IMPROVENET INC
Form 10-Q
August 20, 2002

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

ý	**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2002.**
	OR
o	**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Transition Period from to .**

COMMISSION FILE NUMBER 000-29927

IMPROVENET, INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0452868**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*

1286 Oddstad Drive

Redwood City, CA 94063-2469

(Address of principal executive offices)

(888) 777-2212

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ý NO o

The number of shares outstanding of the registrant s common stock, $.001 par value, was 17,295,394 as of July 31, 2002

ImproveNet, Inc.

Form 10-Q

For the Quarter Ended June 30, 2002

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

IMPROVENET, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

(UNAUDITED)

	June 30, 2002	December 31, 2001
Assets		
Current assets:		
Cash and cash equivalents	$ 3,147	$ 9,612
Accounts receivable, net	673	1,000
Prepaid expenses	790	549
Total current assets	4,610	11,161
Property and equipment, net	260	1,496
Other assets	75	478
Total assets	$ 4,945	$ 13,135
Liabilities & Stockholders Equity		
Current liabilities:		
Accounts payable	$ 317	$ 636
Accrued liabilities	1,044	2,267
Accrual for restructuring	318	1,026
Deferred revenue	17	180
Total current liabilitites	1,696	4,109
Long-term liabilities		10
Total liabilities	1,696	4,119
Stockholders equity:		
Common stock	17	17
Treasury stock	(56)	(56)

Additional paid-in-capital		144,529		145,362
Unearned stock-based compensation				(5,711)
Accumulated deficit		(141,241)		(130,596)
Total stockholders equity		3,249		9,016
Total liabilities and stockholders equity	$	4,945	$	13,135

The accompanying notes are an integral part of these condensed consolidated financial statements.

IMPROVENET, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(UNAUDITED)

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2002	**2001**	**2002**	**2001**
REVENUES				
Service revenues	$ 1,094	$ 1,827	$ 2,154	$ 2,965
Marketing revenues	40	372	140	845
Total revenues	1,134	2,199	2,294	3,810
COST OF REVENUES				
Cost of service revenues (excludes stock-based compensation of $20 and $58 in 2002 and $86 and $211 in 2001)	711	1,111	1,445	2,388
Cost of marketing revenues (excludes stock-based compensation of $8 and $24 in 2002 and $32 and $83 in 2001)	1	90	60	226
Total cost of revenues	712	1,201	1,505	2,614
Gross profit	422	998	789	1,196
OPERATING EXPENSES				
Sales & marketing (excludes stock-based compensation of $1,043 and $1,869 in 2002 and $1,053 and $2,143 in 2001)	773	4,514	1,943	10,895
Product development	438	939	1,077	1,996
General & administrative (excludes stock-based compensation of $2 and $6 in 2002 and $28 and $171 in 2001)	567	1,060	1,211	2,626
Stock-based compensation and warrant amortization	3,942	1,199	4,710	2,608
Corporate restructuring	975	181	2,562	2,173
Total operating expenses	6,695	7,893	11,503	20,298
Operating loss	(6,273)	(6,895)	(10,714)	(19,102)
Interest/Other income	31	231	68	647
Net loss	$ (6,242)	$ (6,664)	$ (10,646)	$ (18,455)
Basic and diluted net loss per common share	$ (0.36)	$ (0.38)	$ (0.62)	$ (1.05)
Weighted average shares used in calculating basic and diluted net loss per common share	17,296	17,585	17,299	17,613

The accompanying notes are an integral part of these consolidated financial statements.

IMPROVENET, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(UNAUDITED)

	SIX MONTHS ENDED JUNE 30, 2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (10,646)	$ (18,455)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	388	756
Loss on disposal of property		5
Restructuring charges net of cash expenditures		
Reduction in force	208	218
Facilities exit costs	(916)	607
Asset write-downs	848	770
Allowance for doubtful accounts	(218)	132
Amortization of stock-based compensation	1,376	2,608
Accelerated warrant amortization	3,334	
Warrant charges amortized	169	169
Notes receivable from related party		(60)
Net change in operating assets and liabilities:		
Accounts receivable	545	(381)
Prepaid expenses	(241)	1,238
Other assets	403	2
Accounts payable	(319)	(1,020)
Accrued liabilities	(1,223)	(959)
Deferred revenue	(163)	(30)
Other long-term liabilities		17
Net cash used in operating activities	(6,455)	(14,383)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment		(187)
Restricted cash		(61)
Net cash used in investing activities		(248)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of stock options/warrants/ESPP		76
Payment of long-term debt	(10)	
Payment for treasury stock purchase		(56)
Net cash (used in) provided by financing activities	(10)	20

Net decrease in cash and cash equivalents	(6,465)	(14,611)
Cash and cash equivalents, beginning of period	9,612	31,565
Cash and cash equivalents, end of period	$ 3,147	$ 16,954

The accompanying notes are an integral part of these condensed consolidated financial statements.

IMPROVENET, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - FORMATION AND BUSINESS OF THE COMPANY

Nature of the business

ImproveNet, Inc. (ImproveNet or the Company) (formerly Netelligence, Inc.) was incorporated in California in January 1996 and reincorporated in Delaware in September 1998. The Company is a source for home improvement information and services on the Internet. Through its ImproveNet.com and ImproveNetPro.com Web sites, matching services and targeted advertising, the Company is creating a national marketplace for home improvement products and services in which homeowners, service providers and suppliers of home improvement products and related services benefit from an organized and efficient online flow of information and communication. The Company generates quality job leads for its network of screened contractors from interested homeowners within their geographic area using its proprietary matching service.

Basis of Presentation

The accompanying interim condensed consolidated financial statements as of June 30, 2002 and December 31, 2001, and for the three and six months ended June 30, 2002 and 2001, are unaudited. The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which are of a normal recurring nature, necessary to present fairly the Company s financial position as of June 30, 2002, results of operations for the three and six months ended June 30, 2002 and 2001, and cash flows for the six months ended June 30, 2002 and 2001. The Company s results for an interim period are not necessarily indicative of the results that may be expected for the year.

Although the Company believes that all adjustments necessary for a fair presentation of the interim periods presented are included and that the disclosures are adequate, these condensed consolidated financial statements and notes thereto are unaudited and should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2001 included in the Company s Form 10-K filed on April 12, 2002, with the Securities and Exchange Commission. The balance sheet at December 31, 2001 has been derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States of America. Such disclosures are contained in our annual report on Form 10-K.

The Company has completed several rounds of private equity financing and raised, in its initial public offering, approximately $39.7 million, net of issuance costs, in March 2000. However, the Company has incurred substantial negative cash flows from operations in every fiscal period since inception. For the six month period ended June 30, 2002, the Company incurred a loss from operations of approximately $10.6 million and negative cash flows from operations of approximately $6.5 million. As of June 30, 2002, the Company had an accumulated deficit of approximately $141.2 million. Management expects operating losses and negative cash flows to continue for the foreseeable future.

The Company expects that losses will decrease from fiscal year 2001 levels due primarily to reduced operations, including decreased marketing expenditures and reductions in workforce. Operational restructuring has already been initiated - the Company reduced its workforce by 7% in 2000, 46% in 2001, and 95% for the six months ending June 30, 2002. The Company has $3.1 million of cash and cash equivalents at June 30, 2002. Failure to generate sufficient revenues, raise additional capital or reduce discretionary spending could have a material adverse effect on the Company s ability to continue as a going concern and to achieve its intended business objectives.

On June 25, 2002, the Company announced it would begin the process of liquidating certain assets while it continues to review strategic alternatives. Subsequent to the end of the quarter, the company announced a new agreement to merge with eTechLogix. The Company continues to operate its websites, provide referral services and remain active until further notice. The Company is operating with a minimal level of staffing.

NOTE 2 - NET LOSS PER SHARE

Basic net loss per common share is calculated by dividing net loss by the average number of outstanding common shares during the period. Diluted net loss per common share is calculated by adjusting the average number of outstanding common shares assuming conversion of all potentially dilutive stock options and warrants under the treasury stock method. For all periods presented, potentially dilutive convertible preferred stock, stock options and warrants were excluded from the calculation of diluted net loss per common share, as their effect would have been anti-dilutive.

Options to purchase approximately 0.3 million shares of common stock and warrants to purchase approximately 1.3 million shares of common stock were outstanding as of June 30, 2002.

The reconciliation of the numerator and denominator used in the calculation of the basic and diluted net loss per common share follows (in thousands, except per share amounts):

	Three Months Ended, June 30,		Six Months Ended, June 30,	
	2002	**2001**	**2002**	**2001**
Numerator:				
Net loss attributable to common stockholders	$ (6,242)	$ (6,664)	$ (10,646)	$ (18,455)
Denominator:				
Weighted average common shares	17,296	17,912	17,301	18,128
Weighted average common shares subject to repurchase	(2)	(327)	(2)	(515)
Denominator for basic and diluted calculation	17,294	17,585	17,299	17,613
Basic and diluted net loss per common share	$ (0.36)	$ (0.38)	$ (0.62)	$ (1.05)

NOTE 3 MULTI-YEAR COMMERCIAL CONTRACTS

Commencing in September 1999, the Company entered into multi year commercial marketing contracts, some of which are with related parties. These commercial contracts generally provided for a fixed annual fee, an advertising or branding package that includes a mix of buttons, banners, SmartLeads and other marketing or branding services, including Find A Contractor or Powered by ImproveNet, plus a continuous presence, as defined, on the Company s Web sites. These commercial contracts were for periods ranging between 2 and 12 years, including renewal options. These commercial contracts also include cooperative marketing arrangements under which the Company is obligated to fund, as defined, co operative branding expenditures on television and in the print media, with or on behalf of the commercial party. Most commercial contracts provide for the Company to spend 50% to 100% of the fees the Company expected to receive. In return, the Company is expected to receive significant marketing and branding benefits including better advertising rates, stronger brand recognition, and access to customer databases, direct mail inserts and marketing resources all designed to generate more traffic to its sites and jobs to its proprietary matching services.

As the Company does not have an established historical practice of selling advertising for cash for similar multi year commercial contracts, the Company has not assigned any value to the exchange of services or barter element of these transactions and accordingly, the Company has not recorded either revenue or sales and branding expense for the barter element. However, some of these multi year commercial contracts do generate an overall net cash component to the Company, and in these cases, the Company has recorded revenue based on the cash received or receivable under the contract, net of the obligation, if any, to reimburse the commercial party for the cooperative branding and other marketing services. These revenues are recognized over the term of the commercial contract once marketing and other services have been delivered to the commercial party and collection of the resulting net receivable is deemed probable.

For the three and six months ended June 30, 2002, the Company did not have any barter element amounts for these commercial contracts.

Furthermore, in connection with certain of these multi year commercial contracts, the Company also issued warrants to purchase shares of the Company s common stock to the commercial parties. These warrants have been valued by the Company using the Black Scholes option-pricing model. As the fair value of these warrants represent an additional rebate on the revenue otherwise recorded under the contracts, the amortization of the warrants has been netted against the related revenue over the term of the respective commercial contract. To the extent that there has been insufficient revenues, the remaining amortization of warrant stock based compensation has been expensed, and characterized as sales and marketing expense. On June 25, 2002, the Company announced it would begin the process of liquidating certain assets while it continues to review strategic alternatives. Subsequent to the end of the quarter, the company announced a new agreement to merge with eTechLogix. As a result, the Company believes that there is little benefit to be derived from the remaining long-term multi-year commercial contracts and accordingly the remaining unamortized stock based compensation arising from the warrants associated with these contracts has been expensed in the three months ended June 30, 2002.

NOTE 4 SEGMENT INFORMATION

The Company currently operates in a single business segment, as there is only one measurement of profitability for its operations. Through June 30, 2002, foreign operations have not been significant in either revenues or investments in long-lived assets.

Summary of the Company s revenue by service offerings is as follows (in thousands):

	Three Months Ended, March 31,		Six Months Ended, June 30,	
	2002	**2001**	**2002**	**2001**
Service revenues:				
Lead fees	$ 436	$ 348	$ 999	$ 811
Win fees	348	1,401	568	1,978
Other fees	310	78	587	176
Total service revenues	1,094	1,827	2,154	2,965
Marketing revenues	40	372	140	845
Total service and marketing revenues	$ 1,134	$ 2,199	$ 2,294	$ 3,810

For the three and six month periods ended June 30, 2002 and 2001, no customers represented over 10% of service or marketing revenues.

NOTE 5 COMPREHENSIVE LOSS

The Company follows Statement of Financial Accounting Standard (SFAS) No. 130, Reporting Comprehensive Income (SFAS No. 130). SFAS No. 130 establishes standards for reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. There was no difference between the Company s net loss and its comprehensive loss for any of the periods presented in the accompanying condensed consolidated statements of operations.

NOTE 6 RECENT PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets . Under SFAS No. 141, all business combinations initiated after June 30, 2001 must be accounted for using the purchase method. SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the statement includes provisions upon adoption for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles and the testing for impairment of existing goodwill and other intangibles. The Company has adopted the provisions of SFAS No. 142 and SFAS No. 141 effective January 1, 2002. The implementation of SFAS No. 142 and SFAS No. 141 did not have a material effect on the Company s financial position and results of operations.

In October 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets , which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS No. 121 and the accounting and reporting provisions of Accounting Principles Board ("APB"), Opinion No. 30 Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions , for the disposal of a segment of a business.

The Company adopted the provisions of SFAS No. 144 effective January 1, 2002. The implementation of SFAS No. 144 did not have a material effect on the Company s financial position and results of operations.

In November 2001, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 01-09, Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor s Products, (EITF No. 01-09). EITF No. 01-09 requires recording certain consideration paid to distributors of the Company s products as a reduction of revenue. The Company adopted the provisions of EITF No. 01-09 effective January 1, 2002. The implementation of EITF No. 01-09 did not have a material effect on the Company s financial position and results of operations.

In April of 2002, FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections, which is effective for fiscal years beginning after May 15, 2002. Under SFAS No.145, gains and losses from the extinguishment of debt should be classified as extraordinary items only if they meet the criteria of APB Opinion No. 30. SFAS No. 145 also addresses financial accounting and reporting for capital leases that are modified in such a way as to give rise to a new agreement classified as an operating lease. The Company believes that the adoption of SFAS No. 145 will not have a material impact on the consolidated financial position or results of the operations of the Company.

In June 2002, the FASB issued SFAS No. 146, Accounting for Exit or Disposal Activities . SFAS No. 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for under EITF No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit and Activity (including Certain Costs Incurred in a Restructuring). The scope of the SFAS No.146 also includes cots related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS No.146 will be effective for exit or disposal activities that are initiated after December 31, 2002, but early application is encouraged. The provisions of EITF No. 94-3 shall continue to apply for an exit activity initiated under an exit plan that met the criteria of EITF No. 94-3 prior to the adoption of SFAS No.146. Adopting the provisions of SFAS No. 146 will change, on a prospective basis, the timing of when restructuring charges are recorded from a commitment date approach to when the liability is incurred.

NOTE 7 - RESTRUCTURING ACCRUAL

During 2001, the Company announced several restructuring plans to reduce costs and to improve productivity. These related to facilities costs, workforce reductions and asset write-downs.

During 2001, the Bay Road, Redwood City, and Camarillo facilities were closed and the Company took a charge of approximately $1.8 million. Approximately $780,000 of rental payments was made during the year resulting in an accrual at December 31, 2001 of approximately $1 million. During 2001, the Company terminated 101 employees and incurred a charge of $738,000 for termination benefits which were almost fully utilized at December 31, 2001. In addition under the restructuring plan the Company took a charge of approximately $1.7 million net of salvage value in the year ended December 31, 2001 for the write-down of assets included in property and equipment. These assets primarily included office furniture and equipment.

In February and March 2002, the Company announced further restructuring plans to further reduce costs and to improve productivity which including the closure of its Ft. Lauderdale, Florida, facility, the termination of 71 employees, and additional asset write-downs.

In the second quarter of 2002, the Company announced restructuring plans to further reduce costs, which included the termination of 27 employees, the write-down of fixed assets, and terminating facility leases.

In the second quarter of 2002, $50,000 was reallocated from other unused facility exits costs to restructuring charges relating to the exit costs of the Oddstad Road, California facility. After subtracting rental payments and settlement fees made of $1.1 million, the balance at June 30, 2002, is $90,000, of which approximately $50,000 relates to the Oddstad Road facility and the remainder relates to the facilities closed as part of the restructurings in the prior year.

The Company recorded $689,000 of costs relating to employee termination benefits, of which $844,000 was utilized in the period. The remaining liability of $228,000 is expected to be fully utilized, by the fourth quarter of 2002. Under the restructuring plan, the Company took a charge of $286,000 in the second quarter, for the write-down of assets included in property and equipment. This was fully utilized in the period.

The restructuring charges were determined based on formal plans approved by the Company s management using the best information available to it at the time. The amounts the Company may ultimately incur may change as the restructuring initiatives are executed.

The activity impacting the accrual for restructuring charges through the second quarter ended June 30, 2002 are summarized in the table below (in thousands):

	Facilities	Workforce reductions	Asset write-downs	Total
Balance at December 31, 2001	$ 1,006	$ 20	$	$ 1,026
Restructuring charges to operations in three months ended March 31, 2002	391	634	562	1,587
Cash payments made during the three months ended June 30, 2002	(241)	(271)		(512)
Non cash write-offs during the three months ended June 30, 2002			(562)	(562)
Balance at March 31, 2002	1,156	383		1,539
Restructuring charges to operations in three months ended June 30, 2002		689	286	975
Cash payment made during the three months ended June 30, 2002	(1,066)	(844)		(1,910)
Non cash write-offs during the three months ended June 30, 2002			(286)	(286)
Balance at June 30, 2002	$ 90	$ 228	$	$ 318

NOTE 8 SUBSEQUENT EVENTS

On July 30, 2002, ImproveNet, Inc. and eTechLogix, Inc. entered into an Agreement and Plan of Merger to merge the two companies. Pursuant to the terms of the Agreement and Plan of Merger, the merger is scheduled to close no later than November 30, 2002. Under the terms of the merger, ImproveNet agreed to present a cash tender offer to its current stockholders, which is anticipated to occur immediately following the closing of the merger. The price per share will be based in part on ImproveNet s available cash balance at the closing of the merger.

As part of our restructuring efforts Ron Cooper has stepped down as President and Chief Executive Officer. Mr. Cooper will provide management support, as well as remain ImproveNet s Chairman of the Board until the merger is completed. Upon completion of the merger, Mr. Cooper will serve as a board member of the merged company.

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

The following discussion and analysis of our financial condition and results of operation should be read with Selected Condensed Consolidated Financial Data and our condensed consolidated financial statements and notes included elsewhere in this Report on Form 10-Q. The discussion in this Report on Form 10-Q contains 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, including statements using terminology such as can, may, believe, designated to, will, expect, plan, anticipate, estimate, potential, or continue, or the negative thereof or other con terminology regarding beliefs, plans, expectations or intentions regarding the future. Forward-looking statements involve risks and uncertainties and actual results could differ materially from those discussed in the forward-looking statements. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to the Company as of the date thereof, and the Company assumes no obligation to update any forward-looking statement or risk factors, unless we are required to do so by law. The cautionary statements made in this Report on Form 10-Q should be read as applying to all related forward-looking statements wherever they appear in this Report on Form 10-Q. Our actual results could differ materially from those discussed here. Factors that could cause or contribute to these differences include those discussed in Business Risks below as well as those discussed elsewhere.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

ImproveNet, Inc. s discussion and analysis of its financial condition and results of operations are based upon ImproveNet, Inc. consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires ImproveNet to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, ImproveNet evaluates its estimates, including those related to customer programs, bad debts, intangible assets, income taxes, restructuring, and contingencies and litigation. ImproveNet bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

ImproveNet believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements. ImproveNet records estimated reductions to revenue for customer allowances and incentive offerings including special pricing agreements, and promotions. ImproveNet recognizes revenue, profit and potential losses on fixed price contracts using the completed contract method. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Costs in excess of amounts billed on uncompleted contracts are classified as deferred costs. Billings in excess of costs on uncompleted contracts are classified as deferred revenue. ImproveNet maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of ImproveNet s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. ImproveNet records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. While ImproveNet has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event ImproveNet were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should ImproveNet determine that it would not be able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

OVERVIEW

Our business started in January 1996 as a regional contractor matching service. We spent most of 1996 and 1997 building our service provider database, developing our services and technology, recruiting personnel and raising capital. We launched our Web site and homeowner/service provider matching service on a national scale in August 1997. In December 1998, we began selling Web site advertising and direct marketing services to suppliers of home improvement products as a way to send targeted messages about their products, including product promotions, to homeowners at the time of purchase, as well as to our network of service providers. In March 1999, we began to hire our senior management team, including our chief executive officer. In April 1999, we introduced Powered by ImproveNet, a service that allows third parties to offer the ImproveNet matching services and content on their Web sites. We completed the acquisition of two regional contractor referral companies, Contractor Referral Service, LLC and The J.L. Price Corporation, in September and November 1999, respectively. These entities were integrated into our operations during the course of calendar year 2000. In March 2000, we completed our IPO. From January through June 2000 we spent substantial amounts primarily on marketing and marketing related activities, as well as the development and expansion of our service and operations infrastructure. In July 2000, we had a reduction in force, reducing our staff by approximately 7%. In March 2001, we restructured our operations again resulting in a staff reduction of 25% and we closed our largest facility at Bay Road, in Redwood City, California. In September 2001, we further reduced our staff by 29% and closed our Camarillo, California facility. At December 31, 2001, we employed 111 full-time employees and had our Ft. Lauderdale, Florida and Oddstad Road, California facilities operating. In the first quarter 2002, we reduced staff by an additional 69% and closed our Ft Lauderdale, Florida facility. In the second quarter 2002, we reduced staff by an additional 82%. We currently have 6 full-time employees.

We currently generate the majority of our revenues from service provider referral services, installed sales services, marketing packages and advertisements placed on our Web site. We generate service revenues primarily in the form of lead fees and win fees from our service providers and, to a much lesser extent, other fees for the enrollment of service providers. We also generate installed sales revenue from the fees that we charge home improvement suppliers (primarily Home Depot) to provide labor services when they sell products on an installed basis. In the second quarter we completed our contract with Home Depot and do not expect installed sales revenue in the future. We generate marketing revenues from the sale of banner, button and other advertising on our Web sites, from the sale of SmartLeads generated from the traffic of homeowners visiting our Web sites and from the sale of Find-A-Contractor or Powered by ImproveNet products. Our marketing revenues are generally derived from suppliers of home improvement products.

On June 25, 2002, the Company announced it would begin the process of liquidating certain assets while it continues to review strategic alternatives. On July 30, 2002, subsequent to the end of the quarter, the Company entered into an Agreement and Plan of Merger with eTechLogix. The Company continues to operate its websites, provide referral services and remain active until further notice. The Company is operating with a minimal level of staffing. As a result the Company believes that there is little benefit to be delivered from the remaining long-term multi-year commercial contracts and accordingly the remaining unamortized stock based compensation arising from the warrants associated with these contracts have been expensed in the three months ended June 30, 2002.

As part of our restructuring efforts, Ron Cooper has stepped down as President and Chief Executive Officer. Mr. Cooper will provide management support, as well as remain ImproveNet s Chairman of the Board until the merger is completed. Upon completion of the merger Mr. Cooper, will serve as a board member of the merged company.

RESULTS OF OPERATIONS

REVENUES

Our revenues decreased to approximately $1.1 million for the three months ended June 30, 2002, from approximately $2.2 million for the three months ended June 30, 2001, a decrease of approximately $1.1 million or 50%. For the six months ended June 30, 2002, revenues decreased to approximately $2.3 million as compared to approximately $3.8 million for the six months ended June 30, 2001, a decrease of approximately $1.5 million or 39%

The following table and discussion highlights our revenues for the three and six months ended June 30, 2002 and 2001 (in thousands):

	Three Months Ended, June 30,			Six Months Ended, June 30,		
	2002	2001	% Change	2002	2001	% Change
Revenues:						
Service revenues	$ 1,094	$ 1,827	-40%	2,154	2,965	-27%
Marketing revenues	40	372	-89%	140	845	-83%
Total revenues	$ 1,134	$ 2,199	-48%	$ 2,294	$ 3,810	-40%

Service Revenues

Service revenues decreased to approximately $1,094,000 for the three months ended June 30, 2002, from approximately $1,827,000 for the three months ended June 30, 2001, a decrease of approximately $733,000 or 40%. For the six months ended June 30, 2002, revenues decreased to approximately $2,154,000 as compared to approximately $2,965,000 for the six months ended June 30, 2001, a decrease of approximately $811,000 or 27%. The decrease in service revenues was primarily due to a decrease in match rate and win rate as a result of the restructuring of operations during the quarter.

As of April 7, 2002, additional pricing changes were announced wherein service providers pay an individual lead fee based on the budgeted dollar value of the job. This lead fee ranges from $25 to $100. Additionally our service providers pay a fee of between 1% and 7% (based on actual contract value) for all jobs they win. The lead fee is waived for all jobs with an actual contract value less than $5,000.

Lead fee revenues are recognized at the time the service providers and the homeowner are first matched, while win fee revenues are recognized at the time the service provider or the homeowner notifies us that a job has been sold. For both lead fees and win fees, the recognition of revenues coincides with the service providers   obligation to pay us. The following table details the components of service revenues, based on a percentage of service revenues:

	Three Months Ended, June 30,		**Six Months Ended, June 30,**	
	2002	**2001**	**2002**	**2001**
Lead fees	40%	19%	47%	27%
Win fees	32%	77%	26%	67%
Other fees	28%	4%	27%	6%
Total service revenue	100%	100%	100%	100%

The revenues we generate from lead and win fees are largely a function of:

The number of job submissions;

The effectiveness in finding a service provider or match for each job submission;

The success of the service provider to win a job; and

The amount we charge the service provider for a lead or a win.

The following table provides information on some of our key business metrics (in thousands):

Key Metrics	**Three Months Ended, June 30,**		**Six Months Ended, June 30,**	
	2002	**2001**	**2002**	**2001**
Job submissions	28.2	31.3	53.6	69.9
Matched jobs	13.7	20.5	21.1	45.7
Won jobs	1.5	3.2	2.5	6

Matched jobs as a % of job submissions	48.6%	65.4%	39.4%	65.3%
Won jobs as a % of job submissions	5.3%	10.3%	4.7%	8.6%

The decrease in Match Rate and Win Rate for the three months ended June 30, 2002, was due to reductions in staff and the transition of closing our Florida facility, which is where we processed all of our jobs. The decrease in Match Rate and Win Rate for the six months ended June 30, 2002, was due to the economic down turn during the two quarters of 2002 and a change in the pricing schedule of lead fees and win fees in the fourth quarter of 2001. Match Rate and Win Rate increased from the first quarter of 2002 to the second quarter 2002 due to another pricing change.

Revenues from new service provider enrollment fees are recognized as revenue ratably over the expected period they participate in our contractor matching service, which is initially estimated to be one year. Revenues from premium service fees to homeowners are recognized at the time the service is provided.

Marketing Revenues

Marketing revenues decreased to approximately $40,000 for the three months ended June 30, 2002, from approximately $372,000 for the three months ended June 30, 2001, a decrease of approximately $332,000 or 89%. For the six months ended June 30, 2002, revenues decreased to approximately $140,000 as compared to approximately $845,000 for the six months ended June 30, 2001, a decrease of approximately $705,000 or 83%. The decline in marketing revenues reflects the overall softening of the market for online advertising and marketing services due to current economic conditions. ImproveNet also completed certain commercial contracts in the fourth quarter 2001 that were not renewed this year.

We generate marketing revenues from the sale of banner, button and other advertising on our Web sites, and from the sale to suppliers of SmartLeads generated from the traffic of homeowners visiting our Web sites and from the sale of Find-A-Contractor or Powered by ImproveNet products. Our marketing revenues generally come from various suppliers of home improvement products.

Revenues from banner, button and other advertising are largely a function of:

The number of Web pages that we serve;

The percentage of those pages on which we are able to sell advertisements; and

The amount we charge per advertisement.

Advertisers pay us to display their banner, button and other advertisements on the Web pages we serve when a user is visiting our Web sites. Our marketing revenues historically have been derived from short-term advertising contracts based on either a guaranteed minimum number of impressions or a fixed fee per thousand impressions.

Multi-year Commercial Contracts

Commencing September 1999, we entered into multi-year commercial contracts, some of which are with related parties. These commercial contracts generally provide for a fixed annual fee, an advertising or branding package that includes a mix of buttons, banners, SmartLeads and other marketing or branding services, including Find-A-Contractor or Powered by ImproveNet, plus a continuous presence, on our Web sites. These commercial contracts are for periods ranging between 2 and 12 years, including renewal options. These commercial contracts also include cooperative marketing arrangements under which we are obligated to fund cooperative branding expenditures on television and in the print media, with or on behalf of the commercial party. Most commercial contracts provide for us to spend 50% to 100% of the fees that we expect to receive. In return, we expect to receive significant marketing and branding benefits including better advertising rates, stronger brand recognition, and access to customer databases, direct mail inserts and marketing resources - all of which are designed to generate more traffic to sites and jobs to proprietary matching services.

We do not have an established historical practice of selling advertising for cash for similar multi-year commercial contracts, we have not assigned any value to the exchange of services or barter element of these transactions and accordingly, we have not recorded either revenue or sales and branding expense for the barter element. However, some of these multi-year commercial contracts do generate an overall net cash component, and in these cases we have recorded revenue based on the cash received or receivable under the contract, net of the obligation, if any, to reimburse the commercial party for the cooperative branding and other marketing services. These revenues are recognized over the term of the commercial contract once advertising and other services have been delivered to the commercial party and collection of the resulting net receivable is deemed probable. There was no revenue generated by multi-year commercial contracts, net of warrant charges, for the three months and six months ended June 30, 2002, compared with revenue of approximately $324,000 for the three months and approximately $749,000 for the six months ended June 30, 2001.

Furthermore, in connection with certain of these multi year commercial contracts, the Company also issued warrants to purchase shares of the Company s common stock to the commercial parties. These warrants have been valued by the Company using the Black Scholes option-pricing model. As the fair value of these warrants represent an additional rebate on the revenue otherwise recorded under the contracts, the amortization of the warrants netted against the revenue over the term of the respective commercial contract. To the extent that there has been insufficient revenues, the remaining amortization of warrant stock based compensation is expensed and characterized as sales and marketing expense. On June 25, 2002, the Company announced it would begin the process of liquidating certain assets while it continues to review strategic alternatives. Subsequent to the end of the quarter, the company announced a new agreement to merge with eTechLogix. The Company continues to operate its websites, provide referral services and remain active until further notice. The Company is operating with a minimal level of staffing. As a result, the Company believes that there is little benefit to be derived from the remaining long-term multi-year commercial contracts and accordingly the remaining unamortized stock based compensation arising from the warrants associated with these contracts has been expensed in the three months ended June 30, 2002.

Total revenues may be analyzed as follows (in thousands):

	Three Months Ended, June 30,		Six Months Ended, June 30,	
	2002	**2001**	**2002**	**2001**
Service revenues	$ 1,094	$ 1,827	$ 2,154	$ 2,965
Marketing revenues	40	846	140	1,722
Less: Amounts invoiced and accrued under multi-year commercial contracts with related parties		(390)		(708)
Less: Amortization of warrant stock-based compensation		(84)		(169)
Total marketing revenues	40	372	140	845
Total revenues	$ 1,134	$ 2,199	$ 2,294	$ 3,810

OPERATING EXPENSES

Cost of Revenues

Our cost of revenues decreased to approximately $712,000 for the three months ended June 30, 2002, from approximately $1,201,000 for the three months ended June 30, 2001, a decrease of approximately $489,000 or 41%. For the six months ended June 30, 2002, cost of revenues decreased to approximately $1,505,000 as compared to approximately $2,614,000 for the six months ended June 30, 2001, a decrease of approximately $1,109,000 or 42%.

Cost of revenues consists of materials and related subcontractor labor costs for premiere kitchen and bath remodels, employee payroll and related costs and occupancy, telecommunications and other administrative costs for our project service group, which is responsible for all phases of our proprietary matching services and includes our project advisors. In addition, cost of revenues includes an allocation of direct Web site operations costs, consisting of payroll and related costs, data transmission costs and equipment depreciation.

Cost of Service Revenues

Our cost of service revenues decreased to approximately $711,000 for the three months ended June 30, 2002, from approximately $1,111,000 for the three months ended June 30, 2001, a decrease of approximately $400,000 or 36%. For the six months ended June 30, 2002, cost of service revenues decreased to approximately $1,445,000 as compared to approximately $2,388,000 for the six months ended June 30, 2001, a decrease of approximately $943,000 or 39%.

The decrease in the cost of service revenues was primarily a result of restructurings during the six months of 2002, which reduced payroll and related costs and facilities and related costs.

Cost of Marketing Revenues

Our cost of marketing revenues decreased to approximately $1,000 for the three months ended June 30, 2002, from approximately $90,000 for the three months ended June 30, 2001, a decrease of approximately $89,000 or 99%. For the six months ended June 30, 2002, cost of marketing revenues decreased to approximately $60,000 as compared to approximately $226,000 for the six months ended June 30, 2001, a decrease of approximately $166,000 or 73%.

Cost of marketing revenue includes an allocation of direct Web site operations costs, consisting of payroll and related costs, data transmission costs and equipment depreciation. The decrease in the cost of marketing revenue was a result of the restructurings during the first quarter and second quarter of 2002.

Sales and Marketing

Our sales and marketing expense decreased to approximately $773,000 for the three months ended June 30, 2002, from approximately $4.5 million for the three months ended June 30, 2001, a decrease of approximately $3.7 million or 83%. For the six months ended June 30, 2002, sales and marketing expense decreased to approximately $1.9 million as compared to approximately $10.9 million for the six months ended June 30, 2001, a decrease of $9.0 million or 83%.

Our sales and marketing expense includes all of our online and offline direct marketing and advertising, public relations and trade show expenses. Sales and marketing expenses also include payroll and related costs, support staff expenses, travel costs and other general expenses of our marketing, professional services and partnership services departments.

The decrease in sales and marketing expenses was primarily attributable to:

Renegotiating or transitioning new and existing agreements from a high fixed cost formula to a variable performance based formula based on jobs won;

Reduced online and offline brand advertising spending; and

Reduced staffing related expenses as a result of our restructurings during the first and second quarters.

We plan to leverage our existing infrastructure and to continue the process of negotiating or transitioning agreements from a high fixed cost formula to a variable performance-based formula.

Product Development

Our product development expenses decreased to approximately $438,000 for the three months ended June 30, 2002, from approximately $939,000 for the three months ended June 30, 2001, a decrease of approximately $501,000 or 53%. For the six months ended June 30, 2002, product development expense decreased to approximately $1.1 million as compared to approximately $2.0 million for the six months ended June 30, 2001, a decrease of approximately $919,000 or 46%.

Our product development costs include the payroll and related costs of our technology staff, fees for contract content providers, other costs of Web site design and new technologies required to enhance the performance of our Web sites. The decrease in product development expenses was primarily attributable to decreased payroll and related costs and decreased usage of contract content providers. We expect product development costs to continue to be minimal until the close of the merger.

General and Administrative

Our general and administrative expenses decreased to approximately $567,000 for the three months ended June 30, 2002, from approximately $1,060,000 for the three months ended June 30 2001, a decrease of approximately $493,000 or 47%. For the six months ended June 30, 2002, general and administrative expense decreased to approximately $1.2 million as compared to approximately $2.6 million for the six months ended June 30, 2001, a decrease of approximately $1.4 million or 54%.

Our general and administrative expenses include payroll and related costs, travel, recruiting, professional and advisory services and other general expenses for our executive, finance, legal, and human resource departments. The decrease in our general and administrative expenses was a result of the restructurings during the first and second quarter of 2002.

Stock-based Compensation and Warrant Amortization

Our stock-based compensation expenses increased to approximately $3,942,000 for the three months ended June 30, 2002, from approximately $1,199,000 for the three months ended June 30, 2001, an increase of approximately $2,743,000 or 229%. For the six months ended June 30, 2002, stock-based compensation increased to approximately $4,710,000 as compared to approximately $2,608,000 for the six months ended June 30, 2001, an increase of approximately $2,102,000 or 81%. The increase of stock-based compensation was primarily due to the acceleration of approximately $3,334,000 of warrant amortization that we charged in the second quarter of 2002.

The Company believes that there is little benefit to be delivered from the remaining long-term multi-year commercial contracts and accordingly the remaining unamortized stock-based compensation arising from the warrants associated with these contracts have been expensed in the three months ended June 30, 2002. Due to this acceleration, there will be no additional stock-based compensation expense arising from these warrants in the future. In addition, no employee stock based compensation expense remains to be recognized relating to pre-IPO employee stock options.

Corporate Restructuring

During the first quarter ended March 31, 2002, the Company announced restructuring plans which resulted in a total charge of approximately $1.6 million of which approximately $634,000 related to reduction in workforce costs, approximately $391,000 related to facility exit costs, and approximately $562,000 related to asset write-downs. During the first quarter of 2002, a total of approximately $1,074,000 of costs was charged against the restructuring accrual of which approximately $271,000 related to reduction in workforce costs, approximately $241,000 related to facility exit costs, and approximately $562,000 related to asset write-downs.

During the second quarter ended June 30, 2002, the Company announced additional restructuring plans, which resulted in a total charge of approximately $975,000, of which approximately $689,000 related to reduction in workforce costs, and approximately $286,000 related to asset write-downs. During the second quarter of 2002, a total of approximately $2,196,000 of costs was charged against the restructuring accrual of which approximately $844,000 related to reduction in workforce costs, approximately $1,066,000 related to facility exit costs, and approximately $286,000 related to asset write-downs.

Interest/Other Income

Our Interest/Other Income decreased to approximately $31,000 for the three months ended June 30, 2002 from approximately $231,000 for the three months ended June 30, 2001, a decrease of approximately $200,000 or 87%. For the six months ended June 30, 2002, interest income decreased to approximately $68,000 as compared to approximately $647,000 for the six months ended June 30, 2001, a decrease of approximately $579,000 or 89%.

The decrease in interest income is attributable to a decrease in our average invested cash balances. We expect the decline in our interest income to continue during the remainder of 2002 due to the expected decline in our cash and cash equivalents balances during the year.

Income Taxes

We have recorded a 100% valuation allowance against our net deferred tax assets, which arose primarily as a result of our aggregate operating losses. The valuation allowance will remain at this level until such time as we believe that the realization of the net deferred tax assets is more likely than not. Accordingly, our results of operations do not reflect any tax benefits for our reported losses.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents totaled approximately $3.1 million at June 30, 2002, a decrease of approximately $6.5 million or 67% from approximately $9.6 million at December 31, 2001. The decrease primarily came from the $6.5 million cash used in operating activities and restructuring costs.

Since our inception, we have primarily financed our operations through private sales of our convertible preferred stock and common stock. In March 2000, we closed our initial public offering that generated net cash proceeds of approximately $39.7 million. Our primary capital uses have been funding our operating losses, the prepayment of our large media purchases and capital expenditures.

Net cash used in operating activities for the six months ended June 30, 2002, decreased approximately $7.9 million or 55% from approximately $14.4 million for the six months ended June 30, 2001. Net cash used in operating activities results primarily from our net loss before non-cash charges for amortization of stock-based compensation, warrant amortization, restructuring charges net of cash expenditures and depreciation, offset by changes in operating assets and liabilities and allowances for doubtful accounts.

Net cash used in investing activities was nil in the six months ended June 30, 2002, a decrease of approximately $248,000 or 100% from net cash used of approximately $248,000 for the six months ended June 30, 2001.

Net cash used in financing activities was approximately $10,000 in the six months ended June 30, 2002, a decrease of approximately $30,000 or 150% from the net cash provided by financing activities of approximately $20,000 at June 20, 2001. In 2002, the net cash used in financing activities was related to debt repayment. In 2001, the net cash provided by financing activities was from the exercise of stock options.

Our capital requirements depend on numerous factors, including the success of our strategies for generating revenues and the amount of resources we devote to operating activities. Our expenditures have substantially decreased as a result of our restructuring. Based on the realignment of our resources, we expect a decrease in most of our operating expense categories detailed above for the year 2002 as compared to year 2001. We do expect to experience ongoing operating losses for the foreseeable future. Pursuant to the agreement with Microsoft that we entered into during December 1999 and renegotiated in April 2002, an annual fee of $400,000 is due and payable to Microsoft in 2002 for services through April 2003. Pursuant to the two-year agreement with AT&T that we entered into in December 2000, the minimum payment of $1.4 million is due at the end of the contract, December 2002. The Company is in the process of disputing the commitment based on a provision within the agreement that allowed for revision of commitment levels based on actual experience. No resolution has been reached as of the filing of this document. As at June 30, 2002, operating lease commitments of approximately $225,000 are payable over the next four years.

Our limited operating history and operating losses have limited our ability to obtain vendor credit or extended payment terms and bank financing on favorable terms; accordingly, we depend on our cash and cash equivalent balances to fund our operations.

We currently believe that our available cash resources will be sufficient to meet our anticipated needs for operations and capital expenditures until the merger is complete. We will strive to make ongoing realignments, as required, to achieve positive cash flow with our existing cash resources. We are additionally decreasing our marketing expenditures to assist us in maintaining our available cash resources. We will continue to evaluate our needs for funds based on our assessment of access to public or private capital markets and the timing of our need for funds. Although we have no present intention to conduct additional public equity offerings, we may seek to raise these additional funds through private or public debt or equity financings. If we raise additional funds by selling equity securities, the percentage of ownership of our stockholders will be reduced. We cannot be sure that additional financing will be available on terms favorable to us, or at all. Failure to generate sufficient revenues, raise additional capital or reduce discretionary spending could have a material adverse effect on the Company's ability to continue as a going concern and to achieve its intended business objectives.

RECENT PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets . Under SFAS No. 141, all business combinations initiated after June 30, 2001 must be accounted for using the purchase method. SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the statement includes provisions upon adoption for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles and the testing for impairment of existing goodwill and other intangibles. The Company has adopted the provisions of SFAS No. 142 effective January 1, 2002. The implementation of SFAS No. 141 and SFAS No. 142 did not have a material effect on the Company s financial position and results of operations.

In October 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets , which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS No. 121 and the accounting and reporting provisions of Accounting Principles Board, Opinion No. 30 Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions , for the disposal of a segment of a business. The Company adopted the provisions of SFAS No. 144 effective January 1, 2002. The implementation of SFAS No. 144 did not have a material effect on the Company s financial position and results of operations.

In November 2001, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 01-09, Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor s Products, (EITF No. 01-09). EITF No. 01-09 requires recording certain consideration paid to distributors of the Company s products as a reduction of revenue. The Company adopted the provisions of EITF No. 01-09 effective January 1, 2002. The implementation of EITF No. 01-09 did not have a material effect on the Company s financial position and results of operations.

In April of 2002, FASB issued SFAS No. 145 (SFAS 145), *Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections,* which is effective for fiscal years beginning after May 15, 2002. Under SFAS No.145, gains and losses from the extinguishment of debt should be classified as extraordinary items only if they meet the criteria of APB Opinion No. 30. SFAS No. 145 also addresses financial accounting and reporting for capital leases that are modified in such a way as to give rise to a new agreement classified as an operating lease. The Company believes that the adoption of SFAS No. 145 will not have a material impact on the consolidated financial position or results of the operations of the Company.

In June 2002, the FASB issued SFAS No. 146, Accounting for Exit or Disposal Activities . SFAS No. 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for under EITF No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit and Activity (including Certain Costs Incurred in a Restructuring). The scope of the SFAS No.146 also includes cots related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS No.146 will be effective for exit or disposal activities that are initiated after December 31, 2002, but early application is encouraged. The provisions of EITF No. 94-3 shall continue to apply for an exit activity initiated under an exit plan that met the criteria of EITF No. 94-3 prior to the adoption of SFAS No.146. Adopting the provisions of SFAS No. 146 will change, on a prospective basis, the timing of when restructuring charges are recorded from a commitment date approach to when the liability is incurred.

RISK FACTORS THAY MAY AFFECT OUR RESULTS OF OPERATIONS AND FINANCIAL CONDITION

This document contains certain forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as anticipates , believes , continue , could , estimates , expects , intends , plans , potential , predicts , should or will or the negative of these terms or other comparable terminology intended to identify certain of these forward-looking statements. The cautionary statements made in this document should be read as being applicable to all related forward-looking statements wherever they appear in this document. The Company s actual results could differ materially from those discussed in this document. Factors that could cause or contribute to such differences include those discussed below, as well as those discussed in the Company s Annual Report on Form 10-K.

We have large accumulated losses, we expect future losses, and we may not achieve or maintain profitability.

We have incurred substantial losses and used substantial cash to support our operations as we have expanded our sales and marketing programs, funded the development of our services, promoted our Web sites and matching service and expanded our operations infrastructure. As of June 30, 2002, our accumulated loss was approximately $141 million. We expect our expenditures on sales and marketing activities, support field services and the development of new products, services and technologies to continue at a reduced rate, as we restructured our business in June 2002. This restructuring included operational efficiencies caused by headcount reductions of approximately 82% during the second quarter. We will continue to lose money unless we significantly increase our revenues. We cannot predict when, if ever, we will operate profitably.

We are an early stage company and we have recently restructured our business to offer new services. As a result, we have a limited history, which makes it difficult to evaluate our business.

We were incorporated in January 1996; however, we did not begin offering home improvement services on the Internet until August 1997. In December 1998, we began selling Web site advertising. Until March 1999, we focused primarily on building our network of service providers and refining our matching services processes. In March 1999, we hired our Chief Executive Officer and commenced recruiting our senior management team. In April 1999, we introduced Powered by ImproveNet, a service that allows third parties to offer the ImproveNet matching services and content on their Web sites, for national suppliers of home improvement and repair products. In November 1999, we launched our customized Web site for service providers. We completed the acquisition of two regional contractor referral companies, Contractor Referral Service, LLC and The J.L. Price Corporation, in September and November 1999. We experienced reductions in force in July 2000. In the second half of 2000 we significantly reduced our marketing expenditures. In the first and third quarters of 2001, first quarter of 2002, and most recently as of June 2002, we implemented cost restructuring initiatives that included a reduction in workforce. Furthermore, even if our business is successful, we may change our business to enter into new business areas such as our Premiere Services offerings, which are in the process of launching into selected geographic regions. These and other new business initiatives are areas in which we do not have extensive experience.

Because we are no longer listed on the Nasdaq National Market, the liquidity of our common stock may be seriously limited.

On June 29, 2001, we received a Nasdaq Qualification Panel Decision indicating that we have failed to comply with the minimum bid price requirement for continued listing, and were delisted from the Nasdaq National Market. Our stock is currently being traded on the Nasdaq Over-The-Counter Bulletin Board; however, we believe that our liquidity will be significantly lower than when it was on the Nasdaq National Market.

Failure to raise additional capital or generate the significant capital necessary to expand our operations and invest in new products and services could reduce our ability to compete and result in lower revenues.

We expect that currently available funds will be sufficient to meet our working capital and capital expenditure needs until the merger is completed; however, if we are unable to generate sufficient cash flows from operations to meet our anticipated needs for working capital and capital expenditures, we will need to raise additional funds. We cannot be certain that we will be able to obtain additional financing on favorable terms, or at all. If we need additional capital and cannot raise it on acceptable terms, we may not be able, among other things, to:

Develop or enhance our services;

Develop or acquire new technologies, products or businesses;

Expand operations in the United States or internationally;

Hire, train and retain employees; or

Respond to competitive pressures or unanticipated capital requirements.

Our failure to do any of these things could result in lower revenues and could harm our business or cause us to discontinue operations.

In addition, we may seek to raise additional funds, finance acquisitions or develop commercial relationships by issuing equity or convertible debt securities, which would reduce the percentage ownership of existing stockholders. Furthermore, any new securities could have rights, preferences or privileges senior to those of our common stock.

Our market is competitive and we may suffer price reductions, be unable to attract homeowners to our Web site, be unable to maintain our service provider network or enter into new multi year commercial contracts if we do not compete effectively.

The market for our services is intensely competitive, evolving and subject to rapid technological change. To remain competitive, we must continue to enhance and improve the ease of use, responsiveness, functionality and features of our online and offline services in order to attract homeowners to our Web site and maintain our service provider network. We expect the intensity of competition to increase in the future. Increased competition may result in changes in our pricing model, fewer homeowners visiting our Web site, service providers leaving our network, less marketing revenue, reduced gross margins and loss of market share, any one of which could significantly reduce any future profitability. In addition, technological barriers to entry are relatively low. As a result, current competitors, including local referral businesses and online referral companies including ServiceMagic.com, iMandi, Bid Express, and Contractor.com as well as potential competitors such as The Home Depot, Lowe s and Sears Roebuck & Company who have launched Web sites similar to ours that could gain broader market acceptance based on content, products and services.

Some of our competitors have more resources and broader and deeper customer access than we do. In addition, several of these competitors have or can readily obtain extensive knowledge of the home improvement industry. Our competitors may be able to respond more quickly than we can to new technologies or changes in Internet user preferences and devote greater resources than we can to the development, promotion and sale of their services. We may not be able to maintain our competitive position against current and future competitors, especially those with significantly greater resources and brand recognition.

Homeowners and service providers may be reluctant to accept an Internet based service provider matching service.

Currently most homeowners use traditional means including word of mouth referrals, Yellow Pages and local contractor matching services to obtain service providers for their home improvement projects. In addition, many service providers do not use the Internet for business purposes and may be reluctant to become part of a network of service providers on an Internet based service provider matching service. If homeowners do not use our matching service or service providers do not join our network, we will not be able to generate significant revenues from either services or advertising.

If we do not attract and retain a network of high quality service providers, our business could be harmed.

We expect to derive the majority of our revenues from our network of service providers in the form of payments for each homeowner referral that we provide to them and for each home improvement project that they win. Our business is highly dependent on homeowners use of our Web site to find service providers for their home improvement projects so that service providers will achieve a satisfactory return on their participation in the ImproveNet program.

A key element of the growth of our business is the pace at which service providers adopt the ImproveNet matching process. This adoption includes responding to homeowner inquiries within 72 hours, providing a competitive, firm quote to homeowners quickly, and paying the service fees to ImproveNet. We devote significant effort and resources to screening and supporting participating service providers and to developing programs that monitor service providers job wins and that collect service fees from service providers for these wins. Our inability to screen and support service providers effectively, or the failure of our service providers to respond professionally and in a timely manner to homeowner inquiries, could result in low homeowner satisfaction and harm our business. In addition, the failure of our service providers to win home improvement projects, report their wins to us, or pay us service fees could harm our business.

We must actively recruit new service providers and retain and motivate our current service providers to ensure that we continually have adequate coverage. We believe that service providers in the home improvement industry suffer from a relatively high failure or turnover rate that makes it difficult for us to retain service providers. Accordingly, we expect that not all of our service providers will remain active participants in our network. If we are unable to achieve low turnover among our network of service providers our business could be harmed.

If homeowners fail to report, and service providers fail to report and to pay to us win fees, directly or indirectly, our business would be harmed.

Our service providers are responsible for paying us a win fee for each job that they obtain from us. We ask service providers not to pass on the cost of the win fee to the homeowner. However, we do not currently provide any guarantee to the homeowner that our service providers have not raised their rates to cover the win fee nor do we audit or plan to audit our service providers to confirm that they have not raised their rates. Homeowners may believe that they are indirectly paying us our win fee through the higher rates of service providers and, therefore, choose to select service providers through word of mouth referrals, Yellow Pages, local contractor matching services or other means rather than using our matching service. If homeowners choose not to use our service, we will lose service revenues and visitors to our Web sites and our business will be harmed.

We depend on our service providers to report that they have won a job and pay us our win fee. We rely on our relationships with our service providers and the incentive to receive future leads from us to encourage service providers to report wins and pay win fees. Currently, we do not have a control or an oversight mechanism in place with either service providers or homeowners to ensure that they report wins and pay win fees. If service providers do not report wins or pay us win fees, we will lose service revenues and our business will be harmed.

We depend on third party relationships to attract visitors to our Web sites.

We have entered into commercial contracts with suppliers of home improvement products and services to generate revenues and increase the number of visitors to our Web sites. Under these contracts, suppliers have placed links to our Web site from their Web sites to allow their customers to visit our Web site if the customers are interested in obtaining home improvement information or searching for a service provider. We believe that increasing the number of visitors to our Web sites will increase the number of job submissions. We cannot assure you that these contracts will lead to increased visits to our Web sites or that increased visits to our Web sites will result in increased job submissions. If we do not maintain our existing contracts on terms as favorable as currently in effect or if we are not able to establish new contracts on commercially reasonable terms, our business could be harmed.

Companies that we may pursue for a commercial contract may offer services competitive with suppliers with which we currently have contracts. As a result, these suppliers may be reluctant to enter into commercial contracts with us.

We purchase preferential placement on high traffic Web sites. We believe these Web sites can help us to increase the number of visitors to ImproveNet.com. Web site traffic originated from AltaVista, Lycos, Microsoft HomeAdvisor and Yahoo! There is intense competition for preferential placements on these Web sites. If we lose our relationships with any one of these Web sites, job submissions on ImproveNet.com may decrease and we may not be able to enter into commercially reasonable contracts with replacement high traffic Web sites, if at all.

We depend on third party relationships to provide software tools and infrastructure.

We integrate third party software into our service offerings on our Web sites. We would be harmed if the providers from which we license software ceased to deliver and support reliable products, to enhance their current products, or to respond to emerging industry standards. In addition, third party software may not continue to be available to us on commercially reasonable terms or at all. The loss of, or inability to maintain or obtain, this software could limit the features available on our Web sites, which could harm our business.

If we fail to retain qualified personnel, our ability to continue to operate could be harmed.

We depend on the continued service of our key technical, operational and administrative personnel. In particular, the loss of the services of any of the remaining personnel, individually or as a group, could cause us to incur increased operating expenses and divert other personnel time in searching for their replacements. We do not have employment agreements with any employee, and we do not maintain any key person life insurance policies for any of our employees. The loss of any of our remaining personnel could harm our business.

If we fail to adequately protect our proprietary rights, we could lose these rights and our business could be harmed.

We depend upon our ability to develop and protect our intellectual property rights, including our databases of homeowners and service providers and our internally developed matching criteria and algorithms, to distinguish our services from our competitors services. We rely on a combination of copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. We have no issued patents. Our databases are protected by trade secret laws and our matching service is protected primarily by trade secret and copyright laws. Existing laws afford only limited protection of intellectual property rights. Attempts could be made to copy or reverse engineer aspects of our processes or services or to obtain and use information that we regard as proprietary.

Accordingly, we may not be able to protect our intellectual property rights against unauthorized third party copying or use. Furthermore, policing the unauthorized use of our intellectual property is difficult, and expensive litigation may be necessary in the future to enforce our intellectual property rights. The use by others of our proprietary rights could harm our business.

Our services could infringe the intellectual property rights of others causing costly litigation and the loss of significant rights.

Third parties could claim that we have infringed their intellectual property rights by claiming that our matching service infringes their patents, trade secrets or copyrights. In the ordinary course of business, we have received, and may receive in the future, notices from third parties claiming infringement of their proprietary rights. In addition, providers of goods and services over the Internet are increasingly subject to claims that they infringe patents that cover basic elements of electronic commerce. The resolution of any claims could be time consuming, result in costly litigation, delay or prevent us from offering our services or require us to enter into royalty or licensing agreements, any of which could harm our business. In the event an infringement claim against us is successful and we cannot obtain a license on acceptable terms, license a substitute technology or redesign our services, our business would be harmed. Furthermore, former employers or our current and future employees may assert that our employees have improperly disclosed to us or are using confidential or proprietary information in our business.

If we experience system failures, our reputation would be harmed and users might seek alternative service providers, causing us to lose revenues.

We depend on the efficient and uninterrupted operation of our computer and communications hardware and software systems. Substantially all of our computer hardware for operating our Web sites is currently located at Qwest Communications in Sunnyvale, California, with backups located at our facility in Redwood City, California. These systems and operations are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunication failures and similar events. They are also subject to break ins, sabotage, intentional acts of vandalism and similar misconduct. We do not have fully redundant systems, a formal disaster recovery plan or alternative providers of hosting services, and we do not carry business interruption insurance to compensate us for losses that could occur. Despite any precautions we may take, the occurrence of a natural disaster or other unanticipated problems either at Qwest or at our facility could result in interruptions in our services. Any damage to or failure of our systems could result in interruptions in our service. In addition to placing an increased burden on our engineering staff, any system failure could create user questions and complaints that must be responded to by our customer support personnel. The system failures of various third party Internet service providers, online service providers and other Web site operators could result in interruptions in our service to those users who require the services of these third party providers and operators to access our Web sites. These interruptions could reduce our revenues and profits, and our future revenues and profits will be harmed if our users believe that our system is unreliable. Since we have been keeping logs of our Web sites, our ImproveNet.com Web site has been unintentionally interrupted for periods ranging from two minutes to one hour, the latter prior to February 2000.

We may have capacity restraints that could limit the growth of or reduce our revenues.

The satisfactory performance, reliability and availability of our Web sites, processing systems and network infrastructure are critical to our reputation and our ability to attract and retain large numbers of users. If the volume of traffic, including at peak times, on our Web sites increases, we may need to expand and upgrade our technology, transaction processing systems and network infrastructure. We may not be able to accurately project the rate or timing of these increases, if any, in the use of our services or to expand or upgrade our systems and infrastructure in a timely manner to accommodate these increases.

We use internally developed systems for operating our services and processing our transactions, including billing and collections processing. We must continually improve these systems in order to accommodate the use of our Web sites. If we add new features and functionality to our services, we could be required to develop or license additional technologies. Our inability to add additional software and hardware or upgrade our technology, transaction processing systems or network infrastructure could cause unanticipated system disruptions, slower response times, degradation in levels of customer support, impaired quality of the users experience, delays in accounts receivable collection or losses of recorded financial information. Our failure to provide new features or functionality also could result in these consequences. The required hardware may not be readily available or affordable and we may be unable to effectively upgrade and/or expand our systems in a timely manner or to integrate smoothly any newly developed or purchased technologies with our existing systems. These difficulties could harm or limit our ability to expand our business.

We could be held liable for products and services.

We could be subject to claims relating to products and services that we perform on behalf of homeowners or referrals to selected contractors through our Web site. Homeowners may bring claims against us or our service providers, who may have among other things, provided them with poor workmanship or caused bodily injury or damage to property. Our existing insurance coverage may not cover all potential claims, may not adequately cover all costs incurred in defense of potential claims, may not indemnify us for all liability that may be imposed or may not be renewable in future periods or renewable on terms and conditions satisfactory to us. In addition, claims, with or without merit, would result in diversion of our financial resources and management resources.

We depend on the use of the Internet. If the use of the Internet does not grow, our revenues may not grow and could decline and our business could be harmed.

We depend on increased acceptance and use of the Internet. In particular, our matching service depends upon service providers being willing to use the Internet to find jobs through our service. We believe that service providers generally have not traditionally used computers or the Internet to operate their businesses. Demand and market acceptance for recently introduced products and services over the Internet are subject to a high level of uncertainty. As a result, acceptance and use of the Internet may not develop or a sufficiently broad base of users may not adopt or continue to use the Internet as a medium of commerce.

The Internet is characterized by rapidly changing technologies, frequent new product and service introductions and evolving industry standards.

To succeed, we will need to adapt effectively to rapidly changing technologies and continually improve the performance features and reliability of our services. We could incur substantial costs in modifying our products, services or infrastructure to adapt to these changes, and we may also lose customers and revenues if our services fail to adapt to the rapid changes characteristic of the Internet.

Conversely, if the Internet experiences increased growth in number of users, frequency of use and bandwidth requirements, the Internet infrastructure may be unable to support the demands placed on it. The success of our business will rely on the Internet providing a convenient means of interaction and commerce. Our business depends on the ability of users to access information without significant delays or aggravation.

Future government regulations and legal uncertainties pertaining to the Internet could decrease the demand for our services or increase the cost of doing business.

There is, and will likely continue to be, an increasing number of laws and regulations pertaining to the Internet. These laws and regulations may relate to liability for information retrieved from or transmitted over the Internet, online content, user privacy, taxes or the quality of services. Any new law or regulation pertaining to the Internet, or the adverse application or interpretation of existing laws, could decrease the demand for our services or increase our cost of doing business.

We are not certain how our business may be affected by the application of existing laws governing issues such as property ownership, copyrights, encryption and other intellectual property issues, taxation, libel, obscenity and export or import matters. The vast majority of these laws were adopted prior to the advent of the Internet. As a result, they do not contemplate or address the unique issues created by the Internet and related technologies. Changes in laws intended to address these issues could create uncertainty for or adversely affect companies doing business on the Internet. This could reduce demand for our services or increase the cost of doing business.

General economic conditions may change dramatically from year to year.

General economic conditions, which affect consumer confidence and home improvement and home-building spending, including interest rates, the overall level of economic activity, the availability of consumer credit and mortgage financing and unemployment rates may change dramatically and impact our ability to operate.

We are new to the general contracting field and may experience project and management coordination problems.

We will act as contractor of record for construction of our premium service projects with our personnel supervising the construction process. As contractor of record, we are responsible for managing the construction process, coordinating the activities of all subcontractors, suppliers and building inspectors and following design plans generally prepared by consulting architects and engineers whom we may retain and whose designs target the local market. In addition, we work closely with contractors and subcontractors on site preparation, purchasing, architectural design, site planning, coordinating governmental approvals, contract management and closings. We sometimes require our general contractors or subcontractors to post lien-free completion and performance construction bonds. We believe that our relations with our contractors are good.

Legislative and regulatory initiatives regarding the collection and use of our users personal information may result in liability and expenses.

Current computing and Internet technology allows us to collect personal information about our users. In the past, the Federal Trade Commission has investigated companies that have sold personal information to third parties without permission or in violation of a stated privacy policy. Currently, we collect personal information only with the users consent and under our privacy policy. If we begin collecting or selling personal information without permission or in violation of our privacy policy, we could face potential liability for compiling and providing information to third parties.

The imposition of additional state and local taxes on Internet based transactions would increase our cost of doing business and harm our ability to become profitable.

We file state tax returns as required by law based on principles applicable to traditional businesses. However, one or more states could seek to impose additional income tax obligations or sales and use tax collection obligations on out of state companies such as ours that engage in or facilitate Internet based commerce. A number of proposals have been made at state and local levels that could impose taxes on the sale of products and services through the Internet or the income derived from those sales. These proposals, if adopted, could substantially impair the growth of Internet based commerce and harm our ability to become profitable.

United States of America federal law limits the ability of the states to impose taxes on Internet-based transactions. Until October 21, 2001, state and local taxes on Internet-based commerce that are discriminatory against Internet access are prohibited, unless the taxes were generally imposed and actually enforced before October 1, 1998. It is possible that this tax moratorium will not be renewed by October 21, 2001 or at all. Failure to renew this legislation would allow various states to impose taxes on Internet-based commerce. The imposition of state and local taxes could harm our ability to become profitable.

We depend on the very reduced staff.

We are operating on a very reduced staff. We currently have one person in engineering and operating our website. If the website goes down or any part of our network breaks, it could greatly effect our revenue source. We also only have one person in marketing and operations. If we were to lose that person is could greatly effect our operations and job flow, which could greatly reduce our source of revenue.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

The primary objective of ImproveNet s investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash and cash equivalents in a variety of securities, including both government and corporate obligations and money market funds.

Our exposure to market risk for changes in interest rates relates primarily to increases or decreases in the amount of interest income we earn on our investment portfolio and on increases or decreases in the amount of interest expense we must pay with respect to any outstanding debt instruments. We mitigate default risk by investing in only high credit quality securities that we believe to be low risk and by positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor.

We do not hold derivative financial instruments as of June 30, 2002, and have never held such instruments in the past. In addition, we had no debt instruments outstanding as of June 30, 2002. We currently transact all of our revenues, which are all traded in the United States of America, in U.S. dollars.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may be involved in litigation relating to claims arising out of our operations. As of the date of this filing, we are not engaged in any material legal proceedings.

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

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

The Company held its annual meeting of stockholders on June 6, 2002. At such meeting the following actions were voted upon:

(a) Election of two directors, Charles Brown and Garrett Gruener, to hold office until the 2005 annual meeting of stockholders.

	Votes in Favor	Votes Withheld
Charles Brown	11,018,234	197,115
Garrett Gruener	11,141,234	74,115

(b) Ratification of PricewaterhouseCoopers LLP as the Company s independent auditors for the fiscal year ending December 31, 2002.

Votes in Favor	Votes Against	Abstentions	Broker Non Votes
11,071,372	142,578	1,399	

Based on these voting results, each of the directors nominated was elected and the second matter was approved.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

EXHIBIT NUMBER	DESCRIPTION OF DOCUMENT
10.35	AT&T Master Agreement MA Reference No. DCMT306779.(1)
10.39	Agreement and Plan of Merger dated July 30, 2002 by and among ImproveNet, Inc., eTechLogix, Inc., and eTech Acquisition, Inc.(2)
99.1	Certification Pursuant to Section 906 of the Public Company Accounting Reform and Investor Protection Act of 2002.(3)

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(1) Incorporated by reference to the Registrant s Form 10-Q for the period ended March 31, 2002 filed on April 15, 2002.

(2) Incorporated by reference to the Registrant s Form 8-K filed on August 6, 2002.

(3) Filed herewith.

(b) Reports on Form 8-K

On June 11, 2002, the Registrant filed a Current Report on Form 8-K relating to the execution of a Letter of Intent to enter into an Agreement and Plan of Merger with eTechLogix, Inc.

On June 18, 2002, the Registrant filed a Current Report on Form 8-K relating to the amendment of the Letter of Intent to enter into an Agreement and Plan of Merger with eTechLogix, Inc.

On June 24, 2002, the Registrant filed a Current Report on Form 8-K relating to the cancellation of its intent to merge with eTechLogix, Inc.

On August 6, 2002, the Registrant filed a Current Report on Form 8-K relating to the execution of an Agreement and Plan of Merger with eTechLogix, Inc.

Signatures

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed, August 14, 2002 on its behalf by the undersigned duly authorized.

IMPROVENET, INC.
(Registrant)

By:/s/ Ronald B. Cooper

Ronald B. Cooper
Chairman
(Principal Financial Officer)

By:/s/ Christopher A. Kendall

Christopher A. Kendall
Controller
(Principal Accounting Officer)

Date: August 20, 2002