireless Solutions, Inc.
Consolidated Statements of Cash Flows

	Six Months Ended June 30, 2002	Six Months Ended June 30, 2001
	(unaudited)	
Operating activities		
Net income (loss)	$ 605,000	$ (873,000)
Adjustments to reconcile net income (loss) to net cash used in Operating activities:		
Depreciation and amortization	151,000	590,000
Debt cancellations	(226,000)	--
Non-cash expense for issuance of stock and options	36,000	125,000
Changes in operating assets and liabilities:		
Restricted cash	--	194,000
Accounts receivable, trade and vendor	(392,000)	(1,195,000)
Inventory	(611,000)	620,000
Prepaids and other current assets	(140,000)	(327,000)
Deposits	(1,000)	22,000
Accounts payable and accrued expenses	58,000	(693,000)
Other	--	--
Net cash used in operating activities	(520,000)	(1,537,000)
Investing activities		
Patent acquisition costs	(29,000)	(5,000)
Acquisition of businesses, net of cash acquired	--	27,000
Purchase of plant and equipment	(47,000)	(91,000)
Net cash used in investing activities	(76,000)	(69,000)
Financing activities		
Repayment of notes and capital lease obligations	(6,000)	(8,000)
Net borrowings under lines of credit	319,000	484,000
Proceeds from private placement, net	121,000	862,000
Proceeds from exercise of common stock options	--	5,000
Acquisition of treasury shares	(75,000)	--
Net cash provided by financing activities	359,000	1,343,000
Net increase (decrease) in cash	(237,000)	(263,000)
Cash, beginning of period	345,000	1,078,000
Cash, end of period	$ 108,000	$ 815,000
Supplemental cash flow information:		
Cash paid for interest	$ 99,000	$ 107,000

See accompanying notes.

ARC Wireless Solutions, Inc.
Notes to Consolidated Financial Statements
June 30, 2002

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-QSB and Item 310(b) of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2001.

The Company operates in three business segments, which are identified as distribution of wireless communications products, antenna design and manufacturing, and cable products, offering a wide variety of wireless component and network solutions to service providers, systems integrators, value added resellers, businesses and consumers, primarily in the United States.

Operating results for the six months ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002 or any future period.

Certain prior-year amounts have been reclassified to conform to the current-year presentation. These reclassifications had no effect on the results of operations or shareholders' equity as previously reported.

Note 2. Consolidation Policy

The accompanying unaudited consolidated financial statements include the accounts of ARC Wireless Solutions, Inc. ("ARC") and its wholly-owned subsidiary corporations, Winncom Technologies Corp. ("Winncom") and Starworks Wireless Inc. ("Starworks"), since their respective acquisition dates, after elimination of all material intercompany accounts, transactions, and profits.

Note 3. Earnings Per Share

As of December 31, 1998, the Company adopted Statement of Financial Accounting Standards No. 128, "Earnings per Share" (SFAS 128). SFAS 128 provides for the calculation of "Basic" and "Dilutive" earnings per share. Basic earnings per share includes no dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of the entity. For the three months and six months ended June 30, 2001, the Company incurred net losses. Stock options and stock warrants totaling 1,000,000 were not included in the computation of diluted loss per share because their effect was anti-dilutive; therefore, basic and fully diluted loss per share are the same for the three months and six months ended June 30, 2001.

The following table represents a reconciliation of the shares used to calculate basic and diluted earnings per share for the respective periods indicated:

	Three Months Ended June 30, 2002	Three Months Ended June 30, 2001	Six Months Ended June 30, 2002	Si Jun
Numerator: Net Income (Loss)	$ 141,000	$ (84,000)	$ 605,000	$
Denominator:				
Denominator for basic earnings per share - weighted average shares	153,298,000	145,546,000	152,916,000	14
Effect of dilutive securities				
Employee stock options	532,000	--	401,000	
Common stock warrants	--	--	--	
Denominator for diluted earnings per share - adjusted weighted average shares and assumed conversion	153,830,000	145,546,000	153,317,000	14
Basic earnings per share	$ .001	$ (.001)	$ .004	$
Diluted earnings per share	$ .001	$ (.001)	$ .004	$

Note 4. Revolving Bank Loan

Winncom Technologies Corp. has two bank lines of credit bearing an interest rate of prime plus 0.5% (5.25% on June 30, 2002). One line of credit is a revolving line of credit for $3.5 million, of which $2.8 million is outstanding at June 30, 2002. It expires in April 2003. The other line of credit is for $1 million, of which $925,000 is outstanding at June 30, 2002 and which was due July 31, 2002. We are currently in negotiations with the Bank to increase our revolving line of credit facility and combine the two outstanding lines into a single credit line. The credit lines are collateralized by accounts receivable, inventory and otherwise unencumbered fixed assets of Winncom. The credit line provides that Winncom is prohibited from guaranteeing any obligations of, or paying or advancing any distribution or other amount to, ARC Wireless Solutions, Inc. or any of its subsidiaries. ARC is a general corporate guarantor of this loan.

Note 5. Acquisitions

On August 21, 2001 the Company acquired certain commercial assets of the wireless communications products line of Ball Aerospace & Technologies Corp. (BATC), a wholly owned subsidiary of Ball Corporation, for $925,389. The assets acquired consist mainly of raw materials and finished goods inventory, testing and production equipment, and the purchase price has been allocated to these specifically identifiable assets. In November 2001 the purchase price was

adjusted in accordance with the Purchase Agreement for variances in actual assets delivered to the Company by BATC. BATC refunded to the Company $99,271 pursuant to the Agreement.

Note 6. Equity Transactions

In July 2001, the Company offered each investor who had purchased units ("Unit Investor") of common stock and common stock purchase warrants ("Warrants") in the Company's private placement in 2000 the opportunity to either (1) exchange each three Warrants for one share of Common Stock ("Alternative A"), or (2)

reduce the exercise price of each Warrant from $1.50 per share to $1.00 per share upon the Unit Investor's agreement to reduce the price associated with the Company's 30-day notice of redemption from $1.75 to $1.50 ("Alternative B"); provided, however, that if the Unit Investor determined to participate in either Alternative A or B, the Unit Investor was required to waive the Company's obligation to register the Unit Investor's sale or other transfer of the Registrable Securities (the "Registration Obligation").

Each Unit Investor electing Alternative A also was required to enter into a Restricted Sales Agreement (the "Restricted Sales Agreement") that includes the following restrictions with respect to the sale of all shares of Common Stock owned by the Unit Investor, except for any shares purchased subsequent to June 30, 2001:

- On any trading day during the one-year period beginning on the day Alternative A goes into effect (which was August 9, 2001), the Unit Investor may sell or otherwise dispose of up to the Pro Rata Share, as defined below, for that Unit Investor, of (i) 15 percent of the reported trading volume of the Common Stock for the immediately preceding trading day if the reported trading volume of the Common Stock for the prior trading day was 400,000 shares or less, or (ii) 20 percent of the reported trading volume of the Common Stock for the immediately preceding trading day if the reported trading volume of the Common Stock for the prior trading day was greater than 400,000 shares; and

- On any trading day during the one-year period between the first and second anniversaries of the effective date of Alternative A, the Unit Investor may sell or otherwise dispose of up to the Pro Rata Share for that Unit Investor of (i) 20 percent of the reported trading volume of the Common Stock for the immediately preceding trading day if the reported trading volume of the Common Stock for the prior trading day was 400,000 shares or less, or (ii) 25 percent of the reported trading volume of the Common Stock for the immediately preceding trading day if the reported trading volume of the Common Stock for the prior trading day was greater than 400,000 shares.

The number of shares of Common Stock that the Unit Investor may sell shall not be increased as a result of any failure by the Unit Investor to sell the maximum number of Unit Investor Shares permissible at a prior time.

For purposes of Alternative A, the "Pro Rata Share" of any Unit Investor means the percentage obtained by dividing (1) the number of Units purchased by the subject Unit Investor in the Year 2000 Placement, by (2) the aggregate total number of Units purchased by all investors in the Year 2000 Placement who agree to the sales restrictions described above (the "Contracting Unit Investors"). Notwithstanding the foregoing, if the aggregate number of Units purchased in the

Year 2000 Placement by the Contracting Unit Investors is less than 90 percent of the total number of Units purchased in the Year 2000 Placement by all investors in the Year 2000 Placement, then "Pro Rata Share" shall instead mean the percentage obtained by dividing (X) the number of Units purchased by the subject Unit Investor in the Year 2000 Placement, by (Z) 90 percent of the aggregate number of Units purchased by all investors in the Year 2000 Placement.

As of September 30, 2001 holders representing an aggregate of 13,062,000 Units had agreed to participate in Alternative A and were issued 4,354,003 shares of common stock and holders representing an aggregate of 1,148,000 Units had agreed to participate in Alternative B.

The Company sold 5,000,000 shares of restricted common stock at $.20 per share in a private placement offering through September 2001 from which it received gross cash proceeds of $1,000,000. Related offering expenses were $22,000.

The Company sold 754,545 shares of restricted common stock at $.165 per share in a private placement offering through June 30, 2002 from which it received gross cash proceeds of $124,500. Offering costs associated with this private placement offering were $4,100. Within 30 days following the filing with the SEC of the

Company's Annual Report on Form 10-KSB for the year ended December 31, 2001, the Company was obligated to file a registration statement covering the resale of these shares. This registration statement is intended to be filed with the SEC by August 31, 2002.

In January 2002 the Company exercised its option to repurchase the remaining 500,000 shares from the McConnell litigation settlement for $75,000.

In March 2002, the Company issued 200,000 shares of restricted common stock for consulting services valued at $34,000.

In the second quarter of 2002 the Company recorded the issuance of 13,945 shares of common stock to directors for outstanding obligations for accrued directors fees in the amount of $6,400.

Note 7. Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards No. 141 "Business Combinations" ("SFAS 141") and No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for under the purchase method. For all business combinations for which the date of acquisition is after June 30, 2001, SFAS 141 also establishes specific criteria for the recognition of intangible assets separately from goodwill and requires unallocated negative goodwill to be written off immediately as an extraordinary gain, rather than deferred and amortized. SFAS 142 changes the accounting for goodwill and other intangible assets after an acquisition. The most significant changes made by SFAS 142 are: 1) goodwill and intangible assets with indefinite lives will no longer be amortized; 2) goodwill and intangible assets with indefinite lives must be tested for impairment at least annually; and 3) the amortization period for intangible assets with finite lives will no longer be limited to forty years. SFAS 142 is effective for fiscal years beginning after December 15, 2001 and as such the Company adopted SFAS 142 effective January 1, 2002. The adoption of Statement SFAS 141 did not have any impact on the Company's financial position or cash flows.

In accordance with SFAS No. 142, the Company discontinued the amortization of goodwill effective January 1, 2002. Additionally, under the new accounting standard, goodwill and other intangible assets will be tested differently than prior to the adoption of SFAS No. 142. The Company is required to perform these impairment tests on an annual basis and has performed the transitional impairment test required upon adoption of SFAS No. 142, using certain valuation techniques, and has determined that no impairment exists at this time. It is possible but not predictable that a change in the Company's wireless business, market capitalization, operating results or other factors could affect the carrying value of goodwill or other intangible assets and cause an impairment write-off. As of June 30, 2002 the Company has approximately $10.8 million of goodwill and other intangible assets subject to SFAS No. 142. Results of operations prior to the adoption of SFAS No. 142 are not restated.

The following reconciles the reported net income (loss) and earnings (loss) per share to that which would have resulted had SFAS No.142 been applied to the three months and six months ended June 30, 2001.

	Three Months Ended June 30, 2001	Six Months Ended June 3 2001
Reported net loss	$ (84,000)	$(873,000)
Add: Goodwill amortization, net of tax	248,000	498,000
Adjusted net income (loss)	$ 164,000	$(375,000)
Reported basic loss per share	$ (.001)	$ (.006)
Add: Goodwill amortization, net of tax, per basic share	.002	.003
Adjusted basic income (loss) per share	$ .001	$ (.003)

In June 2001, the FASB also approved for issuance SFAS 143 "Asset Retirement Obligations." SFAS 143 establishes accounting requirements for retirement obligations associated with tangible long-lived assets, including (1) the timing of the liability recognition, (2) initial measurement of the liability, (3) allocation of asset retirement cost to expense, (4) subsequent measurement of the liability and (5) financial statement disclosures. SFAS 143 requires that an asset retirement cost should be capitalized as part of the cost of the related long-lived asset and subsequently allocated to expense using a systematic and rational method. The Company will adopt the statement effective no later than January 1, 2003, as required. The transition adjustment resulting from the adoption of SFAS 143 will be reported as a cumulative effect of a change in accounting principle. The Company does not believe that the adoption of this statement will have a material effect on its financial position, results of operations, or cash flows.

In October 2001, the FASB also approved SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS 144 replaces SFAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. The new accounting model for long-lived assets to be disposed of by sale applies to all long-lived assets, including discontinued operations, and replaces the

provisions of APB Opinion No. 30, Reporting Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, for the disposal of segments of a business. Statement 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. Statement 144 also broadens the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The Company adopted the provisions of Statement 144 effective January 1, 2002 and the adoption did not have a material effect on its financial position, results of operations, or cash flows.

Statement of Financial Accounting Standards No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections," effective for fiscal years beginning May 15, 2002 or later that rescinds FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt", FASB Statement No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements", and FASB Statement No. 44, "Accounting for Intangible Assets of Motor Carriers". This Statement Amends FASB Statement No. 4 and FASB Statement No. 13, "Accounting for Leases", to eliminate an inconsistency between the required accounting for sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The Company does not expect the implementation of SFAS No. 145 to have a material impact on its financial condition or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS 146 requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management's commitment to an exit plan, which is generally before an actual liability has been incurred. Adoption of SFAS 146 is required with the beginning of fiscal year 2003. The Company does not anticipate a significant impact on its results of operations from adopting this Statement.

Note 8. Industry Segment Information

SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information," requires that the Company disclose certain information about its operating segments where operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, financial information is required to be reported on the basis that is used internally for evaluating segment performance and deciding how to allocate resources to segments.

The Company has three reportable segments that are separate business units that offer different products as follows: distribution of wireless communication products, antenna design and manufacturing, and cable products. Each segment consists of a single operating unit and the accounting policies of the reporting

segments are the same as those described in the summary of significant accounting policies. Intersegment sales and transfers are recorded at cost plus an agreed upon intercompany profit on intersegment sales and transfers.

Financial information regarding the Company's three operating segments for the six months ended June 30, 2002 and 2001 are as follows:

	June 30	Distribution	Manufacturing	Cable	Corporate
Net Sales	2002	$11,987,000	$ 3,741,000	$ 285,000	$ (56,000)
	2001	$14,000,000	$ 1,305,000	$ 841,000	$ (79,000)
Net Earnings (Loss)	2002	$ 123,000	$ 515,000	$ (54,000)	$ 21,000
	2001	$ 397,000	$ (130,000)	$ (243,000)	$ (897,000)
Earnings (Loss) before Income Taxes	2002	$ 162,000	$ 515,000	$ (54,000)	$ 21,000
	2001	$ 405,000	$ (130,000)	$ (243,000)	$ (897,000)
Identifiable Assets	2002	$22,025,000	$ 4,242,000	$ 400,000	$(1,834,000)
	2001	$20,244,000	$ 2,772,000	$ 3,245,000	$ (684,000)

Corporate represents the operations of the parent Company, including segment eliminations.

Note 9. Critical Accounting Policies

The Company's significant accounting policies are summarized in Note 1 of its consolidated financial statements on Form 10-KSB. The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported therein, including estimates about the effects of matters or future events that are inherently uncertain. Policies determined to be critical are those that have the most significant impact on the Company's financial statements and require management to use a greater degree of judgment and/or estimates. Actual results may differ from these estimates under different assumptions or conditions.

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On an on-going basis, management evaluates its estimates and judgments, including those related to allowance for doubtful accounts, inventory valuations and recoverability of intangible assets, including goodwill. Management bases its estimates and judgments on historical experience and on various other factors that are also believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent form other sources. Our major operating assets are trade and vendor accounts receivable, inventory, property and equipment and intangible assets. Our reserve for doubtful accounts of $1,084,000 should be adequate for any exposure to loss in our accounts receivable as of June 30, 2002. We have also established reserves for slow moving and obsolete inventories and believe the current reserve of $309,000 is adequate. We depreciate our property and equipment over their estimated useful lives and we have not identified any items that are impaired.

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

Results of Operations, Three Months Ended June 30, 2002 and 2001

Sales were approximately $8 million for both the three-month periods ended June 30, 2002 and 2001. Revenues from the Wireless Communications Products Division, increased from $739,000 for the quarter ended June 30, 2001 to $1,782,000 for the quarter ended June 30, 2002, primarily from revenues from base station antennas which were $730,000 for the quarter ended June 30, 2002 and $0 for the quarter ended June 30, 2001,. The increase in the Wireless Communications Products Division revenues were offset by a decrease in Starworks revenues from $429,000 for the quarter ended June 30, 2001 to $91,000 for the quarter ended June 30, 2002 and a decrease in Winncom revenues from $6.8 million for the quarter ended June 30, 2001 to $6.1 million for the quarter ended June 30, 2002.

Gross profit margins were 20.1% and 19.8% for the three-months ended June 30, 2002 and June 30, 2001, respectively. The slight increase in gross margin for the quarter ended June 30, 2002 vs. the quarter ended June 30, 2001 is primarily the result of the increase in revenues from the Wireless Communications Products Division, whose products have a higher margin than those of Winncom or Starworks. As a result of product mix Winncom's profit margins decreased from 17.8% for the quarter ended June 30, 2001 to 13.1% for the quarter ended June 30, 2002. When the Company purchased certain commercial assets of the wireless communications products line of BATC, which consisted of raw materials and finished goods inventory among other assets, these assets were purchased at a substantial discount from their fair market or replacement value. During the quarter ended June 30, 2002, the Wireless Communications Products Division benefited from the sale of portions of the inventory purchased from BATC, and this benefit is reflected in higher gross margins. Depending on the product mix, the Company may realize additional benefit from the below-market cost of the BATC inventory in the future, but the benefit will diminish as the inventory is depleted and replaced with inventory purchased at current market prices. Based on the Company's estimates of current replacement costs for the BATC inventory included in cost of goods sold during the second quarter, the Company estimates that the benefit resulting from inventory purchased at below-market costs was between $50,000 and $100,000 for the quarter ended June 30, 2002. Because the BATC inventory was not purchased until August 21, 2001, no such benefit was recognized for the quarter ended June 30, 2001.

Selling, general and administrative expenses (SG&A) increased slightly by $76,000 for the three months ended June 30, 2002 compared to the three months ended June 30, 2001. This increase in SG&A is primarily the result of the addition of management and staff as a result of the acquisition of certain commercial assets form BATC. SG&A as a percent of revenue increased from 17.2% for the three months ended June 30, 2001 to 18.2% for the three months ended June 30, 2002.

In accordance with SFAS No. 142, the Company discontinued the amortization of goodwill effective January 1, 2002. Consequently, there was no amortization of purchased intangibles for the quarter ended June 30, 2002 as compared to $248,000 in amortization of purchased intangibles for the quarter ended June 30, 2001. (See Note 7)

Net interest expense was $53,000 for the three months ended June 30, 2002 and $59,000 for the three months ended June 30, 2001. The average balance outstanding on the lines of credit was higher by $1.6 million for the quarter ended June 30, 2002 as compared to the quarter ended June 30, 2001 but the interest rate was 5.25% for 2002 as compared to 9% for 2001. The line of credit

balance was increased by $925,000 in September 2001 as the proceeds were used to finance the Ball assets acquisition (see Note 6 above.)

Included in other income for the three months ended June 30, 2002 is a gain from debt settlements of $48,000. There was no gain from debt settlements for the quarter ended June 30, 2001.

The Company had net income for the three months ended June 30, 2002 of $141,000 compared to a net loss of $84,000 for the three months ended June 30, 2001 primarily due to three factors, 1) an increase in gross margin percent from 20.3% for the quarter ended June 30, 2001 to 21.1% for the quarter ended June 30, 2002, which resulted partially from the use of inventory at below-market cost and partially from increased sales of higher margin products, 2) the termination of amortization of goodwill effective January 1, 2002 which was $250,000 for the quarter ended June 30, 2001 and $0 for the quarter ended June 30, 2002 and 3) the gain from debt settlements of $48,000 recorded for the quarter ended June 30, 2002.

Results of Operations, Six Months Ended June 30, 2002 and 2001

Sales were $15,957,000 and $16,067,000 for the six-month periods ended June 30, 2002 and 2001, respectively. The slight decrease, less than 1%, in revenues comparing the six months ended June 30, 2002 to the six months ended June 30, 2001 is attributable to a decrease in Starworks revenues from $841,000 for the six months ended June 30, 2001 to $284,000 for the six months ended June 30, 2002 and a decrease in Winncom revenues from $14 million for the six months ended June 30, 2001 to $12 million for the six months ended June 30, 2002, which decreases were substantially offset by the increase in revenues from the Wireless Communications Products Division, primarily revenues from base station antennas which were $2 million for the six months ended June 30, 2002 and $0 for the six months ended June 30, 2001.

Gross profit margins were 21.3% and 18.0% for the six months ended June 30, 2002 and June 30, 2001, respectively. The increase in gross margin for the six months ended June 30, 2002 vs. the six months ended June 30, 2001 is primarily the result of the increase in revenues from the Wireless Communications Products Division, whose products have a higher margin than those of Winncom or Starworks. When the Company purchased certain commercial assets of the wireless communications products line of BATC, which consisted of raw materials and finished goods inventory among other assets, these assets were purchased at a substantial discount from their fair market or replacement value. During the six months ended June 30, 2002, the Wireless Communications Products Division benefited from the sale of portions of the inventory purchased from BATC and this benefit is reflected in higher gross margins. Depending on the product mix, the Company may realize additional benefit from the below-market cost of the BATC inventory in the future, but the benefit will diminish as the inventory is depleted and replaced with inventory purchased at current market prices. Based on the Company's estimates of current replacement costs for the BATC inventory included in cost of goods sold for the six months ended June 30, 2002, the Company estimates that the benefit resulting from inventory purchased at below-market costs was between $200,000 and $300,000 for the six months ended June 30, 2002. Because the BATC inventory was not purchased until August 21, 2001, no such benefit was recognized for the six months ended June 30, 2001.

Selling, general and administrative expenses (SG&A) decreased by $283,000 for the six months ended June 30, 2002 compared to the six months ended June 30, 2001. In addition, SG&A as a percent of revenue decreased from 19.8% for the six

months ended June 30, 2001 to 18.2% for the six months ended June 30, 2002. The decrease in SG&A comparing 2002 to 2001 is primarily due to legal fees in connection with the Starworks' litigation and certain employee termination costs, which were incurred in 2001 but not in 2002. During the six months ended June 30, 2001, termination agreements were entered into with the former CEO of the Company and the former CFO of the Company. The former CEO received $63,000 of severance payments plus options to purchase 250,000 shares of the Company's common stock at an exercise price of $0.325 per share and the former CFO received $47,000 of severance payments plus options to purchase 350,000 shares of the Company's common stock at $0.26 per share. The Company recognized $232,000 of expense related to these termination agreements during the six months ended June 2001, including $122,000 of non-cash compensation related to the issuance of the options. This expense was partially offset by the elimination of $96,000 of accrued bonuses as part of the severance agreements. In addition, the six months ended June 30, 2001 included $283,000 in expenses related to impairment of assets, adjustments, litigation and other costs of the Kit Company acquisition.

In accordance with SFAS No. 142, the Company discontinued the amortization of goodwill effective January 1, 2002. Consequently, there was no amortization of purchased intangibles for the six months ended June 30, 2002 as compared to $498,000 in amortization of purchased intangibles for the six months ended June 30, 2001. (See Note 7)

Net interest expense was $101,000 for the six months ended June 30, 2002 compared to $107,000 for the six months ended June 30, 2001. The average balance outstanding on the lines of credit was higher by $1.6 million for the quarter ended June 30, 2002 as compared to the quarter ended June 30, 2001 but the interest rate was 5.25% for 2002 as compared to 9% for 2001. The line of credit balance was increased by $925,000 in September 2001 as the proceeds were used to finance the Ball assets acquisition (see Note 6 above.)

Included in other income for the six months ended June 30, 2002 is a gain from debt settlements of $226,000. There was no gain from debt settlements for the six months ended June 30, 2001.

The Company had net income for the six months ended June 30, 2002 of $605,000 compared to a net loss of $873,000 for the six months ended June 30, 2001 primarily due to four factors, 1) an increase in gross margin percent from 18% for the six months ended June 30, 2001 to 21.3% for the six months ended June 30, 2002, which resulted partially from the use of inventory at below-market cost and partially from increased sales of higher margin products, 2) a reduction in SG&A expenses relative to revenues from 19.8% in 2001 to 18.2% in 2002, 3) the termination of amortization of goodwill effective January 1, 2002 which was $498,000 for the six months ended June 30, 2001 and 4) gain from debt settlements of $226,000 recorded for the six months ended June 30, 2002.

Financial Condition

The net cash used in operating activities decreased from $1,537,000 for the six months ended June 30, 2001 to $520,000 for the six months ended June 30, 2002 primarily due to an increase in income from operations in 2002 of $502,000 as compared to a loss from operations in 2001 of $792,000. The increase in inventory in 2002 was largely attributable to increases in Winncom's inventory from $3.9 million at December 31, 2001 to $4.6 million at June 30, 2002. Accounts receivable have increased due to increases in receivables from vendors for special pricing discount and other purchase discounts, which typically are outstanding for 90 to 105 days. There was only a slight decrease in accounts payable in 2002 which was primarily due to improved efforts to increase inventory turns and the depletion of the BATC inventory purchased in August 2001 whose purchase was financed by a bank line of credit rather than trade accounts payable.

The net cash used in investing activities of $76,000 in 2002 and $69,000 in 2001 is primarily the result of increases in patents and purchases of equipment.

The net cash provided by financing activities of $359,000 in 2002 is primarily the result of increases in net borrowings under lines of credit of $319,000 and net proceeds from a private placement of $121,000, offset by the purchase of treasury stock in the amount of $75,000 in connection with the McConnell litigation settlement. For 2001 the net cash provided by financing activities of $1,343,000 is primarily the result of increases in net borrowings under lines of credit of $484,000 and net proceeds from a private placement of $862,000.

The Company's working capital at June 30, 2002 was $3.7 million compared to $5.6 million at December 31, 2001. The decrease is the result of the classification of the bank line of credit in the amount of $2.9 million from long-term debt to current liabilities as it is due April 2003. Excluding this reclassification, working capital would have improved to $6.6 million as compared to $5.6 million at December 31, 2001.

In conjunction with the acquisition of Winncom Technologies Corp. on May 24, 2000, the Company assumed a $1,500,000 revolving line of credit from a bank bearing an interest rate of prime plus 0.5% (5.5% at December 31, 2001 and at June 30, 2002). The line is collateralized by accounts receivable, inventory and otherwise unencumbered fixed assets of Winncom. The credit line provides that Winncom is prohibited from guaranteeing any obligations of, or paying or advancing any distribution or other amount to, ARC Wireless Solutions, Inc. or any of its subsidiaries. ARC is a general guarantor of this loan. On November 27, 2000 the line was increased to $3,000,000, of which $2,621,000 was outstanding at December 31, 2001, and $2,940,000 was outstanding at June 30, 2002. This agreement expires in April 2003, at which time all borrowings are due in full in the event the line is not renewed.

In connection with the acquisition of the Ball Assets in August 2001, Winncom established a new line of credit in the amount of $1 million bearing an interest rate of prime plus 0.5% (5.5% at December 31, 2001 and at June 30, 2002). This line is also collateralized by accounts receivable, inventory and otherwise unencumbered fixed assets of Winncom. ARC is a general corporate guarantor of this loan. As of December 31, 2001 and June 30, 2002, $925,000 was outstanding under this line of credit. This balance due under this letter of credit was due March 31, 2002. The Company is currently negotiating with the bank to convert this line of credit, currently due, to a long-term credit facility.

In conjunction with the acquisition of Starworks Technology Inc. on September 29, 2000, the Company assumed a $1.5 million revolving bank loan, which was secured by accounts receivable and restricted cash maintained in a non-collection reserve account. The Company ceased assigning Starworks' accounts receivable to the bank in February 2001. There is no balance outstanding under the revolving bank loan at June 30, 2002 or December 31, 2001.

The Company has recently been approved for a $500,000 lease line of credit. Under this agreement $229,000 of capital assets acquired from Ball in August 2001 will be subject to a sale lease-back in which the Company will receive proceeds of approximately $229,000. The remaining open balance on the lease line will be used to finance capital expenditures budgeted for the remainder of 2002.

The Company closed the operations of Starworks in the Atlanta location on July 12, 2002. The expected closure costs were accrued as of December 31, 2001. With

the closure of Starworks in Atlanta the Company expects to reduce monthly operating costs by approximately $16,000 to $20,000.

Management believes that current working capital, available borrowings on existing bank lines of credit, proceeds from the sale and leaseback and from available borrowings on the new lease line of credit, the renegotiation of the $1 million line of credit that was due March 31, 2002, together with additional equity infusions that management believes will be available, will be sufficient to allow the Company to maintain its operations through December 31, 2002 and into the foreseeable future.

Forward Looking Statements

This report contains forward-looking statements. Although the Company believes that the expectations reflected in the forward looking statements and the assumptions upon which the forward looking statements are based are reasonable, it can give no assurance that such expectations and assumptions will prove to be correct. See the Company's Annual Report on Form 10-KSB for additional statements concerning important factors, such as demand for products, manufacturing costs and competition that could cause actual results to differ materially from the Company's expectations.

PART II. OTHER INFORMATION

Item 2. Changes in Securities and Use of Proceeds; Recent Sales of Unregistered Securities

In March 2002, the Company sold 754,545 shares of restricted common stock at $.165 per share to two accredited investors in a private placement transaction. These sales resulted in gross proceeds to the Company of $124,500. The issuance of these shares of common stock were made pursuant to exemptions from registration in accordance with Rules 505 and/or 506 and/or Sections 3(b) and/or 4(2) of the Securities Act. The Company intends to use the net proceeds from this offering for working capital purposes. The Company is obligated to file with the SEC, within 30 days after the filing with the SEC of the Company's Annual Report on Form 10-KSB for the year ended December 31, 2001, a registration statement covering resale of these shares, which is intended to be filed with the SEC by August 31, 2002.

Item 6. Exhibits And Reports On Form 8-K

(a) Exhibits.

None

(b) Reports on Form 8-K.

During the period ended June 30, 2002, the Company filed a Current Report on Form 8-K reporting Regulation FD disclosure pursuant to Item 9 on March 19, 2002.

SIGNATURE

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

ARC WIRELESS SOLUTIONS, INC.

Date: August 12, 2002

By: /s/ Randall P. Marx

Randall P. Marx
Chief Executive Officer

Date: August 12, 2002

By: /s/ Monty R. Lamirato

Monty R. Lamirato
Chief Financial Officer