HEROES INC
Form 10QSB
August 19, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-QSB

(Mark One)
[X] 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

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

For the transition period from __________ to ___________

Commission File No. 0-12597

HEROES, INC.
(Exact name of registrant as specified in its charter)

Nevada	11-1843262
(State of Incorporation)	(I.R.S. Employer Identification No.)

1915 - B Chain Bridge Road, Suite 506, McLean, Virginia 22102
(Address of principal executive offices)

(703) 627-4479
(Registrant's telephone number, including area code)

1980 Gallows Road, Suite 200, Vienna, Virginia 22182
(Former name, former address and former fiscal year, if changed since last report)

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

Yes [X] No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY
PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by court. Yes[ ] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common Stock, $0.001 par value per share, 99,213,109 shares issued and outstanding as of August 12, 2002.

Transitional Small Business Disclosure Format (check one):
YES [ ] NO [X]

HEROES, INC.

INDEX TO FORM 10-QSB

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited):

Balance Sheet as of June 30, 2002	4
Statements of Operations for the three and six months ended June 30, 2002 and 2001	5
Statements of Cash Flows for the six months ended June 30, 2002 and 2001	6
Notes to Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.	8

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.	9
Item 2. Changes in Securities.	10
Item 3. Defaults Upon Senior Securities.	10
Item 4. Submission of Matters to a Vote of Securities Holders.	10
Item 5. Other Information	10
Item 6. Exhibits and Reports on Form 8-K.	10
Signature	10

PART I

FORWARD-LOOKING STATEMENTS

Certain statements contained in this filing are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, such as statements relating to financial results and plans for future business development activities, and are thus prospective. These statements appear in a number of places in this Form 10-QSB and include all statements that are not statements of historical fact regarding intent, belief or our current expectations, with respect to, among other things: (i) our financing plans; (ii) trends affecting our financial condition or results of operations; (iii) our growth strategy and operating strategy; and (iv) the declaration and payment of dividends. The words "may," "would," "could," "will," "expect," "estimate," "anticipate," "believe," "intend," "plans," and similar expressions and variations thereof are intended to identify forward-looking statements.

Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, many of which are beyond our ability to control. Actual results may differ materially from those projected in the forward-looking statements as a result of various factors. Among the key risks, assumptions and factors that may affect operating results, performance and financial condition are changes in technology, fluctuations in our quarterly results, ability to continue and manage our growth, liquidity and other capital resources issues, competition and the other factors discussed in detail in our filings with the Securities and Exchange Commission.

HEROES, INC.

BALANCE SHEET
AS OF JUNE 30, 2002
(Unaudited)

ASSETS	
CURRENT ASSETS - Cash	$ 75
OTHER ASSETS	100
Total Assets	$ 175
LIABILITIES AND STOCKHOLDERS' DEFICIT	
CURRENT LIABILITIES:	
Accounts payable and accrued expenses	$ 7,558,138
Line of credit, including accrued interest	3,847,241
Notes payable, including accrued interest	1,300,637
Accrued compensation	633,640
Deferred maintenance and training revenue	415,997
Total Current Liabilities	13,755,653
STOCKHOLDERS' DEFICIT:	
Common stock, 500 million shares authorized, $.001 par value, 99,213,109 shares issued and outstanding	99,213
Paid-in capital	6,166,833
Accumulated deficit	(20,021,524)
Total Stockholders' Deficit	(13,755,478)
Total Liabilities and Stockholders' Deficit	$ 175

See notes to financial statements.

HEROES, INC.

STATEMENTS OF OPERATIONS
(Unaudited)

	For the Six-Months Ended June 30, 2002	For the Six-Months Ended June 30, 2001	For the Three-Months Ended June 30, 2002
Revenue	$ -	$ -	$ -
Direct Costs	-	55,291	-
Gross Margin	-	(55,291)	-
Other Operating Expenses:			
Advertising	-	127,469	-
Consulting fees	-	419,205	-
Interest and other bank fees	243,051	228,200	114,154
Insurance	-	103,811	-
Legal and accounting	31,327	196,557	31,077
Payroll taxes	13,645	152,110	5,421
Rent	-	101,775	-
Salaries and wages	215,000	1,052,740	107,500
Software license and development	-	182,711	-
Travel	-	128,639	-
Other operating expenses	1,314	330,869	293
Total other operating expenses	504,337	3,024,086	258,445
LOSS BEFORE PROVISION FOR INCOME TAXES	(504,337)	(3,079,377)	(258,445)
PROVISION FOR INCOME TAXES	-	-	-
NET LOSS	$ (504,337)	$ (3,079,377)	$(258,445)
NET LOSS PER SHARE - basic and diluted	$ (0.005)	$ (0.080)	$ (0.003)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING - basic and diluted	99,213,100	39,354,838	99,213,100

See notes to financial statements.

HEROES, INC.

STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six-Months Ended June 30, 2002	For the Six-Months Ended June 30, 2001
Net Loss	$ (504,337)	$ (3,079,377)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	-	4,200
Forfeited security deposit	-	46,572
Issuance of common stock for services	-	417,244
Changes in operating assets and liabilities:		
Decrease in prepaid maintenance costs	-	464,164
Decrease in other assets	-	10,498
Increase in accounts payable and accrued expenses	264,467	862,374
Increase in accrued compensation	228,645	186,245
Decrease in deferred maintenance and training revenues	-	(415,997)
NET CASH USED IN OPERATING ACTIVITIES	(11,225)	(1,504,077)
CASH FLOWS FROM INVESTING ACTIVITIES -		
Acquisition of equipment	-	(332,455)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from note payable to stockholder	11,300	677,722
Proceeds from issuance of common stock	-	1,105,750
NET CASH PROVIDED BY FINANCING ACTIVITIES	11,300	1,783,472
NET CHANGE IN CASH AND CASH EQUIVALENTS	75	(53,060)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	-	70,268
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 75	$ 17,208
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Income taxes paid	$ -	$ -
Interest paid	$ -	$ -

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

During the six-months ended June 30, 2001, the Company issued 17,084,182 shares of common stock for compensation to certain employees for a total expense of $257,242.

During the six-months ended June 30, 2001, the Company converted $124,570 of capital contributions to notes payable.

See notes to financial statements.

HEROES, INC.

NOTES TO FINANCIAL STATEMENTS
(Unaudited)

NOTE A - FORMATION AND OPERATIONS OF THE COMPANY

Heroes, Inc. ("we", "us", "our"), formerly known as Penn-Akron Corporation (Penn-Akron), was in the business of providing turnkey installations of an internet-based video distribution and multimedia network to school districts primarily in metropolitan Atlanta, Savannah and Brunswick, Georgia. On December 7, 2000, we changed our name from Penn-Akron Corporation to Heroes, Inc.

Use of Estimates

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. The reported amounts of revenues and expenses during the reporting period may be affected by the estimates and assumptions we are required to make. Actual results could differ from those estimates.

Basis of Presentation

Our accompanying unaudited statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-QSB and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission ("SEC"). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America. In our opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2002 are not necessarily indicative of the results for the year ending December 31, 2002. The accompanying financial statements and notes thereto should be read in conjunction with our audited financial statements as of December 31, 2001 and 2000 contained in our current Annual Report on Form 10-KSB.

NOTE B - GOING CONCERN

On December 4, 2001, we filed for protection under Chapter 11 of the Bankruptcy Code. The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. We have an accumulated stockholders' deficit of approximately $14,000,000 through June 30, 2002, and anticipate incurring net losses for the foreseeable future and will require a significant amount of capital to commence our planned principal operations and proceed with our business plan. Accordingly, our ability to continue as a going concern is dependent upon our ability to secure an adequate amount of capital, through either additional equity funding or loans with appropriate repayment terms, to finance our planned principal operations and/or implement the business plan which we are currently developing. Our major plan is to devote appropriate resources to obtain a quick and favorable resolution of the matters related to our MRESAnet 2000 Project. We recognize that additional working capital will be required for us to be successful in achieving these goals. These factors, among others, may indicate that we will be unable to continue as a going concern for a reasonable period of time.

The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

Liquidity And Capital Resources

On December 4, 2001, we filed for protection under chapter 11 of the Bankruptcy Code.

As of June 30, 2002, we had cash of $75, a working capital deficit and stockholders deficit of approximately $13.7 million. These deficits continue to increase while we develop and market our products. Our continuation as a going concern is dependent upon our ability to obtain additional working capital. If adequate financing is not available or is not available on acceptable terms, our ability to meet our capital requirements may be significantly limited and could have a material adverse effect on us and ultimately could impair our ability to continue as a going concern.

Results of Operations

We did not have any revenues for the three-month or six-month periods ended June 30, 2002 and 2001. This is primarily due to the fact that no additional work has been performed in Year 2 and 3 of our three-year contract with our current customer, the Metropolitan Regional Educational Service Agency ("MRESA"), pending the outcome of an audit of MRESA by Arthur Andersen, LLP, and the determination by both the Federal Communications Commission ("FCC") and the Schools and Libraries Division ("SLD") as to whether or not the MRESA project shall continue, and under what terms and conditions.

Our current customer is MRESA, an administrative services agency of the Georgia Department of Education. The MRESA jurisdiction covers over 11 school districts, and nearly 750 schools. Our contract with MRESA was executed in March 1999, and we began performance there under in August 1999. This contract continues for a three-year period. As of December 31, 1999, we had completed Year 1 of the three Years under this contract and installed our services at 192 schools. All invoices and installations for Year 1 were approved by MRESA. We began performance on Year 2 of our contract with MRESA in early May 2000. Lynxus, Inc. ("Lynxus"), our main contractor at that time, was responsible for all performance under the contract, including the procurement and installation of all equipment.

In August 2000, Arthur Andersen, LLP, began an audit of MRESA. The MRESA contract is funded by the SLD of the Universal Service Administrative Company. This is a non-profit entity under the jurisdiction of the Federal Communications Commission ("FCC"). The latter administers all " E rate" funds, which were enacted pursuant to the Federal Telecommunications Act of 1996. The program under which the SLD provides funding to MRESA requires a 10% to 50% matching commitment for each school from private, corporate or charitable contributions. The audit is part of an ongoing program integrity process initiated by the SLD to ensure that applicants and vendors (beneficiaries) of the E-rate program comply fully with all FCC and SLD program guidelines, rules and regulations. A number of beneficiaries of the SLD program are audited annually. The determination of which beneficiaries are audited is done both randomly and based on the size of the beneficiary's award. We, as the service provider of the contract, are also being audited as part of this process. As of the date of this report, we have invoiced a total of $3,595,648 for services performed under our contract for Year 2 of this program to the SLD, with all invoices being approved by MRESA. As of the date of this report, all of that amount remains outstanding and unpaid by the SLD. We have also invoiced MRESA $2,600,735 for Year 2 matching funds which also remains outstanding as of the date of this report. We do not anticipate payment from the SLD for past services performed by us. The total amount of invoices to the SLD and MRESA for Year 2, as per our agreement, could eventually exceed $12,000,000.

Other operating expenses decreased to approximately $258,000 for the three months ending June 30, 2002 from approximately $1,070,000 for the same period in 2001 and to approximately $504,000 for the six-month period ending June 30, 2002 from approximately $3,024,000 for the same period in 2001. Our salary expense decreased to approximately $108,000 for the three months ending June 30, 2002 from approximately $310,000 for the same period in 2001 and to approximately $215,000 for the six-month period ending June 30, 2002 from approximately

$1,053,000 for the same period in 2001, primarily due to the reduction of operations.

PART II

Item 1. Legal Proceedings.

Lynxus, Inc. v. Penn-Akron Corporation n/k/a Heroes, Inc. On September 7, 2000, one of our subcontractors, Lynxus, Inc., filed suit against us in the United States District Court for the Northern District of Georgia. The claim arises out of a network implementation agreement between us and Metropolitan Regional Education Services Agency ("MRESA"). We are the general contractor under the agreement, and Lynxus agreed to act as a subcontractor on the project. Lynxus claims that we have breached the subcontract, that Lynxus has performed work under the contract, and that Lynxus is entitled to approximately $483,000 plus interest.

We have denied liability and have asserted a counterclaim for the damages we have suffered as a result of breach of the subcontract by Lynxus. We believe our damages exceed $2.8 million.

In the early stages of this litigation, Lynxus filed a bankruptcy petition in the United States Bankruptcy Court for the Northern District of Georgia, thereby staying action in the lawsuit.

Maurice Delamont v. Penn-Akron Corporation n/k/a Heroes, Inc. On August 24, 2000, Maurice Delamont, one of our former employees, filed two related actions in state courts in Cobb and Fulton Counties, Georgia. The two actions have been consolidated and are pending as a single arbitration proceeding. Mr. Delamont claims that we owe him $1,050,000 arising out of (i) a right to redemption of his stock in the Company, and (ii) a bonus. He also seeks access to certain books and records of the Company. We have asserted a counterclaim against Mr. Delamont, claiming that he breached his fiduciary duty and his employment agreement with us. We maintain that our damages for Mr. Delamont's actions are a defense to his claims and that its actual damages exceed the amount of Mr. Delamont's claims.

On November 13, 2000, we entered into a consent scheduling order with the Plaintiff, which, among other things, ordered the action to be decided by binding arbitration. Mr. Delamont filed a motion for summary judgment on June 15, 2001. On August 14, 2001, the Arbitrator denied the motion as untimely.

In August 2001, Mr. Delamont filed a motion to enforce settlement agreement or for the entry of a summary judgment in the State Court of Cobb County. On, November 9, 2001, the Court denied the motions. Based on oral arguments heard on September 17, 2001, the Court found that Mr. Delamont had failed to establish as a matter of law that there was an enforceable settlement. The Court also found that Mr. Delamont had failed to provide evidence that is sufficient to allow the court to grant summary judgment. Due to our Chapter 11 petition filing on December 4, 2001, action on this lawsuit has been stayed.

Heroes, Inc. v. Sanswire.Net. We are the plaintiff in an action against Sanswire.Net in the Superior Court of Fulton County, Georgia. We filed the lawsuit in March 2001, seeking to recover $200,000 in principal, together with accrued interest and attorneys' fees, under the terms of a promissory note. The promissory note was executed by Sanswire.Net on March 1, 2000.

Mastermind, Inc. v Heroes, Inc. On May 31, 2001, Mastermind Marketing filed a civil action in the State Court of Fulton County, Georgia. On September 19, 2001 Mastermind Marketing was awarded a default judgment in the amount of $169,246.41, including interest, for the preparation of presentations, marketing strategies, and other promotional programs and delivered intellectual property and other products, services and expenses. We are currently evaluating whether to appeal this judgment.

Item 2. Changes in Securities.

NONE

Item 3. Defaults upon Senior Securities.

NONE

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

NONE

Item 5. Other Information.

NONE

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

NONE

(b) Reports on Form 8-K.

NONE

SIGNATURE

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Heroes, Inc.

By:/s/ Amer A. Mardam-Bey
Amer A. Mardam-Bey
(President, CEO & Chief Accounting Officer)
Date: August 19, 2002