IENTERTAINMENT NETWORK INC
Form 10QSB
November 14, 2001

U.S. Securities and Exchange Commission
WASHINGTON, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended September 30, 2001

Commission file number 0-29750

IENTERTAINMENT NETWORK, INC.
(Exact name of small business issuer as specified in its charter)

North Carolina	56-2092059
(State of incorporation)	(I.R.S. Employer Identification Number)

124-126 Quade Drive
Cary, North Carolina 27513
(Address of principal executive office)

(919) 678-8301
(Issuer's telephone number)

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

Yes [X] No [_]

As of November 05, 2001, (the most recent practicable date), there were 15,914,311 shares of the issuer's Common Stock, $.10 par value per share, outstanding.

Transitional Small Business Disclosure Format (check one)

Yes [_] No [X]

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IENTERTAINMENT NETWORK, Inc.

Form 10-QSB Quarterly Report

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

iEntertainment Network, Inc.
Consolidated Balance Sheets
(In thousands, except share data)

	September 30 2001	De
	UNAUDITED	
Assets		
Current assets:		
Cash and cash equivalents	$ 69	
Trade receivables, net of allowances of $75 and $80 at September 30, 2001 and December 31, 2000, respectively	178	
Prepaid expenses and other	287	
Total current assets	534	
Property and equipment, net	629	
Software development costs, net	676	
Other noncurrent assets	17	
Total assets	$ 1,856	
Liabilities and stockholders' equity Current liabilities:		
Accounts payable and accrued expenses	$ 1,152	
Current portion of capital lease obligations	30	
Total current liabilities	1,182	

Capital lease obligations, less current portion	26
Total liabilities	1,208
Stockholders' equity:	
Series D Convertible Preferred Stock $.10 par value; liquidation and stated value of $1,000 per share, plus accumulated accretion, 4,911 shares authorized, issued and outstanding	5,467
Common stock, $.10 par value; 50,000,000 shares authorized; 15,914,311 and 15,914,311 shares issued and outstanding	1,591
Additional paid-in capital	38,157
Accumulated deficit	(44,512)
Accumulated other comprehensive loss	(55)
Total stockholders' equity	648
Total liabilities and stockholders' equity	$ 1,856

See accompanying notes.

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iEntertainment Network, Inc.

Consolidated Statements of Operations
(In thousands, except share and per share data)

	Three months ended September 30 2001	September 30 2000	Septem 20
	UNAUDITED		
Net revenues:			
CD-ROM product sales	$ -	$ 60	$
Online sales	240	346	
Advertising and other	117	1,493	
Royalties and licenses	36	4	
Total net revenues	393	1,903	
Cost of revenues:			
Cost of products and services	61	43	
Royalties and amortized software costs	69	44	
Total cost of revenues	130	87	
Gross profit	263	1,816	
Operating expenses:			
Sales and marketing	122	1,494	
Product development	411	363	
General and administrative	310	398	
Goodwill amortization	-	400	
Debt Concessions	-	(265)	
Reversal of accrued liabilities for prize points	-	-	

Total operating expenses	843	2,390	
Operating loss	(580)	(574)	(
Other (income) expense:			
Interest (income)/expense	1	(8)	
Other	(14)	(3)	
Total other income	(13)	(11)	
Loss before income taxes	(567)	(563)	(
Income tax expense	-	1	
Net loss	(567)	(564)	(
Accretion of Series D Convertible Preferred Stock	(74)	(74)	
Net loss available to common stockholders	$ (641)	$ (638)	$ (
Basic and diluted loss per share:			
Net loss per share	$ (0.04)	$ (0.04)	$
Weighted average shares used in computing basic and diluted loss per share	15,914,311	15,747,188	15,91

iEntertainment Network, Inc.

Consolidated Statements of Cash Flows
(In Thousands)

	Nine months end 2001
	UNAU
Operating activities	
Net loss	$ (1,105)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	428
Amortization of capitalized software development costs	149
Noncash compensation expense	-
Issuance of common stock for services	-
Write-off of accrued liability for prize points	(447)
Changes in operating assets and liabilities:	
Trade receivables	636
Prepaid expenses and other assets	(118)
Accounts payable and accrued expenses	420
Royalties and commissions payable	-
Net cash used in operating activities	(37)

Investing activities	
Purchase of property and equipment	(142)
Capitalized software development costs	(167)
Net cash used in investing activities	(309)
Financing activities	
Proceeds from issuance of common and preferred stock	-
Stock registration costs	-
Payments on capital lease obligations	(23)
Net cash (used in) provided by financing activities	(23)
Effect of currency exchange rate changes on cash and cash equivalents	1
Net decrease in cash and cash equivalents	(368)
Cash and cash equivalents at beginning of period	437
Cash and cash equivalents at end of period	$ 69

iEntertainment Network, Inc.

Consolidated Statements of Cash Flows (continued)
(In Thousands)

	Nine months end 2001
	UNAUD
Noncash investing and financing activities	
Issuance of common stock in connection with development agreement	$ -
Issuance of common stock in connection with employee severance	$
Issuance of common stock in settlement of liabilities	$ -
Fixed assets acquired under capital lease	$ -

See accompanying notes.

iEntertainment Network, Inc.

Notes to Consolidated Financial Statements
(INFORMATION AS OF September 30, 2001 AND FOR THE NINE AND THREE MONTHS ENDED September 30, 2001 AND 2000 IS UNAUDITED)

1. Description of Business and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting solely of normal recurring accruals) considered necessary for a fair presentation of the statements have been included. The interim operating results are not necessarily indicative of the results that may be expected for a full fiscal year. The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. For further information, refer to the financial statements and accompanying footnotes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2000.

Description of Business

iEntertainment Network, Inc. (the "Company") is a developer and publisher of Internet games and an operator of online game services. The Company develops and publishes proprietary online multi-player games and has built an Internet distribution infrastructure which offers online gamers a variety of free, subscription and pay-per-play games and services, including simulation, parlor, strategy, role playing and action games.

Disposition of CD-ROM Assets

In connection with the Company's September 1999 disposition of its CD-ROM assets, management decided to terminate certain CD-ROM distribution agreements and began negotiations to mutually release each partner from any obligation under the terms of these agreements. In the second quarter of 1999, the Company estimated a liability of $850,000 for potential settlements upon termination of these agreements. The balance of this liability at September 30, 2001 and December 31, 2000 was $195,000 and is reflected as accounts payable and accrued expenses in the consolidated balance sheets. In the first quarter of 2000, the Company settled with its two largest distributors by paying $250,000 in cash and issuing common stock valued at $300,000.

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, iMagicOnline Corporation, Interactive Magic Ltd. and Interactive Magic GmbH. All significant intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include amounts in demand deposit accounts and investments with an original maturity date of three months or less when purchased.

iEntertainment Network, Inc.

Notes to Consolidated Financial Statements (continued)

1. Description of Business and Significant Accounting Policies (continued)

Software Development Costs

The Company capitalizes costs incurred in the development of its gaming software. Capitalization of such costs is discontinued when a product is available for general release to customers. Capitalized software development costs are capitalized at the lower of cost or net realizable value and amortized using the greater of the revenue curve method or the straight-line method over the estimated economic life of the related product. Amortization begins when a product is ready for general release to customers.

Information related to net capitalized software development costs is as follows (in thousands):

	September 30 2001	December 31 2000
Balance at beginning of year	$ 658	$ 92
Capitalized	167	658
Amortized	(149)	(92)
Balance at end of year	$ 676	$ 658

Revenue Recognition

Revenue from online sales is recognized at the time the game is played and is based either upon actual usage by the customer on an hourly basis or on an unlimited use subscription basis. The Company records advertising revenues in the period the advertising impressions are delivered to customers. The Company records advertising revenues net of related administrative fees as reported by its outside advertising vendor. The Company's advertising contracts do not guarantee a minimum number of impressions to be delivered.

In December 1999, the Securities and Exchange Commission released Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements", which provides guidance on the recognition, presentation, and disclosure of revenue in financial statements. SAB No. 101 provides guidance on a variety of revenue recognition issues, including gross versus net income statement presentation. Based on the criteria of SAB No. 101, the Company presents its advertising revenues net of these administrative fees.

iEntertainment Network, Inc.

Notes to Consolidated Financial Statements (continued)

Description of Business and Significant Accounting Policies (continued)

Revenue Recognition (continued)

Revenue from CD-ROM product sales was recognized at the time of product shipment. Revenue from royalties and licenses is recognized when earned under the terms of the relevant agreements with original equipment manufacturers ("OEMs"), international distributors and other third parties. With respect to license agreements that provide customers the right to multiple copies in exchange for guaranteed amounts, net revenue is recognized upon delivery of the product master or the first copy provided collectibility is probable. Per copy royalties on sales that exceed the guarantee are recognized as earned. The Company accepts product returns and provides price protection on certain unsold merchandise. Revenue is recorded net of an allowance for estimated future returns, markdowns, price protection and warranty costs. Such reserves are based upon management's evaluation of historical experience, current industry trends and estimated costs.

In October 1997, the Accounting Standards Executive Committee "(AcSEC)" issued Statement of Position "(SOP)" 97-2, "Software Revenue Recognition" as amended in March 1998 by SOP 98-4 and October 1998 by SOP 98-9. These SOPs provide guidance on applying generally accepted accounting principles in recognizing revenue on software transactions. The Company adopted SOP 97-2 for software transactions entered into beginning January 1, 1998. Based on the current requirements of the SOPs, application of these statements did not have a material impact on the Company's revenue recognition policies. However, AcSEC is currently reviewing further modifications to the SOP with the objective of providing more definitive, detailed implementation guidelines. This guidance could lead to unanticipated changes in the Company's operations and revenue recognition practices.

Revenue from certain software development contracts with fixed price components is recognized on the percentage of completion basis in accordance with the American Institute of Certified Public Accountants' SOP 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." In accordance with SOP 81-1, the Company recognizes percentage of completion revenue based upon the ratio of accumulated incurred costs to the total estimated costs to complete each contract.

The accounts receivable allowance at September 30, 2001 and December 31, 2000 includes a reserve for doubtful accounts, which management records based on historical experience and current evaluation of potential collectibility issues. The Company does not require collateral for unpaid balances. Credit losses have historically been within management's expectations.

Reclassifications

The Company reclassified Software Development Costs in the balance sheet as of December 31, 2000 from a current asset to a non-current asset to conform with the presentation in the September 30, 2001 balance sheet. The reclassification did not affect stockholders' equity or net loss as previously reported.

iEntertainment Network, Inc.

Notes to Consolidated Financial Statements (continued)

Description of Business and Significant Accounting Policies (continued)

Comprehensive Loss

The following chart details the Company's comprehensive loss for the periods presented (in thousands):

	Three months ended September 30 2001	2000	Nine months ended September 30 2001	2000
Net Loss	$(567)	$(564)	$(1,105)	$(2,026)
Other comprehensive income - foreign currency translation adjustment	(3)	6	1	44
Comprehensive loss	$(570)	$(558)	$(1,104)	$(1,982)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include provisions for doubtful accounts, sales returns and allowances, warranty provisions, and estimates regarding the recoverability of capitalized software development costs. Actual results could differ from those estimates.

Basic Net Loss Per Share

Basic net loss per share has been calculated in accordance with SFAS No. 128, "Earnings Per Share". Basic net loss per share is calculated by dividing net loss available to common stockholders by the weighted average shares of common stock outstanding during the period.

Had the Company been in a net income position, diluted earnings per share would have been presented and would have included potential common shares related to outstanding options and warrants. The diluted earnings per share computation is not included, as all potential common shares are antidilutive.

Impact of Recently Issued Accounting Pronouncements

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities," which was later amended by SFAS 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133" and by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities ? an Amendment of FASB Statement No. 133." SFAS 133 establishes new standards of accounting and reporting for derivative instruments and hedging activities. SFAS 133 requires that all derivatives be recognized at fair value in the statement of financial position, and that the corresponding gains or losses be reported either in the statements of operations or as a component of comprehensive income, depending on the type of hedging relationship that exists. If the derivative is determined to be a hedge, depending on the nature of the hedge, changes in the fair value of

iEntertainment Network, Inc.

Notes to Consolidated Financial Statements (continued)

Description of Business and Significant Accounting Policies (continued)

Impact of Recently Issued Accounting Pronouncements (continued) derivatives are offset against the change in fair value of the hedged assets, liabilities, or firm commitments through the statements of operations or recognized in other comprehensive income until the hedged item is recognized in the statements of operations. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings. We were required to adopt SFAS 133 as of January 1, 2001. The adoption of SFAS 133 did not have a significant impact on our results of operations, financial position, or cash flows.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 as well as all purchase method business combinations completed after June 30, 2001. SFAS No. 141 also specifies criteria that intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill, noting that any purchase price allocable to an assembled workforce may not be accounted for separately. SFAS No. 142 will require that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 will also require that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of".

The Company is required to adopt the provisions of SFAS No. 141 immediately, except with regard to business combinations initiated prior to July 1, 2001, and SFAS No. 142 will become effective January 1, 2002. We are currently assessing the impacts of adoption of SFAS No. 141 and SFAS No. 142 on goodwill and other intangible assets and the respective impact on the results of operations, financial position and cash flows.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." We will adopt SFAS No. 144 in fiscal year 2002. We do not expect the provisions of SFAS No. 144 to have any significant impact on its financial condition or results of operations. We do not expect the adoption of other recently issued accounting pronouncements to have a significant impact on our results of operations, financial position, or cash flows.

iEntertainment Network, Inc.

Notes to Consolidated Financial Statements (continued)

2. Stockholders' Equity

Series D Redeemable Convertible Preferred Stock

The following is a summary of the terms of the Series D Redeemable Convertible Preferred Stock ("Series D Preferred"):

Dividends

There are no dividends automatically payable on the Series D Preferred. No dividends may be paid to the common stockholders while any Series D Preferred shares are outstanding.

Liquidation Preferences

Upon any liquidation, dissolution or winding up of the Company, before anything can be paid to the holders of common stock, the holders of the Series D Preferred will be entitled to receive $1,000 per share, plus an amount equal to a 6% annual return on that amount since the November 1999 issuance date and any penalty amounts due thereunder, if any.

Redemption

The Series D Preferred must be redeemed by the Company if it is requested to do so by the holders of a majority of the outstanding Series D Preferred shares upon: (1) failure by the Company to comply with certain terms of the Articles of Incorporation, the Securities Purchase and Exchange Agreement or the related Registration Rights Agreement with respect to the Series D Preferred; (2) bankruptcy of the Company; or (3) certain changes in control of the Company.

In any such event, the redemption price per share would be equal to the greater of (1) $1,200 per share, plus an amount equal to a 6% annual return since November 1999 on the $1,000 paid for each share and any penalty amounts due under the terms of the Series D Preferred (including, but not limited to, as a result of the failure to convert or deliver shares on a timely basis), and (2) the "Parity Value" of the shares, which equals the product of (a) the number of shares of the Company's common stock into which the Series D Preferred could have been converted multiplied by (b) the highest reported closing price per share of the common stock between the event triggering the right to request redemption and the payment of the redemption price.

A registration statement was filed and became effective in March 2000, which removed the redemption feature that was outside the control of the Company. Accordingly, the Company classified the Series D preferred stock as permanent equity during the first quarter of 2000.

The Series D preferred stockholders are entitled to a 6% annual return on the stated value of the preferred stock, upon liquidation, conversion, and redemption within control of the Company. Accordingly, the Company has recorded this return as accretion to the stated value of the preferred stock and a charge to accumulated deficit. For the three and nine months ended September 30, 2001 and 2000, the recorded accretion was $74,000 and $221,000 respectively. Accumulated accretion at September 30, 2001 and December 31, 2000 was $556,000 and $335,000, respectively.

iEntertainment Network, Inc.

Notes to Consolidated Financial Statements (continued)

2. Stockholders' Equity (continued)

Conversion

Following shareholder approval of the Series D Preferred Stock financing in December 1999, the Series D Preferred shares were convertible at $1 per share of common stock. At any time, a holder of Series D Preferred Stock may convert all of those shares into common stock. Each share of Series D Preferred was initially convertible into 1,000 shares of common stock. The number of shares of common stock issuable upon conversion of a share of Series D Preferred increases over time to provide the holder additional common stock equal to a 6% annual return since November 1999 and any penalty amounts otherwise due thereunder. Subject to certain conditions, the Series D Preferred Stock will automatically convert into common stock in November 2002.

Voting

The Series D Preferred has no voting rights other than as provided by law and except that the approval of the holders of a majority of the outstanding Series D Preferred is required for: (1) any adverse change to the rights of the Series D Preferred; (2) the creation of securities having senior or equal rights; (3) an increase in the authorized number of shares of Series D Preferred; (4) an increase in the par value of the common stock; or (5) any action that would result in certain taxes being imposed on the Series D Preferred.

3. Stock Options and Warrants

The following summarizes the Company's stock option and warrant activity:

	Shares Available for Grant - 1995 Plans	Shares Available for Grant - 1998 Plans	Outstanding	Weighted-Average Exercise Pri Per Share
Balances at December 31, 2000	331,985	309,815	3,410,142	$1.84
Options granted	(90,000)	-	90,000	$0.25
Options canceled	443,238	57,000	(500,238)	$2.10
Balances at September 30, 2001	685,223	366,815	2,999,904	$1.75

At September 30, 2001, the Company had 2,286,059 options exercisable at exercise prices ranging from $0.25 - $6.00 per share.

The Company had 1,131,905 and 1,210,903 warrants outstanding at September 30, 2001 and December 31, 2000, respectively, all of which were exercisable at prices ranging from $1.00 to $9.60 per share.

iEntertainment Network, Inc.

Notes to Consolidated Financial Statements (continued)

4. Accrued Liability for Prize Points

The Company has operated a prize point system for the users of its online games. In 2000, prize points were redeemable for cash and other prizes. The Company had recorded an accrued liability of $343,000 in accounts payable and accrued expenses on its December 31, 2000 balance sheet based on management's best estimate of prize points that have not been redeemed. At December 31, 2000, the Company also recorded a liability in accounts payable for redeemed but unpaid prize points of $112,000. In 2001, the Company revised its prize point redemption policy such that prize points are no longer directly redeemable for cash or merchandise. Prize points have been converted to chance points and may now be used by customers to enter prize drawings. Due to the change in its prize point system, management has determined that the Company no longer has prize point obligations as previously recorded in the December 31, 2000 balance sheet. Accordingly, the accrued liability of $343,000 and the payable of $112,000 have been reversed and were netted against operating expenses in the Consolidated Statements of Operation for the quarter ending March 31, 2001.

Following the Company's restructuring of its prize point system in early 2001, three individuals filed complaints with the Consumer Protection Division of the Office of the Attorney General for the State of North Carolina with respect to prize points that they wanted to redeem for cash prizes. The Attorney General's Office also has asserted that the Company's operation of the game of "Bingo," which the Company allows users to play for free, violates North Carolina's gambling statutes. Management, after consultation with counsel, does not believe that the Company has violated such statutes, which, as interpreted by North Carolina's Attorney General's Office, would cause free Bingo games operated by many companies to be in violation. In order to avoid costly litigation, however, the Company negotiated a settlement regarding these claims. Settlement was reached in the fourth quarter of 2001. A reserve has been accrued on the balance sheet at September 30, 2001 in the amount of $25,000. This settlement does not bar individual consumer claims or claims of violations of other states' gaming regulations. Consequently, there can be no assurance that future claims will not be made against the Company.

The Company has changed the operations of its "Bingo" game in order to help resolve its dispute with the Office of the Attorney General of North Carolina. As a result of anticipated reductions in "Bingo's" prize point eligibility necessary to effect these changes, the Company may experience a substantial decrease in the amount of traffic on the Company's "Bingo" website. If the amount of traffic on the Company's "Bingo" website does substantially decrease, the Company's advertising revenues will also substantially decrease.

5. Accrued Liability for Consulting Agreement

In August 2001, the Company executed an agreement with Jacob Agam, Chairman of the Company's Board of Directors, for Mr. Agam to provide consulting services to the Company. In recognition of past services to the Company by Mr. Agam, including services provided throughout 2001, the agreement has an effective date of January 01, 2001. The agreement has an initial term expiring on January 01, 2002 and automatically renews for successive one year terms unless terminated under terms of the agreement. The agreement provides for a base compensation that is payable in monthly installments subject to the Company meeting certain contractually defined liquidity events. The amount accrued on the Company's balance sheet at September 30, 2001 regarding this liability was $93,750. The agreement also provides for bonus compensation based on fulfilling certain contractually defined objectives. The payment of either the base or bonus compensation may be in cash or the Company's common stock at the election of Mr Agam.

iEntertainment Network, Inc.

Notes to Consolidated Financial Statements (continued)

6. Contingencies

Responsys, Inc. ("Responsys") filed a complaint with the North Carolina General Court of Justice, Superior Court Division, Wake County, on June 26, 2001, alleging breach of contract with respect to payments claimed for software Responsys licensed to iEntertainment in the amount of $288,102.61, or in the alternative, a quantum meruit award of $102,852.61, plus interest and attorneys' fees. The Company first learned of Responsys' claims when it was served with Responsys' complaint in August 2001. The deadline by which the Company must respond to these claims has been extended to November 21, 2001. The Company is currently evaluating its options with respect to these claims with its counsel, but the Company's management believes Responsys' claims to be without merit and does not believe payment to Responsys is appropriate because the subject software did not perform as described to the Company by Responsys. Because discovery is ongoing, and due to the uncertainties inherent in the complaint process, the Company is unable to predict the outcome of this complaint.

IENTERTAINMENT NETWORK, Inc.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS - THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2000

OVERVIEW

During the fourth quarter of fiscal 2000, the Company, reacting to an adverse pricing environment for online advertising, restructured its operations, thereby significantly reducing personnel and overhead costs.

NET REVENUES

Net revenues decreased by 79% to $.4 million for the three months ended September 30, 2001 from $1.9 million for the three months ended September 30, 2000. Net revenues decreased by 74% to $ 1.4 million for the nine months ended September 30, 2001 from $5.5 million for the nine months ended September 30, 2000.

The following table summarizes the changes in the components of revenue from 2000 to 2001:

	Three months ended September 30 ($000)	Nine months ended September 30 ($000)
Revenue for the period in 2000	$ 1,903	$ 5,463
Increase / (Decrease) in Advertising and Other Revenue	(1,376)	(3,536)
Increase / (Decrease) in Pay for Play Revenue	(106)	(385)
Increase / (Decrease) in Royalty & Licensing	32	(63)
Increase / (Decrease) in CD-ROM revenue	(60)	(70)
Revenue for the period in 2001	$ 393	$ 1,409

Advertising revenues decreased 92% to $0.1 million for the three months ended September 30, 2001 from $1.5 million for the three months ended September 30, 2000. Advertising revenues decreased 86% to $0.6 million for the nine months ended September 30, 2001 from $4.1 million for the nine months ended September 30, 2000. All increases in advertising impressions served over the periods were more than offset by a precipitous drop in advertising pricing across the Internet.

Pay-for-Play revenue decreased 31% to $0.2 million for the three months ended September 30, 2001 from $0.3 million for the three months ended September 30, 2000 and decreased 33% to $0.8 million for the nine months ended September 30, 2001 from $1.2 million for the nine months ended September 30, 2000 primarily due to changes in the pricing model that management implemented in order to stimulate user growth and increase revenues. During the fourth quarter of fiscal 2000, the Company introduced a flat fee, unlimited play option into its pricing matrix. Previously, players paid for each hour played. The new plan drew a significant portion of existing players, but failed to attract a sufficient number of new players to offset the loss of revenues generated by high usage players.

IENTERTAINMENT NETWORK, Inc.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

COST OF REVENUES

Cost of revenues consists of costs of products sold (including cost of Internet access) and royalties and amortization of software development costs. Cost of revenues in the three month period ending September 30, 2001 increased 49% compared to the comparable period in 2000 due primarily to a duplication of internet access charges necessitated by a facilities move. Cost of revenues decreased 33% to $0.3 million in the nine month period ending September 30, 2001 from $0.5 million in the nine month period ended September 30, 2000. This decrease was due primarily to the elimination of royalties associated with operating third-party software.

OPERATING EXPENSES

Operating expenses decreased by 65% to $0.8 million for the three months ended September 30, 2001 from $2.4 million for the three months ended September 30, 2000. Operating expenses decreased by 68% to $2.3 million for the nine months ended September 30, 2001 from $7.1 million for the nine months ended September 30, 2000.

The following table summarizes the changes in the components of operating expenses from 2000 to 2001:

	Three months ended September 30 ($000)	Nine m ended Se 30 ($00
Operating Expenses for the period in 2000	$ 2,390	$ 7
Increase/ (Decrease) in Sales and Marketing	(1,372)	(2
Increase/ (Decrease) in Product Development	48	
Increase/ (Decrease) in General and Administrative	(88)	
Increase/ (Decrease) in Goodwill Amortization	(400)	(1
Increase/ (Decrease) in Debt Concessions	265	
Increase/ (Decrease) in Reversal of liabilities for prize points	-	
Operating Expenses for the period in 2001	$ 843	$ 2

SALES AND MARKETING

Sales and marketing expenses decreased by 92% to $0.1 million for the three months ended September 30, 2001 from $1.5 million for the three months ended September 30, 2000, and decreased by 75% to $0.9 million for the nine months ended September 30, 2001 from $3.4 million for the nine months ended September 30, 2000. These decreases were due primarily to the reduction of costs associated with customer incentives and personnel cost savings arising from the Company's restructuring in late 2000. Beginning with the first quarter of 2001, the Company revised its prize point redemption policy such that prize points were no longer directly redeemable for cash or merchandise. Prize points were converted to chance points and were used to enter fixed-value prize drawings, resulting in decreases of $0.5 million and $1.1 million for the three and nine months ended September 30, 2001, respectively, compared to the corresponding periods in 2000. Accordingly, the associated accrued liability related to unredeemed prize points of $0.3 million and the payable of $0.1 million related to redeemed, but unpaid, prize points were reversed against operating expenses in the quarter ended March 31, 2001.

SALES AND MARKETING (CONTINUED)

Following the Company's restructuring of its prize point system in early 2001, three individuals filed complaints with the Consumer Protection Division of the Office of the Attorney General for the State of North Carolina with respect to prize points that they wanted to redeem for cash prizes. The Attorney General's Office has asserted that the Company's operation of the game of "Bingo," which the Company allows users to play for free, violates North Carolina's gambling statutes. Management, after consultation with counsel, does not believe that the Company has violated such statutes, which, as interpreted by North Carolina's Attorney General's Office, would cause free Bingo games operated by many companies to be in violation. In order to avoid costly litigation, however, the Company negotiated a settlement regarding these claims. Settlement was reached in the fourth quarter of 2001. A reserve for the full settlement has been accrued on the balance sheet at September 30, 2001 in the amount of $25,000. This settlement does not bar individual consumer claims or claims of violations of other states' gaming regulations. Consequently, there can be no assurance that future claims will not be made against the Company.

The Company has changed the operations of its "Bingo" game in order to help resolve its dispute with the Office of the Attorney General of North Carolina. As a result of anticipated reductions in "Bingo's" prize point eligibility necessary to effect these changes, the Company may experience a substantial decrease in the amount of traffic on the Company's "Bingo" website. If the amount of traffic on the Company's "Bingo" website does substantially decrease, the Company's advertising revenues will also substantially decrease.

PRODUCT DEVELOPMENT

Product development expenses increased 13% in the three month period ended September 30, 2001 from the prior year's comparable period and decreased 18% to $1.1 million for the nine months ended September 30, 2001 from $1.3 million for the nine months ended September 30, 2000. The Company's restructuring in December 2000 resulted in decreases in staffing costs and overhead in each of the first three quarters of 2001. The quarter over quarter increase reflects the decrease in amounts capitalized for software development.

GENERAL AND ADMINISTRATIVE

General and administrative expenses decreased by 22% to $0.3 million for the three months ended September 30, 2001 from $0.4 million for the three months ended September 30, 2000. General and administrative expenses decreased by 43% to $0.8 million for the nine months ended September 30, 2001 from $1.4 million for the nine months ended September 30, 2000, primarily due to savings associated with the closure of the Company's European operations and savings in staffing costs effected by the Company's restructuring in December 2000. Savings in the third quarter of 2001 were partially offset by the accrual of compensation expense related to the consulting agreement between the Company and it's Chairman of the Board of Directors.

GOODWILL AMORTIZATION

Goodwill from the MPG-Net acquisition, acquired in mid-first quarter 1999, was previously being amortized to expense over 36 months. Goodwill from the Gamers Net acquisition, acquired in third quarter 1999, was previously being amortized to expense over 24 months. During the second-half of fiscal 2000, the Company experienced a significant revenue stream reduction as a result of a downturn in the online advertising market, which indicated potential impairment of its recorded goodwill values. The Company determined that unamortized goodwill relating to both MPG-Net and The Gamers Net had become fully and permanently

GOODWILL AMORTIZATION (CONTINUED)

impaired. Accordingly, the balance of goodwill at December 31, 2000 was written down to $0.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2001, the Company had cash and cash equivalents of $.1 million. The following table summarizes cash and cash equivalents on hand and major cash flow items:

Cash and cash equivalents on hand, December 31, 2000	$ 437
Net loss	(1,105)
Add: non-cash charges and expenses	130
Changes in working capital	938
Net Cash Used In Operations	(37)
Net investing and financing activities	(332)
Effect of exchange rates on cash and cash equivalents	1
Net change in cash and cash equivalents	(368)
Cash and cash equivalents on hand, September 30, 2001	$ 69

The Company used $2.2 million less net cash in operating activities during the first nine months of 2001 compared with the same period in 2000. This decrease was primarily due to the contraction of the business as effected by the Company's restructuring during the fourth quarter of fiscal 2000, resulting in reduced cash operating requirements.

Certain claims have been made against the Company, as described in Part II, Item 1 of this report under the heading "Legal Matters." The costs of defending or settling these claims may exacerbate the Company's financial position.

The Company's success is dependent upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, to obtain additional financing or refinancing as may be required, and ultimately to attain profitability. Management is seeking to attract additional capital for its online operations. However, there can be no assurance that management's plans will be executed as anticipated.

As of the balance sheet date, the Company believes that it may not have sufficient cash resources to fund its operations through the next twelve months. There is no assurance that the Company will be able to close on any financing transaction. The Company does not have any current arrangements or commitments for any future financing. The Company may not be able to obtain sufficient additional financing to satisfy its cash requirements or may be required to obtain financing on terms that are not favorable to it and its shareholders. The Company's auditors' opinion issued in conjunction with the Company's audited financial statements for the period ended December 31, 2000 raised substantial doubt about the Company's ability to continue as a going concern.

If the Company is unable to obtain additional financing, it may be required to delay or scale back product development and marketing programs in order to meet its short-term cash requirements, which could have a material adverse effect on its business, financial condition and results of operations.

The Company's forecast for the period of time through which its financial resources will be adequate to support its operations is a forward-looking statement that involves risks and uncertainties, and actual results could vary. The factors described in the preceding paragraphs will impact the Company's future capital requirements and the adequacy of its available funds as well as it's ability to continue as a going concern.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND ESULTS OF OPERATIONS (CONTINUED)

EURO CONVERSION

On January 1, 1999, the European Community began denominating significant financial transactions in a new monetary unit, the Euro. The Euro is intended to replace the traditional currencies of the individual EU member countries. During the fourth quarter of 1999, the Company decided to close its European operations and therefore is not converting internal financial systems to the Euro as a functional currency during this closure period.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Following the Company's restructuring of its prize point system in early 2001, three individuals filed complaints with the Consumer Protection Division of the Office of the Attorney General for the State of North Carolina with respect to prize points that they wanted to redeem for cash prizes. The Attorney General's Office also has asserted that the Company's operation of the game of "Bingo," which the Company allows users to play for free, violates North Carolina's gambling statutes. Management, after consultation with counsel, does not believe that the Company has violated such statutes, which, as interpreted by North Carolina's Attorney General's Office, would cause free Bingo games operated by many companies to be in violation. In order to avoid costly litigation, however, the Company negotiated a settlement regarding these claims. Settlement was reached in the fourth quarter of 2001. A reserve for the full settlement has been accrued on the balance sheet at September 30, 2001 in the amount of $25,000. This settlement does not bar individual consumer claims or claims of violations of other states' gaming regulations. Consequently, there can be no assurance that future claims will not be made against the Company.

Responsys, Inc. ("Responsys") filed a complaint with the North Carolina General Court of Justice, Superior Court Division, Wake County, on June 26, 2001, alleging breach of contract with respect to payments claimed for software Responsys licensed to iEntertainment in the amount of $288,102.61, or in the alternative, a quantum meruit award of $102,852.61, plus interest and attorneys' fees. The Company first learned of Responsys' claims when it was served with Responsys' complaint in August 2001. The deadline by which the Company must respond to these claims has been extended to November 21, 2001. The Company is currently evaluating its options with respect to these claims with its counsel, but the Company's management believes Responsys' claims to be without merit and does not believe payment to Responsys is appropriate because the subject software did not perform as described to the Company by Responsys.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

From January 1, 2001 through September 30, 2001, the Company (1) granted options to purchase 12,500 shares of common stock to two contractors for services priced at market value on the date of issuance; (2) granted options to purchase 77,500 shares of common stock to 10 employees priced at market value on the date of grant.

Items (1) and (2) were exempt from registration under Section 5 of the Securities Act of 1933, as amended, by reason of Section 4(2) of the Act and Regulation D of the Securities and Exchange Commission.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

IENTERTAINMENT NETWORK, Inc.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At an annual shareholders meeting held on June 5, 2001, the following matters were approved:

- approval and ratification of an amendment to the Company's Articles of Incorporation reducing the minimum number of directors from five to three.
- election of three directors;
- approval and ratification of an amendment to the Company's 1998 Stock Option Plan to increase the number of shares of common stock reserved for issuance under the plan from 1,800,000 to 2,300,000 shares;
- approval and ratification of the appointment of Ernst & Young LLP.

The respective vote tabulations are detailed below:

Proposal 1	For	Against	Abstain
Amendment to the Articles of Incorporation	12,164,985	83,465	17,205

Proposal 2	For	Withhold
Jacob Agam	8,719,558	3,546,097
Marc S. Goldfarb	8,719,558	3,546,097
Michael Pearce	8,719,558	3,546,097

Proposal 3	For	Against	Abstain
Amendment to the 1998 Stock Option Plan	12,053,904	189,046	22,705

Proposal 4	For	Against	Abstain
Appointment of Ernst & Young, LLC	12,241,851	11,459	12,345

ITEM 5. OTHER INFORMATION

Forward Looking Statements

In connection with the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995, readers of this document are advised that this document contains both statements of historical facts and forward-looking statements. Our forward-looking statements include statements related to capital needs, ability to raise capital, and the market for our common stock. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates" and similar expressions are intended to identify forward-looking statements. Our forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated by the forward-looking statements.

Our forward-looking statements are based on current expectations, estimates and projections about our industry, management's beliefs, and certain assumptions made by management. These statements are not guarantees of future performance and actual actions or results may differ materially. These statements are subject to certain risks, uncertainties and assumptions that are difficult to predict. We undertake no obligation to update publicly any forward-looking statements as a result of new information, future events or otherwise, unless required by law.

IENTERTAINMENT NETWORK, Inc.

ITEM 5. OTHER INFORMATION (continued)

You should carefully consider the risks described in the Company's Form 10-KSB, together with all of the other information included in this Form 10-QSB, before making an investment decision. The risks and uncertainties described are not the only ones we face. If any of the these risks actually occur, it is likely that our business, financial condition or operating results would be harmed. In such case, the trading price of our common stock could decline, and you could lose all or part of your investment.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) EXHIBITS

99.1 Consulting Agreement between the Company and Jacob Agam

(B) REPORTS ON FORM 8-K

None

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IENTERTAINMENT NETWORK, Inc.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

IENTERTAINMENT NETWORK, INC.

By: /s/ Michael C. Pearce

Michael C. Pearce
Chief Executive Officer

By: /s/ Allan Kalbarczyk

Allan Kalbarczyk
Chief Accounting Officer