

CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD

Form 10-Q

February 14, 2001

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2000

Commission File Number 0-31729

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD.

(Exact name of registrant as specified in its charter)

Delaware

23-2498715

(State or other jurisdiction
of incorporation or organization)

(IRS Employer Identification No.)

1735 Market Street, Mellon Bank Center Suite 1300, Philadelphia, PA 19103

(Address of principal executive offices)

Telephone: (215) 979-3600

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

Yes (X) No ()

As of February 2, 2001, there were 35,973,076 shares outstanding of the Registrant's \$.001 par value common stock.

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD.

INDEX TO FORM 10-Q

	PAGE(S)
PART I. FINANCIAL INFORMATION	
Item 1. Consolidated Balance Sheets at December 31, 2000 (unaudited) and June 30, 2000 (audited)	3
Consolidated Statements of Operations and Comprehensive Income (Loss) for the three months and six months ended December 31, 2000 and 1999 (unaudited)	4-5
Consolidated Statement of Stockholders' Equity for the six months ended December 31, 2000 (unaudited)	6
Consolidated Statements of Cash Flows for the three months and six months ended December 31, 2000 and 1999 (unaudited)	7-8
Notes to Consolidated Financial Statements (unaudited)	9-18
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	18-23
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	24-25
Item 2. Changes in Securities and Use of Proceeds	25
Item 3. Defaults Upon Senior Securities	25
Item 4. Submission of Matters to a Vote of Security Holders	25
Item 5. Other Information	25
Item 6. Exhibits and Reports on Form 8-K	25
SIGNATURES	26

PART I. - FINANCIAL STATEMENTS.

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEETS
 (Dollars and Shares in Thousands)

	Dec. 31, 2000	June 30, 2000
	----- (Unaudited)	----- (Audited)
CURRENT ASSETS		
Cash and cash equivalents	\$ 3,908	\$ 14,333
Trade accounts receivable, net	1,037	1,026
Prepaid expenses and other current assets	1,745	1,368
	-----	-----
	6,690	16,727
PROPERTY AND EQUIPMENT, NET	5,223	4,072
INTANGIBLE ASSETS, NET	2,715	5,858
INVESTMENT IN UNCONSOLIDATED SUBSIDIARY	1,781	-
	-----	-----
TOTAL ASSETS	\$ 16,409	\$ 26,657
	=====	=====
CURRENT LIABILITIES		
Accounts payable - trade	\$ 1,338	\$ 1,064
Deferred revenue	961	1,069
Accrued expenses and other current liabilities	3,182	2,041
	-----	-----
	5,481	4,174
LONG-TERM LIABILITIES	774	624
	-----	-----
TOTAL LIABILITIES	6,255	4,798
	-----	-----
COMMITMENTS AND CONTINGENCIES		
COMMON STOCK		
\$.001 par value; authorized 300,000 shares; issued and outstanding, 35,973 shares at		
December 31, 2000 and June 30, 2000	36	36
WARRANTS OUTSTANDING	9,672	14,062
ADDITIONAL PAID-IN-CAPITAL	270,101	264,643
ACCUMULATED DEFICIT	(269,716)	(256,937)
ACCUMULATED OTHER COMPREHENSIVE INCOME	61	55
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	10,154	21,859
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 16,409	\$ 26,657

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

=====

See accompanying notes

3

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
 (UNAUDITED)

(Dollars and Shares in Thousands, Except Per Share Amounts)

	THREE MONTHS ENDED DECEMBER 31,		SIX MONTHS ENDED DECEMBER 31,	
	2000	1999	2000	1999
REVENUE	\$ 3,815	\$ 899	\$ 6,996	\$ 1,217
COST OF REVENUE	3,202	708	6,027	896
GROSS PROFIT	613	191	969	321
Network operating expenses	591	276	1,179	348
Marketing expenses	742	337	1,448	624
Research and development expenses	1,548	815	2,705	1,510
Depreciation and amortization	579	1,246	1,092	2,283
General and administrative expenses	2,703	5,049	6,217	7,607
Equity in net loss of unconsolidated subsidiary	330	-	880	-
Write-down of investment in unconsolidated subsidiary	516	-	516	-
LOSS FROM OPERATIONS	(6,396)	(7,532)	(13,068)	(12,051)
OTHER INCOME (EXPENSE)				
Interest income	65	85	327	101
Interest expense	(26)	(1)	(38)	(39)
	39	84	289	62
Net loss before extraordinary item	(6,357)	(7,448)	(12,779)	(11,989)
EXTRAORDINARY ITEM				
Gain on discharge of indebtedness	-	-	-	32,502
NET INCOME (LOSS)	\$(6,357)	\$(7,448)	\$(12,779)	\$ 20,513
OTHER COMPREHENSIVE INCOME (LOSS):				
Foreign currency translation adjustment	(112)	(10)	6	(27)
COMPREHENSIVE INCOME (LOSS)	\$(6,469)	\$(7,458)	\$(12,773)	\$ 20,486

4

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
 (UNAUDITED)

(Dollars and Shares in Thousands, Except Per Share Amounts)

	THREE MONTHS ENDED DECEMBER 31,		SIX MONTHS ENDED DECEMBER 31,	
	2000	1999	2000	1999
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	35,859	32,797	35,847	32,041
BASIC AND DILUTED EARNINGS (LOSS) PER COMMON SHARE				
Net loss before extraordinary item	\$(.18)	\$(.23)	\$(.36)	\$(.37)
Extraordinary item	-	-	-	1.01
Net income (loss)	\$(.18)	\$(.23)	\$(.36)	\$.64

See accompanying notes

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
SIX MONTHS ENDED DECEMBER 31, 2000
(Dollars and Shares in Thousands)

	COMMON STOCK		COMMON STOCK	ADD'L.
	NUMBER	AMOUNT	WARRANTS	PAID-IN
	OF		OUTSTAN-	CAPITAL
	SHARES		DING, NET	
	-----	-----	-----	-----
BALANCES, JUNE 30, 2000	35,836	\$ 36	\$14,062	\$ 264,643
Six months ended December 31, 2000 (unaudited):				
Common stock issued as additional consideration for acquisition of TWC	222	-	-	743
Common stock returned to the Company pursuant to terms of TWC acquisition agreement	(85)	-	-	(766)
Common stock warrants issued, net of unearned consulting fees of \$349	-	-	608	483
Common stock warrants expired	-	-	(4,998)	4,998
	-----	-----	-----	-----
BALANCES, DECEMBER 31, 2000	35,973	\$ 36	\$ 9,672	\$ 270,101
	=====	=====	=====	=====

	ACCUMULATED	ACCUMULATED
	DEFICIT	OTHER
		COMPREHENSIVE
		INCOME
	-----	-----
BALANCES, JUNE 30, 2000	\$ (256,937)	\$ 55
Three months ended December 31, 2000 (unaudited):		
Net loss	(12,779)	-
Currency translation adjustment	-	6
	-----	-----
BALANCES, DECEMBER 31, 2000	\$ (269,716)	\$ 61
	=====	=====

See accompanying notes

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(Dollars in Thousands)

	SIX MONTHS ENDED DECEMBER 31,	
	2000	1999
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ (12,779)	\$ 20,513
Adjustments to reconcile net income (loss) to net cash flows used in operating activities:		
Extraordinary gain on discharge of indebtedness	-	(32,502)
Depreciation and amortization	1,092	2,283
Equity in net loss of unconsolidated subsidiary	880	-
Write-down of net assets of unconsolidated subsidiary	516	-
Issuance of common stock warrants for expenses	958	2,625
Settlement of interest upon capitalization of loan payable to related party	-	81
Change in current assets and liabilities which increase (decrease) cash:		
Trade accounts receivable, net	(283)	14
Prepaid expenses and other current assets	(387)	(85)
Accounts payable - trade	481	(2,667)
Deferred revenue	(108)	-
Accrued expenses and other current liabilities	652	(108)
Other	43	(6)
	-----	-----
Net cash used in operating activities	(8,935)	(9,852)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of equipment	(1,932)	(587)
Deconsolidation of unconsolidated subsidiary	(46)	-
Advances to unconsolidated subsidiary	(225)	-
Cash received with companies acquired net of cash paid for companies acquired	-	136
	-----	-----
Net cash used in investing activities	(2,203)	(451)
	-----	-----

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

(UNAUDITED)
(Dollars in Thousands)

	SIX MONTHS ENDED	
	DECEMBER 31,	
	2000	1999
CASH FLOWS FROM FINANCING ACTIVITIES		
Sale of common stock for cash	-	25,600
Commission on sale of common stock	-	(2,650)
Proceeds from loan payable	261	-
Repayment of loan payable	(11)	-
Net increase in capital lease obligations	503	-
Net cash received from financing activities	753	22,950
Effect of exchange rate changes on cash	(40)	-
NET CHANGE IN CASH AND EQUIVALENTS	(10,425)	12,647
CASH AND EQUIVALENTS, BEGINNING OF PERIOD	14,333	3,284
CASH AND EQUIVALENTS, END OF PERIOD	\$ 3,908	\$ 15,931
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period:		
Interest	\$ 38	\$ -
Income taxes	\$ -	\$ -
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Issuance of common stock as additional consideration for acquisition of TWC	\$ 743	\$ -
Common stock returned to the Company pursuant to terms of acquisition agreement for TWC	\$ 766	\$ -
Common stock issued as consideration for acquisitions of NKA and TWC	\$ -	\$ 6,462
Capitalization of note payable to related party, including accrued interest	\$ -	\$ 2,000
Issuance of common stock in settlement of loan payable	\$ -	\$ 1,000
Issuance of common stock warrants for unearned consulting fees	\$ -	\$ 1,758

See accompanying notes

NOTE 1 - BASIS OF INTERIM PRESENTATION

The accompanying interim period financial statements of Clariti Telecommunications International, Ltd. ("Clariti" or the "Company") are unaudited, pursuant to certain rules and regulations of the Securities and Exchange Commission, and include, in the opinion of management, all adjustments (consisting of only normal recurring accruals) necessary for a fair statement of the results for the periods indicated, which, however, are not necessarily indicative of results that may be expected for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The financial statements should be read in conjunction with the financial statements and the notes thereto included in Clariti's June 30, 2000 Form 10-K and other information included in Clariti's Forms 8-K and amendments thereto as filed with the Securities and Exchange Commission.

NOTE 2 - DESCRIPTION OF THE BUSINESS

Clariti Telecommunications International, Ltd. ("Clariti" or the "Company") is a diversified international telecommunications company with businesses that cover voice, data, Internet and wireless communications.

The Company has made several acquisitions in the telecommunications industry. In April 1995, the Company acquired its wireless messaging technology. In May 1999, the Company acquired MegaHertz-NKO, Inc., an Internet Service Provider ("ISP") and a provider of enhanced telecommunications and Internet Protocol ("IP") telephony services. In October 1999, the Company acquired NKA Communications Pty, Ltd. ("NKA"), an Australian provider of telephony to corporate clients. In December 1999, the Company acquired Tekbilt World Communications, Inc. ("TWC"), a facilities-based provider of IP and conventional switched telecommunications services with a large distribution network. During the quarter ended June 30, 2000, the Company terminated most of MegaHertz-NKO's revenue-generating activities and consolidated those remaining operations into TWC. In January 2001, the Company sold a majority interest in its Australian subsidiary, Clariti Telecommunications Pty, Ltd. ("Clariti Australia"), formerly NKA (see Note 15).

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

Fiscal Year End

The Company's fiscal year ends on June 30. In these financial statements, the three-month periods ended December 31, 2000 and 1999 are referred to as Fiscal 2Q01 and Fiscal 2Q00, respectively, and the six-month periods ended December 31, 2000 and 1999 are referred to as Fiscal First Half 2001 and Fiscal First Half 2000, respectively.

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (continued)

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and all wholly-owned subsidiaries where management control is not deemed to be temporary. All significant intercompany transactions have been eliminated in consolidation.

For Fiscal 2001 and Fiscal First Half 2001, Clariti Australia was accounted for under the equity method of accounting because the Company sold a majority interest in such subsidiary in January 2001 (see Note 15). Prior to Fiscal 2001, Clariti Australia was accounted for as a consolidated subsidiary.

Revenue Recognition

The majority of the Company's revenue is generated through sales of prepaid calling cards. The Company sells prepaid calling cards to distributors or direct to retailers at a fixed price with normal credit terms. When the customer is invoiced, deferred revenue is recognized. The Company recognizes revenue and reduces the deferred revenue account as the end users utilize calling time and upon expiration of cards containing unused calling time. All prepaid calling cards sold by the Company have expiration dates ranging up to a maximum of six months after first use.

Income Taxes

There was no income tax benefit for operating losses for Fiscal 2001 and Fiscal First Half 2001 due to the following:

- Current tax benefit - the operating losses cannot be carried back to earlier years.
- Deferred tax benefit - the deferred tax assets were offset by a valuation allowance required by FASB Statement 109, "Accounting for Income Taxes." The valuation allowance is necessary because, according to criteria established by FASB Statement 109, it is more likely than not that the deferred tax asset will not be realized through future taxable income.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and equivalents, accounts receivable, accounts payable, and accrued expenses. These balances approximate their fair value because of their short maturities. Accounts receivable are presented net of allowance for uncollectible accounts of \$293,000 as of December 31, 2000 and \$289,000 as of June 30, 2000, respectively.

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

Net Loss Per Common Share

Effective as of July 3, 2000, the Company implemented a 1 for 4 reverse split of its common stock. Prior year amounts presented as net loss per common share have been retroactively restated to give effect to this reverse split.

NOTE 4 - UNCONSOLIDATED SUBSIDIARY

As further described in Note 15, effective as of January 17, 2001, the Company sold a 75% interest in its Clariti Australia. As a result of this divestment, the Company's financial statements for Fiscal 2Q01 and Fiscal First Half 2001 reflect Clariti Australia's results of operations and financial position using the equity method of accounting. The following table presents summary financial information for Clariti Australia for Fiscal 2Q01 and Fiscal First Half 2001.

As of December 31, 2000

Current assets	\$	612
Non-current assets	\$	2,553
Current liabilities	\$	887

	Fiscal 2Q01	Fiscal First Half 2001
	-----	-----
Net sales	\$ 1,067	\$ 1,903
Gross profit	\$ 280	\$ 523
Net loss	\$ (387)	\$ (880)

NOTE 5 - WRITE-DOWN OF INVESTMENT IN UNCONSOLIDATED SUBSIDIARY

As further described in Note 15, effective as of January 17, 2001, the Company sold a 75% interest in Clariti Australia. As a result of this divestment, the Company's net investment in its 100% interest in Clariti Australia as of December 31, 2000 (\$2,297,000) was written down to a net realizable value of \$1,781,000. The resulting write-down included in the Company's consolidated results of operations for Fiscal 2Q01 and Fiscal First Half 2001 was \$516,000.

11

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2000 AND 1999

NOTE 6 - EXTRAORDINARY GAIN

As of October 11, 1999, GlobalFirst Holdings Limited ("GlobalFirst") and Mediate1 Global Communications Limited ("Mediate1") and their respective

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

subsidiaries (the "International Telecommunications Group") filed for voluntary liquidation and ceased operation of their businesses. At the time the liquidation proceedings began, GlobalFirst and Mediatel were wholly owned subsidiaries of the Company. Liquidation proceedings were undertaken because the International Telecommunications Group could not pay its debts, including debt the group owed to the Company. The liquidation proceedings have discharged all liabilities of the International Telecommunications Group. All losses from operations of the International Telecommunications Group had been provided for as of June 30, 1999, including losses from operations during Fiscal First Half 2000. Therefore, the Company recognized an extraordinary gain of \$32,502,000, which was largely attributable to the excess of liabilities over assets of the International Telecommunications Group as of October 11, 1999, the liquidation date.

NOTE 7 - COMPREHENSIVE INCOME

The Company has adopted FASB Statement 130, "Comprehensive Income." The Company's only item of comprehensive income that is excluded from net income is the cumulative foreign currency translation adjustment associated with the Company's ongoing foreign businesses. The Company had foreign currency translation adjustments of \$(112,000) and \$(10,000) during Fiscal 2Q01 and Fiscal 2Q00, respectively, and \$6,000 and \$(27,000) during Fiscal First Half 2001 and Fiscal First Half 2000, respectively. During Fiscal First Half 2000, the Company also reclassified a cumulative foreign currency translation adjustment of \$1,348,000 to net income as a result of the liquidation of the International Telecommunications Group. This reclassification amount was included in the extraordinary gain described in Note 6 above.

NOTE 8 - COMMITMENTS AND CONTINGENCIES

France Telecom SA ("France Telecom") initiated a complaint against the Company on May 12, 2000 before the Tribunal de Commerce de Paris (Paris Commercial Court) in Paris, France. France Telecom's claim relates to a debt it claims it is owed by GlobalFirst Communications SA, a French subsidiary of GlobalFirst Holdings Ltd., for long-distance telephone services. France Telecom seeks payment from Clariti of 20,000,000 French Francs (approximately \$2,800,000). France Telecom further claims unspecified damages corresponding to the loss of revenue resulting from the ceasing of commercial relations with GlobalFirst Communications SA. The Company intends to vigorously defend the claims asserted by France Telecom. Clariti believes that it did not verbally or in writing make a promise to pay any obligations of GlobalFirst Communications SA, and that it caused no damages to France Telecom because commercial relations with GlobalFirst Communications SA had ceased before Clariti held any negotiations with France Telecom. This matter is currently pending in the French Court.

12

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2000 AND 1999

NOTE 8 - COMMITMENTS AND CONTINGENCIES (continued)

On November 30, 1999, IDT Corporation ("IDT") filed a complaint in the Court of Common Pleas in Philadelphia, Pennsylvania against the Company and Clariti Carrier Services Limited, a United Kingdom subsidiary of the Company, seeking payment for long-distance telephone services pursuant to a contract between IDT

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

and GlobalFirst Communications Limited, a subsidiary of GlobalFirst. The complaint seeks damages in the amount of \$690,163 plus interest, costs and attorneys fees. On March 20, 2000, the Court of Common Pleas dismissed the complaint on the basis of jurisdiction, provided that proper jurisdiction lies in England. On or about April 15, 2000, IDT filed an appeal with the Superior Court of Pennsylvania appealing the decision of the Court of Common Pleas. This appeal is currently pending. The Company believes damages IDT may have suffered, if any, must be recovered through the liquidation proceedings of the International Telecommunications Group, and that neither the Company nor Clariti Carrier Services Limited has any liability with respect to IDT's claim.

On or about June 17, 1999 Clariti, together with Mediatel, GlobalFirst, and Chadwell Hall Holdings Ltd. ("CHH"), formerly the owner of record of a majority of Clariti stock (collectively the "Claimants"), filed a Demand for Arbitration with the American Arbitration Association (case no. 50 N 181 0021399) against Frontier Corporation and Frontel Communications Limited (collectively "Frontier") concerning obligations arising under that certain March 4, 1999 agreement entered into by and among Frontier and each of the Claimants ("March 4 Agreement"). The parties entered into the March 4 Agreement for the purpose of resolving certain billing disputes between Frontier on the one part and GlobalFirst and Mediatel on the other part. Under the March 4 Agreement, Clariti paid \$3,000,000 to Frontier during March 1999 in payment of amounts allegedly due Frontier by Mediatel and/or GlobalFirst. Additionally, Clariti issued to Frontier 1,250,000 shares of its common stock (5,000,000 shares before the 1 for 4 reverse split) as security for the remaining balance, if any, due Frontier by Mediatel and/or GlobalFirst ("Clariti Stock"). The amount due Frontier by Mediatel and GlobalFirst as agreed to by the parties or as determined by arbitration is referred to in the March 4 Agreement as the "Account Balance". The terms of the March 4 Agreement provide in part as follows: that CHH is liable for and guarantees payment in full of the Account Balance and, further, shall be obligated to purchase the Clariti Stock from Frontier for an amount equal to the Account Balance. In the event of a default under the March 4 Agreement, Frontier may, at its option, sell a sufficient amount of shares of Clariti Stock in order to satisfy the Account Balance. If Frontier sells all 1,250,000 shares of Clariti Stock for less than the Account Balance, GlobalFirst, Mediatel and CHH are liable to pay Frontier the remaining Account Balance due to Frontier. Once Frontier collects the Account Balance (whether by sale of Clariti Stock or payment made by any of the parties), Frontier must surrender to Clariti any remaining shares of Clariti Stock. A hearing was held in London before an arbitration panel in early December 2000. On January 11, 2001, the Arbitration panel determined in pertinent part as follows:

13

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000 AND 1999

NOTE 8 - COMMITMENTS AND CONTINGENCIES (continued)

- (1) The Account Balance for purposes of the March 4 Agreement is 8,737,397.74 British Pounds (approximately US\$12.7 million). Including interest through January 11, 2001, the total amount due to Frontier is 10,164,534.60 (approximately US\$14.8 million).
- (2) Clariti has complied with its obligations under the March 4 Agreement.

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

Based on the arbitration panel's ruling, the Company believes it has no further obligations to Frontier under the March 4 Agreement. Both GlobalFirst and Mediatel are in liquidation and thus will be unable to pay their portions of the arbitration award. As of February 7, 2001, CHH had not yet paid its obligation to Frontier. If CHH fails to pay the arbitration award to Frontier and Frontier sells a significant amount of the Clariti Stock in the open market, the market price of Clariti's common stock may decline.

The Company is, from time to time, during the normal course of its business operations, subject to various other litigation claims and legal disputes. The Company expects none to have a material adverse impact on its operations; however, no assurance can be given that an adverse determination of any claim or dispute would not have an adverse impact on its operations during any given period.

NOTE 9 - RELATED PARTIES

In connection with the Company's acquisition of Mediatel, the Company issued a promissory note payable to CHH, the owner of Mediatel and formerly the Company's majority shareholder of record, in the amount of \$3,000,000. Such note carried a fixed interest rate of 6.5% and was payable, including any accrued interest thereon, on March 16, 2000. On April 7, 1999 Clariti prepaid \$1 million against the principal balance of the note. During Fiscal First Half 2000 the remaining \$2,000,000 balance of the note plus accrued interest of \$81,000 was capitalized as a contribution to capital of the Company by CHH. The Company issued no common stock to CHH in connection with this contribution to capital.

14

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000 AND 1999

NOTE 10 - COMMON STOCK

Effective as of July 3, 2000, the Company implemented a 1 for 4 reverse split of its common stock. All prior year amounts of Clariti common stock presented in these financial statements and notes have been retroactively restated to give effect to this reverse split.

During Fiscal First Half 2001, the Company issued approximately 222,000 shares of Clariti common stock pursuant to its December 1999 agreement to acquire TWC. In addition, approximately 85,000 shares of Clariti common stock were returned

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

to the Company pursuant to the terms of such agreement to acquire TWC. The Company has retired these returned shares.

During Fiscal First Half 2000, the Company sold approximately 2,952,000 shares of its common stock to several third party investors for proceeds, net of commissions, of \$22,950,000. In addition, the Company issued 500,000 shares to a third party investor in settlement of a loan for \$1,000,000 such investor had made to the Company.

NOTE 11 - STOCK OPTIONS

During Fiscal First Half 2001, the Company granted options to purchase approximately 2,897,000 shares of the Company's common stock at prices ranging from \$3.06 per share to \$8.38 per share (weighted average price of \$4.69 per share). In addition, approximately 2,267,000 previously outstanding common stock options expired during Fiscal First Half 2001. The exercise prices of these expired options ranged from \$4.75 per share to \$13.50 per share (weighted average price of \$8.92 per share). Company stock options have been issued to new and existing employees of the Company and members of the Company's board of directors, may be exercised over a period of 10 years at the fair market value on the date of grant and generally carry such other terms as if they had been issued under the Company's Stock Option Plan.

NOTE 12 - WARRANTS

From time to time, the Company may issue warrants to purchase its common stock to parties other than employees and directors. Warrants may be issued as a unit with shares of common stock, as an incentive to help the Company achieve its goals, or in consideration for cash or services rendered to the Company, or a combination of the above. Cost associated with warrants issued to other than employees is valued based on the fair value of the warrants as estimated using the Black-Scholes model with the following assumptions: no dividend yield, expected volatility of 80%, and a risk-free interest rate of 6.5%.

15

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2000 AND 1999

NOTE 12 - WARRANTS (continued)

During Fiscal First Half 2001 the Company issued to several consultants warrants to purchase a total of 463,000 shares of the Company's common stock at the market price on the date of grant, which ranged from \$4.31 per share to \$5.06 per share (weighted average price of \$4.68 per share). The warrants were issued for services rendered and expire from 1 to 3 years from the date of grant. The Black-Scholes model valued these warrants at a total of \$658,000.

Also during Fiscal First Half 2001, approximately 3,017,000 warrants with exercise prices between \$8.00 and \$20.00 per share expired without being exercised. The book value of such expired warrants (approximately \$4,998,000)

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

was reclassified from warrants outstanding to additional paid-in capital.

NOTE 13 - EARNINGS PER SHARE

The Company utilizes FASB Statement 128, "Earnings Per Share," which prescribes standards for computing and presenting earnings per share. Under FASB Statement 128, basic income or loss per common share is based upon the weighted average number of common shares outstanding during the period. Diluted income or loss per common share is computed after the assumed conversion of potential common shares (warrants and stock options). The treasury stock method is used to calculate dilutive shares. Such method reduces the number of dilutive shares by the number of shares purchasable from the proceeds of the options and warrants assumed to be exercised. Basic and diluted weighted average shares outstanding for Fiscal First Half 2001, Fiscal First Half 2000, Fiscal 2Q01 and Fiscal 2Q00 were the same because the effect of using the treasury stock method would be antidilutive.

NOTE 14 - SEGMENT INFORMATION

The Company has adopted FASB Statement No. 131, "Disclosures About Segments of an Enterprise and Related Information." The Company has divided its operations into two reportable segments, Telephony/Internet Services and Wireless Messaging, based on fundamental differences in their operations as well as their products and services offered. Amounts presented in the following tables are in thousands of dollars, except per share amounts.

16

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 DECEMBER 31, 2000 AND 1999

NOTE 14 - SEGMENT INFORMATION (continued)

	THREE MONTHS ENDED DECEMBER 31,		SIX MONTHS ENDED DECEMBER 31,	
	2000	1999	2000	1999
Revenues				
Telephony/Internet Services	\$ 3,815	\$ 899	\$ 6,996	\$ 1,217
Wireless Messaging	-	-	-	-
Corporate	-	-	-	-
Total revenues	\$ 3,815	\$ 899	\$ 6,996	\$ 1,217

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

	=====	=====	=====	=====
Net Loss Before Extraordinary Item				

Telephony/Internet Services	\$ (1,850)	\$ (2,840)	\$ (4,185)	\$ (4,277)
Wireless Messaging	(2,580)	(1,107)	(4,438)	(2,166)
Corporate	(1,927)	(3,501)	(4,156)	(5,546)
	-----	-----	-----	-----
Total net loss before extraordinary item	\$ (6,357)	\$ (7,448)	\$ (12,779)	\$ (11,989)
	=====	=====	=====	=====
Extraordinary Item				

Telephony/Internet Services	\$ -	\$ -	\$ -	\$ -
Wireless Messaging	-	-	-	-
Corporate	-	-	-	32,502
	-----	-----	-----	-----
Total extraordinary item	\$ -	-	\$ -	\$ 32,502
	=====	=====	=====	=====
Net Income (Loss)				

Telephony/Internet Services	\$ (1,850)	\$ (2,840)	\$ (4,185)	\$ (4,277)
Wireless Messaging	(2,580)	(1,107)	(4,438)	(2,166)
Corporate	(1,927)	(3,501)	(4,156)	26,956
	-----	-----	-----	-----
Total net loss before extraordinary item	\$ (6,357)	\$ (7,448)	\$ (12,779)	\$ 20,513
	=====	=====	=====	=====

17

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2000 AND 1999

NOTE 14 - SEGMENT INFORMATION (continued)

	As of Dec. 31, 2000	As of June 30, 2000
	-----	-----
Assets		

Telephony/Internet Services	\$ 10,650	\$ 11,095
Wireless Messaging	1,479	839
Corporate	4,280	14,723
	-----	-----
Total assets	\$ 16,409	\$ 26,657
	=====	=====

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

NOTE 15 - SUBSEQUENT EVENT

Effective as of January 17, 2001, the Company sold a 75% interest in Clariti Australia in exchange for 314,184 shares of Clariti common stock, which have since been retired. Based on the closing price of Clariti common stock on January 17, 2001 of \$4.75 per share, the consideration was valued at \$1,492,000. The agreement for the sale of Clariti Australia provides for a second closing during February 2001 pursuant to which the Company will receive up to an additional 60,816 shares of Clariti common stock in exchange for up to an additional 18% of Clariti Australia. The actual percentage interest in Clariti Australia sold at the second closing will be prorated based on the actual number of shares of Clariti common stock delivered.

NOTE 16 - MANAGEMENT'S PLANS

Adverse market conditions for telecommunications companies during the second half of calendar 2000 have made it difficult for the Company to raise additional financing to meet its future cash requirements. However, the Company is actively pursuing opportunities to secure additional financing that is expected to be sufficient to meet its operating cash requirements at least through the current fiscal year end. There can be no assurances that such funding will be generated or available, or if available, on terms acceptable to the Company. Failure to secure additional financing will have a material adverse impact on the Company.

18

PART I. ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

Certain information included in this Quarterly Report may be deemed to include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that involve risk and uncertainty, such as information relating to sufficiency of cash resources and expected trends in operating losses and cash flows, as well as the Company's ability to successfully do any or all of the following:

- commercialize its wireless voice messaging technology
- integrate the business operations of MegaHertz-NKO with those of TWC
- obtain the necessary additional financing to achieve its business plans

In addition, certain statements may involve risk and uncertainty if they are preceded by, followed by, or that include the words "intends," "estimates," "believes," "expects," "anticipates," "should," "could," or similar expressions, and other statements contained herein regarding matters that are not historical facts. Although the Company believes that its expectations are based on reasonable assumptions, it can give no assurance that its expectations will be achieved. The important factors that could cause actual results to differ materially from those in the forward-looking statements herein (the "Cautionary Statements") include, without limitation, risks associated with the

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

Company's operating losses, risks relating to the Company's development and expansion and possible inability to manage growth, risks relating to the Company's significant capital requirements, including its ability to obtain additional financing in a challenging market for telecommunications companies, risks relating to competition and regulatory developments, risks relating to implementing local and enhanced services, risks relating to its long distance business, risks related to the various technical aspects of developing the Company's wireless voice messaging technology and the market acceptance of same, as well as other risks referenced in the Company's annual report on Form 10-K for the year ended June 30, 2000 and from time to time in the Company's filings with the Securities and Exchange Commission . All subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements. The Company does not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following discussion should be read in conjunction with the Company's consolidated financial statements appearing elsewhere in this report.

General Operations

The Company's current focus is in two industry segments: wireless messaging services and telephony/Internet services. Clariti's wireless technology will support voice messaging (including wireless voicemail and text-to-speech), data and information services to a high-speed digital wireless device. Clariti's telephony/Internet business is an international facilities-based carrier that utilizes both IP and circuit switched technologies over a unified messaging platform, and includes the following services:

19

- prepaid phone cards;
- residential and business long distance services;
- fax and data services;
- traditional dial-up Internet access, web site design and hosting; and
- Digital Subscriber Line ("DSL") connections for business customers.

Recent Developments

Effective as of January 17, 2001, the Company sold a 75% interest in Clariti Australia in exchange for 314,184 shares of Clariti common stock, which have since been retired. Based on the closing price of Clariti common stock on January 17, 2001 of \$4.75 per share, the consideration was valued at \$1,492,000. The agreement for the sale of Clariti Australia provides for a second closing during February 2001 pursuant to which the Company will receive up to an additional 60,816 shares of Clariti common stock in exchange for up to an additional 18% of Clariti Australia. The actual percentage interest in Clariti Australia sold at the second closing will be prorated based on the actual number of shares of Clariti common stock delivered.

Results of Operations

For Fiscal 2Q01 and Fiscal First Half 2001, Clariti Australia was accounted for under the equity method of accounting because the Company sold a

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

majority interest in such subsidiary in January 2001. For Fiscal 2Q00 and Fiscal First Half 2000, Clariti Australia was accounted for as a consolidated subsidiary. This change to equity method accounting is hereinafter referred to as the "deconsolidation of Clariti Australia."

Three Months Ended December 31, 2000 ("Fiscal 2Q01")
v. Three Months Ended December 31, 1999 ("Fiscal 2Q00")

For Fiscal 2Q01, the Company had a net loss of \$6,357,000, or \$0.18 per share, on revenue of \$3,815,000 as compared to a net loss of \$7,448,000, or \$0.23 per share, on revenue of \$899,000 in Fiscal 2Q00.

Revenues increased from \$899,000 in Fiscal 2Q00 to \$3,815,000 for Fiscal 2Q01. The \$2,916,000 increase resulted from an increase in revenues from TWC, which was acquired in December 1999, and operations in the United Kingdom, where the Company began to utilize some of the switching equipment previously used in the International Telecommunications Group. Partially offsetting these increases were reductions in revenues resulting from the deconsolidation of Clariti Australia in Fiscal 2Q01 and the termination of most of MegaHertz-NKO's revenue-generating activities in the quarter ended June 30, 2000. Likewise, gross profit increased \$422,000, from \$191,000 in Fiscal 2Q00 to \$613,000 in Fiscal 2Q01 due to an increase in gross profit from TWC and operations in the United Kingdom, partially offset by a reduction in gross profit resulting from the deconsolidation of Clariti Australia in Fiscal 2Q01 and the termination of most of MegaHertz-NKO's revenue-generating activities in the quarter ended June 30, 2000.

20

Network operating expenses increased \$315,000, from \$276,000 in Fiscal 2Q00 to \$591,000 for Fiscal 2Q01. This increase resulted from an increase in network operating expenses from TWC, which was acquired in December 1999, and operations in the United Kingdom, where the Company began to utilize some of the switching equipment previously used in the International Telecommunications Group. Marketing expenses increased \$405,000, from \$337,000 in Fiscal 2Q00 to \$742,000 in Fiscal 2Q01. This increase was due to an increase in marketing expenses from TWC as well as higher marketing expenses from the Wireless Messaging group in anticipation of commercial launch of its wireless messaging service. Lower marketing expenses resulting from the termination of most of MegaHertz-NKO's revenue-generating activities in the quarter ended June 30, 2000 partially offset these increases.

All of the Company's research and development expenses relate to the development of its Wireless Messaging technology. Such expenses in Fiscal 2Q01 increased \$733,000, from \$815,000 in Fiscal 2Q00 to \$1,548,000 in Fiscal 2Q01 due to expansion and acceleration of the Company's efforts to complete development and implement commercial deployment of the Wireless Voice Messaging System.

Depreciation and amortization decreased from \$1,246,000 in Fiscal 2Q00 to \$579,000 in Fiscal 2Q01. The \$667,000 decrease resulted from the absence of amortization of goodwill recognized in the acquisition of MegaHertz-NKO because such goodwill had been written off in the quarter ended June 30, 2000. Partially offsetting this decrease was higher depreciation and amortization expense resulting from TWC, which was acquired in December 1999.

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

General and administrative expenses decreased \$2,346,000, from \$5,049,000 in Fiscal 2000 to \$2,703,000 in Fiscal 2001. A substantial reduction in the number of common stock warrants issued as compensation to consultants reduced general and administrative expenses by nearly \$2 million. No cash was expended in connection with the issuance of such warrants. Also contributing to the decrease was the deconsolidation of Clariti Australia. Partially offsetting these decreases were the addition of general and administrative expenses from TWC, which was acquired in December 1999, and the expansion of Wireless Messaging and Corporate Overhead activities in preparation for the anticipated commercial launch of the Company's Wireless Voice Messaging System.

As further described above under Recent Developments, the Company sold a 75% interest in Clariti Australia in January 2001. As a result, for Fiscal 2001 Clariti Australia was accounted for under the equity method of accounting. Prior to Fiscal 2001, Clariti Australia was accounted for as a consolidated subsidiary. The equity in net loss of unconsolidated subsidiary reflects the Company's 100% interest in Clariti Australia's results of operation for Fiscal First Half 2001. In addition, the Company's net investment in Clariti Australia as of December 31, 2000 was written down to reflect net realizable value of such investment based on the terms of the divestment described above under Recent Developments.

Six Months Ended December 31, 2000 ("Fiscal First Half 2001")
v. Six Months Ended December 31, 1999 ("Fiscal First Half 2000")

For Fiscal First Half 2001, the Company had a net loss of \$12,779,000, or \$0.36 per share, on revenue of \$6,996,000 as compared to net income of \$20,513,000, or \$0.64 per share, on revenue of \$1,217,000 in Fiscal First Half

21

2000. Excluding an extraordinary gain of \$32,502,000, or \$1.01 per share, the Company had a net loss of \$11,989,000, or \$0.37 per share, in Fiscal First Half 2000.

As of October 11, 1999, the International Telecommunications Group filed for voluntary liquidation and ceased operation of its businesses. As of June 30, 1999, the Company had written off all assets related to the International Telecommunications Group and had accrued for all of the Group's estimated losses from operations up to the date of liquidation. The liquidation proceedings have discharged all liabilities of the International Telecommunications Group, and as a result the Company recognized an extraordinary gain of \$32,502,000 on the discharge of such indebtedness in Fiscal First Half 2000.

Revenues increased from \$1,217,000 in Fiscal First Half 2000 to \$6,996,000 for Fiscal First Half 2001. The \$5,779,000 increase resulted from an increase in revenues from TWC, which was acquired in December 1999, and operations in the United Kingdom, where the Company began to utilize some of the switching equipment previously used in the International Telecommunications Group. Partially offsetting these increases were reductions in revenues resulting from the deconsolidation of Clariti Australia in Fiscal First Half 2001 and the termination of most of MegaHertz-NKO's revenue-generating activities in the quarter ended June 30, 2000. Likewise, gross profit increased \$648,000, from \$321,000 in Fiscal First Half 2000 to \$969,000 in Fiscal First Half 2001 due to an increase in gross profit from TWC and operations in the United Kingdom, partially offset by a reduction in gross profit resulting from the deconsolidation of Clariti Australia in Fiscal First Half 2001 and the termination of most of MegaHertz-NKO's revenue-generating activities in the quarter ended June 30, 2000.

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

Network operating expenses increased \$831,000, from \$348,000 in Fiscal First Half 2000 to \$1,179,000 for Fiscal First Half 2001. This increase also resulted from an increase in network operating expenses from TWC, which was acquired in December 1999, and operations in the United Kingdom, where the Company began to utilize some of the switching equipment previously used in the International Telecommunications Group. Marketing expenses increased \$824,000, from \$624,000 in Fiscal First Half 2000 to \$1,448,000 in Fiscal First Half 2001. This increase was due to an increase in marketing expenses from TWC as well as higher marketing expenses from the Wireless Messaging group in anticipation of commercial launch of its wireless messaging service. Lower marketing expenses resulting from the termination of most of MegaHertz-NKO's revenue-generating activities in the quarter ended June 30, 2000 partially offset these increases.

All of the Company's research and development expenses relate to the development of its Wireless Messaging technology. Such expenses in Fiscal First Half 2001 increased \$1,195,000, from \$1,510,000 in Fiscal First Half 2000 to \$2,705,000 in Fiscal First Half 2001 due to expansion and acceleration of the Company's efforts to complete development and implement commercial deployment of the Wireless Voice Messaging System.

22

Depreciation and amortization decreased from \$2,283,000 in Fiscal First Half 2000 to \$1,092,000 in Fiscal First Half 2001. The \$1,191,000 decrease resulted from the absence of amortization of goodwill recognized in the acquisition of MegaHertz-NKO because such goodwill had been written off in the quarter ended June 30, 2000. Partially offsetting this decrease was higher depreciation and amortization expense resulting from TWC, which was acquired in December 1999.

General and administrative expenses decreased \$1,390,000, from \$7,607,000 in Fiscal First Half 2000 to \$6,217,000 in Fiscal First Half 2001. A substantial reduction in the number of common stock warrants issued as compensation to consultants reduced general and administrative expenses by more than \$2 million. No cash was expended in connection with the issuance of such warrants. Also contributing to the decrease was the deconsolidation of Clariti Australia. Partially offsetting these decreases were the addition of general and administrative expenses from TWC, which was acquired in December 1999, and the expansion of Wireless Messaging and Corporate Overhead activities in preparation for the anticipated commercial launch of the Company's Wireless Voice Messaging System.

As further described above under Recent Developments, the Company sold a 75% interest in Clariti Australia in January 2001. As a result, for Fiscal First Half 2001 Clariti Australia was accounted for under the equity method of accounting. Prior to Fiscal 2001, Clariti Australia was accounted for as a consolidated subsidiary. The equity in net loss of unconsolidated subsidiary reflects the Company's 100% interest in Clariti Australia's results of operation for Fiscal First Half 2001. In addition, the Company's net investment in Clariti Australia as of December 31, 2000 was written down to reflect net realizable value of such investment based on the terms of the divestment described above under Recent Developments.

Liquidity and Capital Resources

At December 31, 2000, the Company had working capital of \$1,209,000 (including a cash balance of \$3,908,000) as compared to working capital of \$12,553,000 (including a cash balance of \$14,333,000) at June 30, 2000. The working capital decrease of \$11,344,000 is primarily due to the use of cash in operations and capital expenditures during Fiscal First Half 2001.

The Company was unable to secure additional financing it had expected to receive during the fourth quarter of calendar 2000. Adverse market conditions for telecommunications companies during the second half of calendar 2000 were a major factor contributing to this situation. However, the Company is actively pursuing opportunities to secure additional financing that is expected to be sufficient to meet its operating cash requirements at least through the current fiscal year end. There can be no assurances that such funding will be generated or available, or if available, on terms acceptable to the Company. Failure to secure additional financing will have a material adverse impact on the Company.

Significant additional funding will be required beyond June 2001 to launch the Wireless Voice Messaging System in specified target markets and to meet expected negative operating cash flows and capital expenditure plans. However, there can be no assurances that such funding will be generated or available, or if available, on terms acceptable to the Company.

23

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

France Telecom SA ("France Telecom") initiated a complaint against the Company on May 12, 2000 before the Tribunal de Commerce de Paris (Paris Commercial Court) in Paris, France. France Telecom's claim relates to a debt it claims it is owed by GlobalFirst Communications SA, a French subsidiary of GlobalFirst Holdings Ltd., for long-distance telephone services. France Telecom seeks payment from Clariti of 20,000,000 French Francs (approximately \$2,600,000). France Telecom further claims unspecified damages corresponding to the loss of revenue resulting from the ceasing of commercial relations with GlobalFirst Communications SA. The Company intends to vigorously defend the claims asserted by France Telecom. Clariti believes that it did not verbally or in writing make a promise to pay any obligations of GlobalFirst Communications SA, and that it caused no damages to France Telecom because commercial relations with GlobalFirst Communications SA had ceased before Clariti held any negotiations with France Telecom. This matter is currently pending in the French Court.

On November 30, 1999, IDT Corporation ("IDT") filed a complaint in the Court of Common Pleas in Philadelphia, Pennsylvania against the Company and Clariti Carrier Services Limited, a United Kingdom subsidiary of the Company, seeking payment for long-distance telephone services pursuant to a contract between IDT and GlobalFirst Communications Limited, a subsidiary of GlobalFirst. The complaint seeks damages in the amount of \$690,163 plus interest, costs and attorneys fees. On March 20, 2000, the Court of Common Pleas dismissed the complaint on the basis of jurisdiction, provided that proper jurisdiction lies in England. On or about April 15, 2000, IDT filed an appeal with the Superior Court of Pennsylvania appealing the decision of the Court of Common Pleas. This appeal is currently pending. The Company believes damages IDT may have suffered, if any, must be recovered through the liquidation proceedings of the International Telecommunications Group, and that

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

neither the Company nor Clariti Carrier Services Limited has any liability with respect to IDT's claim.

On or about June 17, 1999 Clariti, together with Mediatel, GlobalFirst, and CHH, formerly the owner of record of a majority of Clariti stock (collectively the "Claimants"), filed a Demand for Arbitration with the American Arbitration Association (case no. 50 N 181 0021399) against Frontier Corporation and Frontel Communications Limited (collectively "Frontier") concerning obligations arising under that certain March 4, 1999 agreement entered into by and among Frontier and each of the Claimants ("March 4 Agreement"). The parties entered into the March 4 Agreement for the purpose of resolving certain billing disputes between Frontier on the one part and GlobalFirst and Mediatel on the other part. Under the March 4 Agreement, Clariti paid \$3,000,000 to Frontier during March 1999 in payment of amounts allegedly due Frontier by Mediatel and/or GlobalFirst. Additionally, Clariti issued to Frontier 1,250,000 shares of its common stock (5,000,000 shares before the 1 for 4 reverse split) as security for the remaining balance, if any, due Frontier by Mediatel and/or GlobalFirst ("Clariti Stock"). The amount due Frontier by Mediatel and GlobalFirst as agreed to by the parties or as determined by arbitration is referred to in the March 4 Agreement as the "Account Balance". The terms of the March 4 Agreement provide in part as

24

follows: that CHH is liable for and guarantees payment in full of the Account Balance and, further, shall be obligated to purchase the Clariti Stock from Frontier for an amount equal to the Account Balance. In the event of a default under the March 4 Agreement, Frontier may, at its option, sell a sufficient amount of shares of Clariti Stock in order to satisfy the Account Balance. If Frontier sells all 1,250,000 shares of Clariti Stock for less than the Account Balance, GlobalFirst, Mediatel and CHH are liable to pay Frontier the remaining Account Balance due to Frontier. Once Frontier collects the Account Balance (whether by sale of Clariti Stock or payment made by any of the parties), Frontier must surrender to Clariti any remaining shares of Clariti Stock. A hearing was held in London before an arbitration panel in early December 2000. On January 11, 2001, the Arbitration panel determined in pertinent part as follows:

- (1) The Account Balance for purposes of the March 4 Agreement is 8,737,397.74 British Pounds (approximately US\$12.7 million). Including interest through January 11, 2001, the total amount due to Frontier is 10,164,534.60 British Pounds (approximately US\$14.8 million).
- (2) Clariti has complied with its obligations under the March 4 Agreement.

Based on the arbitration panel's ruling, the Company believes it has no further obligations to Frontier under the March 4 Agreement. Both GlobalFirst and Mediatel are in liquidation and thus will be unable to pay their portions of the arbitration award. As of February 7, 2001, CHH had not yet paid its obligation to Frontier. If CHH fails to pay the arbitration award to Frontier and Frontier sells a significant amount of the Clariti Stock in the open market, the market price of Clariti's common stock may decline.

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

Edgar Filing: CLARITI TELECOMMUNICATIONS INTERNATIONAL LTD - Form 10-Q

None

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

None

Item 5. Other Events

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

None

(b) Reports on Form 8-K:

None

25

SIGNATURES

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

Dated: February 14, 2001

CLARITI TELECOMMUNICATIONS INTERNATIONAL, LTD.
(REGISTRANT)

By: s/James M. Boyd, Jr.

James M. Boyd, Jr.
Vice President of Finance
and Chief Accounting Officer

26