

U.S. Securities and Exchange Commission

Washington, D.C. 20549

Form 10-QSB

(Mark One)

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

For the quarterly period ended March 31, 1999

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 0-21467

FIRST PRIORITY GROUP, INC

(Exact name of small business issuer as specified in its charter)

New York

11-2750412

(State or other jurisdiction of
incorporation or organization)

(IRS Employer
Identification No.)

51 East Bethpage Road
Plainview, New York 11803

(Address of principal executive offices)

(516) 694-1010

(Issuer's telephone number)

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

Yes No
--- ---

State the number of shares outstanding of each of the issuer's classes
of common equity, as of May 14, 1999: 8,331,800 shares of common stock

Transitional Small Business Format (check one)

Yes No

Part I Financial Information

Item 1. Financial Statements

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2

FIRST PRIORITY GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

March 31, 1999
(Unaudited)

ASSETS

<TABLE>

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<C>

Current Assets:

Cash and cash equivalents	\$2,681,327
Accounts receivable, less allowance for doubtful accounts of \$28,223	1,967,813
Prepaid expenses and other current assets	94,084

Total current assets 4,743,224

Property and equipment, net of accumulated depreciation of \$443,658	559,984
Security deposits and other non-current assets	108,728

Total assets \$5,411,936
=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:	
Accounts payable	\$1,003,611
Accrued expenses and other current liabilities	1,193,545
Current portion of long-term debt	46,684

Total current liabilities	2,243,840

	38,093

Long-term debt	
Shareholders' equity:	
Common stock, \$.015 par value, authorized 20,000,000 shares; issued 8,598,467 shares	128,977
Preferred stock, \$.01 par value, authorized 1,000,000 shares; none issued or outstanding	-
Additional paid-in capital	7,762,360
Deficit	(4,671,324)

	3,220,003
Less common stock held in treasury, at cost, 266,667 shares	90,000

Total shareholders' equity	3,130,003

Total liabilities and shareholders' equity	\$5,411,936
	=====

</TABLE>

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

3

FIRST PRIORITY GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

<TABLE>
<CAPTION>

	THREE MONTHS ENDED	
	March 30, 1999	March 30, 1998
	-----	-----
<S>	<C>	<C>
Revenue	\$ 3,578,606	\$ 4,017,501
Costs of revenue (principally charges incurred at repair facilities for services)	2,925,486	3,358,992
	-----	-----
Gross profit	653,120	658,509
Operating expenses	904,991	978,284
	-----	-----
Loss from operations	(251,871)	(319,775)
	-----	-----
Other income (expense):		
Interest and other income	43,929	51,350
Other expenses	--	(6,771)
	-----	-----
Total other income	43,929	44,579
	-----	-----
Net loss	\$ (207,942)	\$ (275,196)
	=====	=====
Basic and diluted loss per share	\$ (0.02)	\$ (0.03)
	=====	=====
Weighted average number of common shares outstanding	8,331,800	8,092,911
	=====	=====

</TABLE>

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

4

FIRST PRIORITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW
(Unaudited)

	THREE MONTHS ENDED	
	March 30, 1999	March 30, 1998
	-----	-----
Cash flows from operating activities:		
Net loss	(\$207,942)	(\$275,196)
	-----	-----
Adjustments to reconcile net loss to net cash used in operating activities:		

Depreciation and amortization	42,461	32,661
Changes in assets and liabilities		
Accounts receivable	(256,169)	(90,515)
Inventories	--	(9,246)
Prepaid expenses and other current assets	(27,877)	48,500
Security deposit and other assets	(756)	13,590
Accounts payable	(234,478)	(264,690)
Accrued expenses and other liabilities	596,760	379,526
	-----	-----
Total adjustments	119,931	109,826
	-----	-----
Net cash used in operating activities	(88,011)	(165,370)
	-----	-----
Cash flows used in investing activities, additions to property and equipment	(1,021)	(98,653)
	-----	-----
Cash flows from financing activities:		
Repayment of long-term debt	(11,821)	--
Collection of shareholder note	--	100,000
Proceeds from issuance of common stock	--	1,000,000
	-----	-----
Net cash provided by (used in) financing activities	(11,821)	1,100,000
	-----	-----
Net increase (decrease) in cash and cash equivalents	(89,032)	835,971
Cash and cash equivalents at beginning of period	2,782,180	3,453,864
	-----	-----
Cash and cash equivalents at end of period	\$2,681,327	\$4,289,845
	=====	=====

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

5

FIRST PRIORITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. UNAUDITED FINANCIAL STATEMENTS

The information contained in the condensed consolidated financial statements for the period ended March 31, 1999 is unaudited, but includes all adjustments, consisting of normal recurring adjustments, which the Company considers necessary for a fair presentation of the financial position and the results of operations for these periods.

The financial statements and notes are presented as permitted by Form 10-QSB, and do not contain certain information included in the Company's annual statements and notes. These financial statements should be read in conjunction with the Company's annual financial statement as reported in its most recent annual report on Form 10-KSB.

2. BUSINESS OF THE COMPANY

The Company, a New York corporation formed on June 28, 1985, is engaged in automotive fleet management and administration of automotive repairs for businesses, insurance companies and members of affinity groups.

The Company's office is located at 51 East Bethpage Road, Plainview, New York 11803 and its telephone number is (516) 694-1010.

3. RESULTS OF OPERATIONS

The unaudited results of operations for the three months ended March 31, 1999 are not necessarily indicative of the results to be expected for the full year.

4. EARNINGS PER SHARE

Basic earnings (loss) per share is computed by dividing earnings by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if common stock equivalents, such as stock options and warrants, were exercised. During the three month periods ended March 31, 1999 and 1998, there was no dilutive effect from stock options and warrants.

6

5. SUBSEQUENT EVENTS

On April 13, 1999, the Company formed a new wholly owned subsidiary, Collision Depot.com, Inc. to provide collision repair claims management services for the insurance industry nationwide through the Internet.

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7

Item 2. Management's Discussion and Analysis or Plan of Operation.

Results of Operations

Automotive Management

Revenues from services of the automotive management operations were \$3,578,606, for the three months ended March 31, 1999, as compared to \$4,017,501 for the three months ended March 31, 1998, representing a decrease of \$438,895, or 10.9%. We attribute the reduction in Revenue for the quarter to a lower national vehicle accident rate. The reduced vehicle accident rate, recognized by various insurance industry sources, is due to: (i) increased safety conditions on both roads and in vehicles, (ii) drivers' safety awareness and defensive driving and (iii) moderate weather conditions. The direct cost of services related to such revenue (principally charges from automotive repair facilities) was \$2,925,486 and \$3,358,992 for the three month periods ended March 31, 1999 and 1998, respectively, resulting in a decrease of \$433,506 or 12.9%. The gross profit percentage for the three months ended March 31, 1999 and March 31, 1998 increased 1.9% to 18.3% from 16.4%. This increase represents better pricing structures and an increase in the Affinity program sales which yields a higher gross profit than the traditional repair services.

Total operating expenses were \$904,991 for the three months ended March 31, 1999, as compared to \$978,284 for the three months ended March 31, 1998, representing a decrease of \$73,293 or 7.5%. The decrease in operating expenses is mainly attributable to pay cuts taken by upper management and a reduction in work force.

Interest and other income was \$43,929 for the three months ended March 31, 1999, as compared to \$51,350 for the same period in 1998, representing a decrease of \$7,421. The decrease is primarily attributable to lower average cash balances available during the quarter ended March 31, 1999.

As a result of the foregoing, the net loss from continuing operations for the three months ended March 31, 1999 was \$207,942 (\$.02 per share) as compared to a net loss of \$275,196 (\$.03 per share) for the comparable three months in 1998.

Liquidity and Capital Resources

As of March 31, 1999, the Company had cash and cash equivalents of \$2,681,327 and working capital was \$2,499,384. The Company's operating activities used \$88,011 of cash in the first quarter of 1999, an improvement of \$77,359, as compared to the first quarter of 1998 where operating activities used \$165,370 of cash.

The Company believes that its present cash position will enable the Company to continue to support its operations for the short and longer term.

8

New Business Developments

On April 19, 1999, the Company announced the formation of a new wholly owned subsidiary, Collision Depot.com, Inc. ("Collision Depot") to provide collision repair claims and management services for the insurance industry nationwide through the Internet. Additionally, the Company announced that Collision Depot retained Fahnstock & Co., Inc. to act as its exclusive placement agent in a private offering of equity securities.

Collision Depot has since changed its name to driversshield.com Corp. The Company holds the registered trademark of Driver's Shield(Registered) and is in the process of assigning this trademark to its subsidiary, driversshield.com Corp. The subsidiary will offer, in addition to the collision repair claims and management services for the insurance industry nationwide through the Internet, a wide array of automotive services and discounts on a nationwide basis, some of which are already being sold wholesale through affinity groups and financial institutions under the Company's existing Driver's Shield(Registered) label.

Year 2000 Compliance

The Company has two computer systems and software products coded to accept only two digit entries to represent years. For example, the year "1998" would be represented by "98." These systems and products will need to be able to accept four digit entries to distinguish years beginning with 2000 from prior years. As a result, systems and products that do not accept four digit year entries will be replaced to comply with such "Year 2000" requirements. The Company believes that its internal systems are Year 2000 compliant or will be replaced in connection with previously planned changes to information systems prior to the need to comply with Year 2000 requirements. Expenses related to Year 2000 compliance amounted to approximately \$100,000 in 1998 and are expected to amount to approximately \$100,000 in 1999. The anticipated costs of any Year 2000 modifications are based on management's best estimates, which were derived utilizing numerous assumptions of future events, including the continued

availability of certain resources and other factors. However, there can be no guarantee that these estimates will be achieved and actual results could differ materially from those anticipated. Specific factors that might cause such material differences include, but are not limited to the availability or cost of personnel trained in this area, the ability to locate and correct all relevant computer codes and similar uncertainties. In addition, there can be no assurance that Year 2000 compliance problems will not be revealed in the future which could have a material adverse affect on the Company's business, financial condition and results of operations. Many of the Company's customers and suppliers may be affected by Year 2000 issues that may require them to expend significant resources to modify or replace their existing systems. This may result in those customers having reduced funds to purchase the Company's products or in those suppliers experiencing difficulties in producing or shipping key components to the Company on a timely basis or at all.

Forward Looking Statements - Cautionary Factors

Certain information contained herein includes information that is forward looking. The matters referred to in forward-looking statements may be affected by the risks and uncertainties involved in the Company's business. These forward-looking statements are qualified in their entirety by the cautionary statements contained in the Company's Form 10-KSB for the year ended December 31, 1998.

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

(a) Exhibits

10.1 Placement Agent Agreement between Fahnstock & Co., Inc. and Collision Depot.com, Inc. dated April 14, 1999.

27 Financial Data Schedules

9

(b) Reports on Form 8-K

None

10

SIGNATURES

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

FIRST PRIORITY GROUP, INC.

Date: May 17, 1999

By: /s/ Barry Siegel

Barry Siegel
Chairman of the Board
of Directors, Chief Executive Officer
Treasurer, Secretary and Principal
Financial and Accounting Officer

11

Index of Exhibits

Exhibit No. Description

10.1 Placement Agent Agreement between Fahnstock & Co., Inc. and Collision Depot.com, Inc. dated April 14, 1999.

27 Financial Data Schedules

12

Placement Agent Agreement

April 14, 1999

Fahnestock & Co. Inc.
125 Broad St., 16th Floor
New York, NY 10004

Dear Sirs:

The undersigned, Collision Depot.com, Inc. (the "Company"), a Delaware corporation, wholly owned by First Priority Group, Inc. ("FPGI"), hereby agrees with Fahnestock & Co. Inc. ("Fahnestock" or "Placement Agent") as follows:

1. Best Efforts Offering. The Company hereby engages Fahnestock to act as its exclusive agent during the term of the offering as outlined herein (the "Offering") to sell, in an aggregate Offering of no less than five million dollars (\$5,000,000) (the "Minimum") and no more than seven million dollars (\$7,000,000) (the "Maximum"), on a "best efforts" basis, shares of preferred stock (the "Preferred Stock" or Preferred Shares") on the terms substantially as set forth in the Term Sheet attached hereto as Exhibit A. The price per share of Preferred Stock will be substantially determined to the mutual satisfaction of the Company and Fahnestock. As part of the Minimum, the Company shall raise a minimum of five hundred thousand (\$500,000) and a maximum of two million dollars (\$2,000,000) of Series A Preferred Stock which shall have similar terms as the Preferred Stock. The Preferred Shares shall be offered without registration under the Securities Act of 1933, as amended and the rules and regulations promulgated thereunder (the "Act") pursuant to the exemption from registration created by Regulation D thereof.

2. Business Plan. The Company shall, as soon as practicable, prepare a Business Plan covering the proposed Offering. The Business Plan shall be in form and substance reasonably satisfactory to Fahnestock and to the Company. The Company agrees that it shall modify or supplement the Business Plan during the course of the Offering to insure that the Business Plan does not contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading. Fahnestock will not make any use of the Business Plan other than for purposes of implementing this Agreement.

3. Compensation. You will be paid at the closing of such sales a cash commission of eight percent (8%) of the subscription price of each Share sold and you may reallow such part thereof to participating Soliciting Dealers on sales effected by such Soliciting Dealers as you in your sole discretion may determine. In addition, you will receive a non-accountable expense allowance of fifty thousand dollars (\$50,000), of which twenty-five thousand dollars (\$25,000) shall be payable upon execution of this Agreement and the balance of which shall be earned and due on the initial closing, to cover your expenses of this Offering including your legal fees and disbursements. In addition, you shall receive warrants to purchase Common Stock equal to ten percent (10%) of the number of as-converted shares of Series B Preferred Stock sold in the Offering at a 10% premium to the conversion price of the Preferred Stock. Your compensation for the amount raised for Series A Preferred Stock shall be reduced to the following: (i) four percent (4.0%) placement agent fee and (ii) warrants to purchase Common Stock equal to five percent (5%) of the number of as-converted shares of Series A Preferred Stock.

Whether or not the Offering is consummated, if during the term of the Offering hereunder, the Placement Agent contacts an investor who purchases within one (1) year after such introduction any private securities of the Company, you shall be entitled to compensation which you would obtain hereunder on the same basis as you would have been entitled if you had arranged for the sale of a comparable dollar amount of securities offered hereunder.

4. Expenses. Whether or not the Offering is successfully completed, it shall be the Company's obligation to bear all of its expenses in connection with the proposed Offering, including, but not limited to, the following:

filing fees, printing and duplicating costs, the Company's and your postage, delivery and advertising expenses, registrar and transfer agent fees, counsel and accounting fees of the Company, issue and transfer taxes, if any, and "blue sky" counsel fees and expenses for filing in such states as may be agreed upon. The "blue sky" registration shall be handled by the Company's counsel at a fee payable at the time of filing of the "blue sky" applications, plus expenses (including state filing fees which shall be advanced by or promptly reimbursed by the Company) to be borne by the Company.

5. Further Representations and Agreements of the Company. In addition to the terms in Exhibit A, the Company further represents and agrees that (i) it is authorized to enter into this Agreement and to carry out the Offering contemplated hereunder and this Agreement constitutes a legal, valid and binding obligation of the Company, enforceable in accordance with its terms, (ii) without your prior written consent, it will not prior to the termination of the Offering, permit any indebtedness nor the number of shares of its Common Stock outstanding or issuable under outstanding warrants, options or conversion rights to exceed that number of Common Stock equivalents on a fully-diluted basis to exceed \$21 million of value, (iii) the Company will, during the course of the Offering and during the period ending five (5) years after the date of the Business Plan, solely at its expense, provide you with all information and copies of documentation with respect to the Company's business, financial condition and other matters as Fahnstock may reasonably deem relevant, including copies of all documents sent to stockholders or filed with any federal authorities, and will, during the course of the Offering, make itself reasonably available to Fahnstock, its auditors, counsel, and officers and directors to discuss with Fahnstock any aspect of the Company or its business which Fahnstock may reasonably deem relevant, (iv) Fahnstock shall have observer rights to meetings of the Board of Directors until the Company's initial public offering and such observer shall be promptly reimbursed for reasonable out-of-pocket expenses incurred in attending such meetings, (v) effective upon the closing of the Minimum, Fahnstock shall have a right of first refusal for all investment banking activities of the Company for a period of two (2) years from the final closing of this Offering, (vi) the Company shall make reasonable efforts to become a public company within twenty-four (24) months from the closing of the Offering, (vii) the Company's stock option plan shall be a maximum of 10% of the number of shares outstanding post-offering and the formula for granting of such options shall be determined by a committee of outside Board members that consists of one (1) Series B representative and (viii) the Company will deliver at the closing of sales conducted hereunder a certificate of the Company's Chief Executive Officer to the effect that the Business Plan meets the requirements hereof and has been modified or supplemented as required by Paragraph 2 hereof and does not contain any untrue statement of material fact or fail to state any material fact required to be stated therein or necessary to make the statements therein not misleading, and all necessary corporate approvals have been obtained to enable the Company to deliver the Shares in accordance with the terms of the Offering. Other representations and warranties shall be contained in the stock purchase agreement for the Preferred Stock.

6. Indemnification. See Exhibit B attached hereto.

7. Breakaway Fee. Except for a termination pursuant to Paragraph 9 below, if the proposed private placement is not completed because the Company is unwilling or unable to proceed or because the Company breaches any of the covenants, representations or warranties of this Agreement, the Company shall be liable to the Placement Agent for all travel and out-of-pocket expenses incurred by the Placement Agent (including the fees and expenses of counsel) prior to, or as a result of, the receipt of notification of the Company's unwillingness or inability to proceed or breach of the said provisions hereof, in addition to a fee equal to one hundred thousand dollars (\$100,000) to compensate the Placement Agent for the effort of its management and

2

staff relative to the intended private placement. In addition, in all events, the Company shall remain liable for all "blue sky" counsel fees and expenses and "blue sky" filing fees.

8. No-Shop Provision. Until the Offering contemplated hereby is completed, but no later than ninety (90) days from the date of the Business Plan, the Company agrees that it will not negotiate with any other person

relating to a possible public or private offering or placement of the Company's securities. In addition, if prior to the closing hereunder the Company is acquired, merges, sells all or substantially all of its assets or otherwise effects a corporate reorganization with any other entity, the Company shall engage Fahnestock as its financial advisor and shall pay a transaction fee to Fahnestock to be determined at that time, but in any event such fee shall be reasonable and customary for the size and nature of such a transaction.

9. Termination. The Company shall have the right to terminate the Offering other than as a result of Paragraph 7 with no further obligation to Fahnestock (except in regard to Sections 3, 4 and 8 hereof and the indemnification provisions set forth in Exhibit B) in the event that there is no closing of the Minimum within ninety (90) days from the date of the Business Plan. In the event that there is a closing on the Minimum, the Company may terminate the Offering after four (4) months from the date of the Business Plan subject to Fahnestock's rights to compensation for securities sold hereunder prior thereto. The Company and Fahnestock may terminate or extend the Offering at any time by mutual written consent.

10. Competing Claims. The Company acknowledges and agrees that no entity has any claims or is entitled to any payments for services in the nature of a finder's fee or any other arrangements, agreements, payments, issuances or understandings pursuant to this Offering or any future investment banking activities of the Company. The Company represents that no other entity has any rights of first refusal to act as placement agent in this Offering or has any rights, claims or other agreements to be paid for any investment made by any entity pursuant to this Offering.

11. Miscellaneous.

(a) Governing Law. This Agreement and the transactions contemplated hereby shall be governed in all respects by the laws of the State of New York, without giving effect to its conflict of laws principles.

(b) Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

(c) Notices. Whenever notice is required to be given pursuant to this Agreement, such notice shall be in writing and shall either be (i) mailed by certified first class mail, postage prepaid, addressed (a) if to Fahnestock, at the address set forth at the head of this Agreement, Attention: Henry P. Williams, Senior Vice President; and (b) if to the Company, at 51 East Bethpage Road, Plainview, NY, 10155 Attention: Barry Siegel, Chief Executive Officer or (ii) delivered personally or by express courier. The notice shall be deemed given, if sent by mail, on the third day after deposit in a United States post office receptacle, or if delivered personally or by express courier, then upon receipt.

(d) Dispute. In the event of any action at law, suit in equity or arbitration proceeding in relation to this Agreement or the transactions contemplated by this Agreement, the prevailing party, or parties, shall be paid its reasonable attorney's fees and expenses arising from such action, suit proceeding by the other party.

3

If the foregoing correctly sets forth the understanding between Fahnestock and the Company, please so indicate in the space provided below for that purpose whereupon this letter shall constitute a binding agreement between us.

Very truly yours,

Collision Depot.com, Inc.

By: _____
Barry Siegel
Chief Executive Officer

Confirmed and agreed to:

By: _____
Henry P. Williams
Senior Vice President

Date: _____

April 14, 1999

Collision Depot.com, Inc.

Private Placement of Convertible Preferred

Preliminary Term Sheet

I. The Offering

Issuer: Collision Depot.com, Inc. (the "Company"), a Delaware corporation wholly-owned by First Priority Group, Inc. ("FPGI").

Issue: Private Placement of Series B Convertible Preferred Stock (the "Series B Preferred Stock") offered to accredited investors only pursuant to Regulation D.

Amount: Minimum of \$5.0 million and maximum of \$7.0 million. As part of the Minimum, the Company shall raise a minimum of five hundred thousand dollars (\$500,000) and a maximum of two million dollars (\$2,000,000) of Series A Preferred Stock which shall have similar terms as the Series B Preferred Stock and shall be funded and held in escrow prior to the marketing of the Series B Preferred Stock.

Pre-Offering Fully-diluted Valuation: \$21 million.

Use of Proceeds: Web site development, marketing expenses and working capital. In return for its equity ownership in the Company, FPGI shall contribute all its tangible and intangible property and personnel related to the internet application of collision damage claims management, repair facilities and damage repairs to the auto insurance industry.

Purchase Agreement: The Series B Preferred Stock shall be purchased pursuant to a Stock Purchase Agreement which shall contain representations, warranties and covenants of the Company and conditions to closing customary for a transaction of this kind.

Estimated Closing Date: Within 60 days from the date of the Business Plan.

II. Summary of Preferred Stock Terms

Right of Conversion: Each Share of Series B Preferred Stock is convertible at any time (at the option of the holder) initially on a share-for-share basis into the Company's Common Stock.

Automatic conversion: Each share of Series B Preferred Stock shall automatically be converted into shares of Common

Stock at the closing of an initial public offering in which the gross proceeds to the Company are not less than \$12 million and the investors of the Series B Preferred Stock realize an internal rate of return of at least 40% (a "Qualified Public Offering").

1

Conversion Price: The purchase price of the Series B Preferred Stock (the "Conversion Price").

Dividend Provisions: The holders of the Series B Preferred Stock shall be entitled to receive cumulative dividends at the rate of 8% per annum when, as and if declared by the Board of Directors.

Seniority: Any future issues of preferred stock shall not be senior to the Series B Preferred Stock, except upon the consent of at least 67% of the then outstanding shares of the Series B Preferred Stock.

Liquidation Preference: The holders of the Series B Preferred Stock shall be entitled to receive, prior and in preference to any distribution of any of the assets of the Company or proceeds thereof to the holders of Common Stock, an amount equal to the purchase price of each Series B Preferred Stock plus any accrued and unpaid dividends (the "Liquidation Preference").

Merger, Consolidation or Sale: Upon the consolidation or merger of the Company in which stockholders of the Company own less than 50% of the voting securities of the resulting or surviving corporation, or the sale or transfer of all or substantially all the assets of the Company, the holders of the Series B Preferred Stock shall have the option to (i) receive the Liquidation Preference plus accrued and unpaid dividends, or (ii) participate with the holders of Common Stock on an as-converted basis.

Voting Rights: The holders of Series A and B Preferred Stock shall be entitled to vote with the Common Stock of the Company as a single class on the basis of one vote per share of Series A and B Preferred Stock. The Common Stockholders shall be entitled to one vote per share.

Registration Rights: The holders of the Series B Preferred Stock will be entitled to certain demand and piggyback registration rights for the Common Stock to be received upon conversion of the Series B Preferred Stock following an initial public offering.

Mandatory Redemption: On or after the earlier of (i) five years from the date of the closing hereunder or (ii) the date at which any other series of preferred stock is entitled to mandatory redemption, the holders of the Series B Preferred Stock shall have the option of "putting" their Series B Preferred Stock back to the Company for the Liquidation Preference plus any accrued and unpaid

dividends.

Anti-dilution Provisions: The holders of the Series B Preferred Stock shall have certain anti-dilution provisions which shall be calculated on a full-ratchet basis.

Preemptive Right
(Rights of First Refusal): Holders of the Series B Preferred Stock shall have the same right of first refusal providing for the purchase of shares of future private offerings of equity securities (or warrants or other securities convertible into equity securities) of the Company that will enable them to maintain their fully-diluted percentage ownership of the Company. This right shall terminate upon a Qualified Public Offering.

2

Tag-Along Provision
(Co-sale rights): In the event that an offer is made to purchase shares of Common Stock owned by any officers, directors or 5% holders of the Company, the holders of the Series B Preferred Stock shall have the right to sell a pro rata portion of their shares to such purchaser.

Board of Directors: The holders of the Series B Preferred Stock, as a class, will be entitled to designate two (2) members of the Board of Directors which shall consist of five (5) members.

Re-set Provision: The ownership interest of the holders of the Series B Preferred Stock shall be adjusted based on the actual operating performance of the Company. The ownership interest shall increase 100% if the Company's actual 2002 EBIT is less than \$11 million. In addition to the adjustment in ownership interest, the holders of the Series B Preferred Stock will be entitled to designate one (1) additional member to the Board of Directors if the Re-set Provision occurs. If the Company completes a Qualified Public Offering, this Re-set Provision will expire.

Negative Covenants: The following corporate actions shall require the approval of the holders of Series B Preferred Stock's representative to the Board of Directors: (i) any material financing transactions including, but not limited to, the addition of debt or issuance of common or preferred securities, with the exception of a Qualified Public Offering; (ii) any sale of the Company, or any merger or similar transaction by the Company; (iii) any material inter-company, related-party or affiliated transactions; (iv) formation of new corporations; and (v) other major decisions or events outside the ordinary course of business.

Information Rights: The holders of the Series B Preferred Stock and Fahnstock shall have the right to promptly receive: (i) quarterly unaudited financial statements within 50 days after the end of each quarter; (ii) annual unaudited financial statements within 105 days after the end of each year; (iii) a budget and operating plan for each year at least 45 days prior to the start of each fiscal year; (iv) copies of all reports sent to stockholders or filed with the SEC; (v) notification of material litigation and (vi) other information as reasonably requested.

Amendments and

Waivers of Rights: Amendments to and waivers of the rights of the holders of the Series A and B Preferred Stock must be approved by the holders representing 67% of the outstanding Series A and B Preferred Stock voting together as one class.

III. Placement Agent Compensation

Exclusive Placement Agent: Fahnestock & Co. Inc.

Placement Agent Fee: 8% of the total amount raised.

Expense Allowance: \$50,000, \$25,000 of which is payable upon the signing of a Placement Agent Agreement. The remaining \$25,000 is earned and due upon closing of the Offering.

3

Warrants: Five-year warrants to purchase Common Stock equal to 10% of the number of as-converted common shares underlying the Series B Preferred Stock sold hereunder at a 10% premium to the conversion price.

Reduced fees for Series A Preferred Stock: Placement Agent Fee of 4.0% of total amount raised and Warrants to purchase Common Stock equal to 5.0% of as-converted common shares underlying the Series A Preferred Stock.

Other: Upon closing of the Offering, Fahnestock shall have a right of first refusal for all investment banking activities of the Company for a period of two years from the final closing and shall have observer rights to meetings of the Board of Directors. The Fahnestock observer shall be promptly reimbursed for reasonable out-of-pocket expenses incurred in attending such meetings.

4

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