

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 MARCH 31, 2001

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 1-14896

NETWORK-1 SECURITY SOLUTIONS, INC.
(EXACT NAME OF SMALL BUSINESS ISSUER AS
SPECIFIED IN ITS CHARTER)

DELAWARE 11-3027591
(STATE OR OTHER JURISDICTION OF (IRS EMPLOYER IDENTIFICATION NO.)
INCORPORATION OR ORGANIZATION)

1601 TRAPELO ROAD, RESERVOIR PLACE, WALTHAM, MASSACHUSETTS 02451
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

781-522-3400
(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 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 /X/ No / /

As of May 1, 2001 there were 6,458,347 shares of Common Stock, \$.01 par value
per share, and 107,023 shares of Series D Convertible Preferred Stock, \$.01 par
value per share, outstanding.

Transitional Small Business Disclosure Format (check one):
Yes No

NETWORK-1 SECURITY SOLUTIONS, INC.

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NETWORK-1 SECURITY SOLUTIONS, INC.
BALANCE SHEETS

<TABLE><CAPTION>

	March 31, 2001	December 31, 2000
	-----	-----
	(Unaudited)	
<S>	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,638,000	\$ 4,425,000
Accounts receivable - net of allowance for doubtful accounts of \$90,000 and \$80,000 respectively	413,000	227,000
Prepaid expenses and other current assets	103,000	153,000
Due from purchaser of discontinued operations	59,000	59,000
	-----	-----
Total current assets	4,213,000	4,864,000
Equipment and fixtures	420,000	437,000
Capitalized software costs - net	688,000	625,000
Security deposits	89,000	81,000
	-----	-----
	\$ 5,410,000	\$ 6,007,000
	=====	=====
LIABILITIES		
Current liabilities:		
Notes payable - related parties	\$ 326,000	\$ 326,000
Notes payable - others	338,000	343,000
Accounts payable	195,000	224,000
Accrued expenses and other current liabilities	675,000	696,000
Interest payable - related parties	33,000	27,000
Interest payable - others	34,000	28,000
Deferred revenue	224,000	181,000
	-----	-----
Total current liabilities	1,825,000	1,825,000
Commitments and contingencies		
STOCKHOLDERS' EQUITY		
Preferred stock - \$.01 par value; authorized 5,000,000 shares; Series A -10% cumulative, none issued and outstanding Series B - none issued and outstanding Series C - none issued and outstanding Series D -107,023 and 115,220 shares issued and outstanding, respectively	1,000	1,000
Common stock - \$.01 par value; authorized 25,000,000 shares; 6,458,347 and 6,448,363 shares issued and outstanding, respectively	65,000	65,000
Additional paid-in capital	31,049,000	30,705,000
Accumulated deficit	(27,494,000)	(26,482,000)
Unearned portion of compensatory stock options	(36,000)	(107,000)

3,585,000	4,182,000
<u>\$ 5,410,000</u>	<u>\$ 6,007,000</u>

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NETWORK-1 SECURITY SOLUTIONS, INC.
STATEMENTS OF OPERATIONS

<TABLE><CAPTION>

	Three Months Ended March 31,	
	2001	2000
	(Unaudited)	(Unaudited)
<S>	<C>	<C>
Revenues:		
Licenses	\$ 396,000	\$ 157,000
Services	61,000	35,000
	<u>457,000</u>	<u>192,000</u>
Cost of revenues:		
Amortization of software development costs		62,000
Cost of licenses	14,000	6,000
Cost of services	62,000	28,000
	<u>138,000</u>	<u>95,000</u>
Gross profit	<u>319,000</u>	<u>97,000</u>
Operating expenses:		
Product development	612,000	293,000
Selling and marketing	896,000	488,000
General and administrative	494,000	517,000
	<u>2,002,000</u>	<u>1,298,000</u>
Loss from continuing operations before interest	(1,683,000)	(1,201,000)
Interest income - net	41,000	33,000
Loss from continuing operations	(1,642,000)	(1,168,000)
Income from discontinued operations	630,000	2,028,000
Net (loss) income	<u>\$(1,012,000)</u>	<u>\$ 860,000</u>
Per common share information - basic and diluted		
Loss from continuing operations	\$ (0.26)	\$ (0.22)
Income from discontinued operations	0.10	0.38
Net (loss) income	<u>\$ (0.16)</u>	<u>\$ 0.16</u>
Weighted average number of common shares outstanding	<u>6,455,316</u>	<u>5,326,112</u>

</TABLE>

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NETWORK-1 SECURITY SOLUTIONS, INC.
STATEMENTS OF STOCKHOLDERS' EQUITY

<TABLE><CAPTION>

	Common Stock		Preferred Stock	
	Shares	Amount	Shares	Amount
<S>	<C>	<C>	<C>	<C>

Balance - December 31, 1998	4,366,520	\$ 44,000	562,836	\$ 6,000
Amortization of compensatory stock options	--	--	--	--
Issuance of common stock and options for services rendered and payment of liability	5,855	--	--	--
Conversion of Series C preferred stock	562,836	6,000	(562,836)	(6,000)
Issuance of Series D preferred stock and warrants, net of expense of \$34,000	--	--	491,803	5,000
Beneficial conversion feature of Series D preferred stock and related imputed dividend	--	--	--	--
Net loss	--	--	--	--
Balance - December 31, 1999	4,935,211	50,000	491,803	5,000
Amortization of compensatory stock options	--	--	--	--
Conversion of Series D preferred stock	376,583	4,000	(376,583)	(4,000)
Exercise of employee & non-employee stock options	470,051	5,000	--	--
Exercise of Warrants	384,091	4,000	--	--
Conversion of Notes and Accrued Interest	282,427	2,000	--	--
Compensation charge for issuance of non-qualified stock options	--	--	--	--
Compensation charge for accelerated vesting of stock options	--	--	--	--
Beneficial conversion feature of Series D preferred stock underlying notes payable and related debt discount	--	--	--	--
Issuance of warrants and options for services	--	--	--	--
Unearned portion of compensatory warrants	--	--	--	--
Net loss	--	--	--	--
Balance - December 31, 2000 (Audited)	6,448,363	\$ 65,000	115,220	\$ 1,000
Amortization of compensatory stock options	--	--	--	--
Conversion of Series D preferred stock	8,197	--	(8,197)	--
Conversion of Notes and Accrued Interest	1,787	--	--	--
Amortization of compensatory warrants	--	--	--	--
Compensation charge for issuance of non-qualified stock options	--	--	--	--
Compensation charge for issuance of warrants	--	--	--	--
Net loss	--	--	--	--
Balance - March 31, 2001 (Unaudited)	6,458,347	\$ 65,000	107,023	\$ 1,000

</TABLE>

NETWORK-1 SECURITY SOLUTIONS, INC.
STATEMENTS OF STOCKHOLDERS' EQUITY(continued)

<TABLE><CAPTION>

	Additional Paid-in Capital	Unearned Accumulated Deficit	Portion of Stock Options Compensatory	Total
<S>	<C>	<C>	<C>	<C>
Balance - December 31, 1998	\$ 20,819,000	\$(13,247,000)	\$ (383,000)	\$ 7,239,000
Amortization of compensatory stock options	--	--	249,000	249,000
Issuance of common stock and options for services rendered and payment of liability	161,000	--	--	161,000
Conversion of Series C preferred stock	--	--	--	0
Issuance of Series D preferred stock and warrants, net of expense of \$34,000	1,461,000	--	--	1,466,000
Beneficial conversion feature of Series D preferred stock and related imputed dividend	1,500,000	(1,500,000)	--	0
Net loss	--	(6,946,000)	--	(6,946,000)

Balance - December 31, 1999	23,941,000	(21,693,000)	(134,000)	2,169,000
Amortization of compensatory stock options	--	--	108,000	108,000
Conversion of Series D preferred stock	--	--	--	--
Exercise of employee & non-employee stock options	2,255,000	--	--	2,260,000
Exercise of Warrants	1,207,000	--	--	1,211,000
Conversion of Notes and Accrued Interest	859,000	--	--	861,000
Compensation charge for issuance of non-qualified stock options	525,000	--	--	525,000
Compensation charge for accelerated vesting of stock options	269,000	--	--	269,000
Beneficial conversion feature of Series D preferred stock underlying notes payable and related debt discount	1,500,000	--	--	1,500,000
Issuance of warrants and options for services	68,000	--	--	68,000
Unearned portion of compensatory warrants	81,000	--	(81,000)	--
Net loss	--	(4,789,000)	--	(4,789,000)
Balance - December 31, 2000 (Audited)	\$ 30,705,000	\$(26,482,000)	\$ (107,000)	\$ 4,182,000
Amortization of compensatory stock options	--	--	17,000	17,000
Conversion of Series D preferred stock	--	--	--	--
Conversion of Notes and Accrued Interest	5,000	--	--	5,000
Amortization of compensatory warrants	--	--	54,000	54,000
Compensation charge for issuance of non-qualified stock options	230,000	--	--	230,000
Compensation charge for issuance of warrants	109,000	--	--	103,000
Net loss	--	(1,012,000)	--	(953,000)
Balance - March 31, 2001 (Unaudited)	\$ 31,049,000	\$(27,494,000)	\$ (36,000)	\$ 3,585,000

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NETWORK-1 SECURITY SOLUTIONS, INC.
STATEMENTS OF CASH FLOWS FOR THE THREE MONTHS ENDED

<TABLE><CAPTION>

	March 31,	
	2001	2000
	(Unaudited)	(Unaudited)
	<C>	<C>
<S>		
Cash flows from operating activities:		
Loss from continuing operations		\$(1,642,000)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:		\$(1,168,000)
Issuance of common stock option and warrants for services rendered	0	43,000
Provision for doubtful accounts	10,000	(5,000)
Amortization of compensatory stock options and warrants		180,000
Depreciation and amortization	96,000	90,000
Changes in:		
Accounts receivable	(196,000)	(87,000)
Prepaid expenses and other current assets		50,000
Accounts payable, accrued expenses and other current liabilities	(50,000)	21,000
Interest Payable	13,000	30,000
Deferred revenue	43,000	22,000
Net cash used in continuing operations		(1,496,000)
Cash provided by (used in) discontinued operations		0
Net cash used in operating activities		(1,067,000)
Cash flows from investing activities:		
Acquisitions of equipment and fixtures		(18,000)
Capitalized software costs	(125,000)	(100,000)
Security deposit	(8,000)	

Loan to officer	0	88,000	
Net proceeds from sale of professional services group		860,000	2,700,000
	-----	-----	
Net cash provided by (used in) investing activities		709,000	2,639,000
	-----	-----	
Cash flows provided by financing activities:			
Proceeds from exercise of options and warrants		0	2,929,000
	-----	-----	
Net increase (decrease) in cash and cash equivalents		(787,000)	4,501,000
Cash and cash equivalents - beginning of period		4,425,000	3,023,000
	-----	-----	
Cash and cash equivalents - end of period		\$ 3,638,000	\$ 7,524,000
	=====	=====	
Supplemental disclosures of noncash investing and financing activity:			
Conversion of notes payable and accrued interest into 1,787 shares of common stock		\$ 5,000	\$ --
	=====	=====	
Compensation charge for non qualified stock options related to employees of discontinued operations		\$ 230,000	\$ 794,000
	=====	=====	

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NETWORK-1 SECURITY SOLUTIONS, INC.
NOTES TO FINANCIAL STATEMENTS

1. FINANCIAL STATEMENT PRESENTATION

a. The financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission with respect to Form 10-QSB. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures made herein are adequate to make the information contained herein not misleading. These interim financial statements and the notes thereto should be read in conjunction with the financial statements included in the Company's Form 10-KSB filed on April 17, 2001 for the year ended December 31, 2000.

In the Company's opinion, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the information shown have been included.

b. The results of operations for the three months ended March 31, 2001 presented herein are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2001.

c. Basic loss per share is calculated by dividing the net loss by the weighted average number of outstanding common shares during the period. Diluted per share data includes the dilutive effects of options, warrants and convertible securities. As all potential common shares are anti-dilutive to the loss from continuing operations, they are not included in the calculation of diluted loss per share.

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

THIS QUARTERLY REPORT ON FORM 10-QSB CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED (THE "EXCHANGE ACT"). ACTUAL RESULTS, EVENTS AND CIRCUMSTANCES (INCLUDING FUTURE PERFORMANCE, RESULTS AND TRENDS) COULD DIFFER MATERIALLY FROM THOSE SET FORTH IN SUCH STATEMENTS DUE TO VARIOUS RISKS AND UNCERTAINTIES, INCLUDING, BUT NOT LIMITED TO, THOSE DISCUSSED IN THE COMPANY'S ANNUAL REPORT ON FORM 10-KSB FOR THE YEAR ENDED DECEMBER 31, 2000 IN THE SECTION ENTITLED "RISK

FACTORS THAT MAY AFFECT FUTURE RESULTS" AS WELL AS THOSE RISKS DISCUSSED ELSEWHERE IN THIS REPORT.

Overview

The Company develops, markets, licenses and supports a family of network security software products designed to provide comprehensive security to computer networks, including Internet based systems and internal networks and computing resources. The Company introduced its first network software product (FireWall/Plus) in June 1995. In January 1999, the Company introduced its CYBERWALLPLUS family of network security products. The Company has made only limited sales of its CYBERWALLPLUS product, upon which an evaluation of its prospects and future performance can be made. Such prospects must be considered in light of the risks, expenses and difficulties frequently encountered in the introduction of new products and the shift from research and product development to commercialization of products based on rapidly changing technologies in a highly specialized and emerging market. The Company will be required to significantly expand its product and development capabilities, introduce new products, introduce enhanced features to existing products, expand its in-house sales force, establish and maintain distribution channels through third-party vendors, increase marketing expenditures, and attract additional qualified personnel. In addition, the Company must adapt to the demands of an emerging and rapidly changing computer network security market, intense competition and rapidly changing technology and industry standards. The Company may not be able to successfully address such risks, and the failure to do so would have a material adverse effect on the Company's business, results of operations and financial condition.

To date, the Company has incurred significant losses and, at March 31, 2001, had an accumulated deficit of \$ 27,494,000. In addition, since March 31, 2001, the Company has continued to incur significant operating losses. The Company expects to incur substantial operating expenses in the future to support its product development activities, as well as continue to expand its domestic and international sales activities and marketing capabilities.

Management believes it currently has cash to fund its operations until December 31, 2001 (or earlier if the Company does not achieve certain revenue assumptions) (See "Liquidity and Capital Resources" on page 11 of this report). The Company is currently seeking additional financing, but it may not be able to secure such financing. The inability of the Company to obtain such financing would have a material adverse effect on the Company requiring it to curtail or possibly cease operations.

In February 2000, the Company completed the sale of its professional services business for a sales price of \$3.815 million which included \$1.115 million held in escrow subject to certain former employees of the Company remaining employed by the purchaser for at least one year and the purchaser securing certain minimum purchase orders within ninety (90) days of the closing. The Company received \$1,000,000 from escrow during the three months ended March 31, 2001 and received the additional \$115,000 in April 2001 plus interest. In connection with the sale, the Company agreed not to offer any professional consulting services competitive with the purchaser until the second anniversary of the closing. Effective upon the sale, the Company granted options to acquire 104,063 shares of Common Stock at \$2.91 per share to certain employees of the professional services business. In connection therewith, the Company incurred a compensation charge of \$794,000 based upon the intrinsic value of the portion of the options vesting at such date and acceleration of other options. The balance of the options vested one year after the closing and an additional charge of \$230,000 was incurred related to these options. The sale has been accounted for by the Company as a sale of a discontinued operation.

The Company's software products have not yet achieved market acceptance. The future success of the Company is largely dependent upon market acceptance of its CYBERWALLPLUS family of software products.

While the Company believes that its family of software products offer advantages over competing products for network security, license revenue from network security software products since the introduction of FireWall/Plus (June 1995), a predecessor product line, through March 31, 2001 has only been \$4,296,000, including a non-refundable pre-paid royalty of \$500,000 in 1997. From January 1999 through March 31, 2001, license revenue from CYBERWALLPLUS has only been

\$1,563,000. CYBERWALLPLUS may not achieve significant market acceptance. Revenue from such commercial products depend on a number of factors, including the influence of market competition, technological changes in the network security market, the Company's ability to design, develop and introduce enhancements on a timely basis, and the ability of the Company to successfully establish and maintain distribution channels. The failure of CYBERWALLPLUS to achieve significant market acceptance as a result of competition, technological change or other factors, would have a material adverse effect on the Company's business, operating results and financial condition.

The Company has committed significant product and development resources to its CYBERWALLPLUS family of products. The Company's anticipated levels of expenditures for product development are based on its plans for product enhancements and new product development. The Company capitalizes and amortizes software development costs in accordance with Statement of Financial Accounting Standards No. 86. These costs consist of salaries, consulting fees and applicable overhead.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2001 COMPARED TO THREE MONTHS ENDED MARCH 31, 2000

Revenues increased by \$265,000 or 138%, from \$192,000 for the three months ended March 31, 2000 to \$457,000 for the three months ended March 31, 2001, primarily as a result of an increase in license revenues during the three months ended March 31, 2001. License revenues increased by \$239,000 or 152%, from \$157,000 for the three months ended March 31, 2000 to \$396,000 for the three months ended March 31, 2001, primarily due to the increased demand in security products. Revenue for the three months ended March 31, 2001 included a large CyberwallPLUS server license issued to a major university totaling \$135,000. The Company recognized \$103,000 in revenue from its distributor in China. In addition, management believes that customers are becoming more aware of the potential impact of security breaches, and that companies are allocating increasing resources to safeguard their assets. Service revenues increased by \$26,000 or 74%, from \$35,000 for the three months ended March 31, 2000 to \$61,000 for the three months ended March 31, 2001 primarily due to increased training revenue. The Company's revenues from customers in the United States represented 89% of its revenues during the three months ended March 31, 2000 and 68% of its revenues during the three months ended March 31, 2001, respectively.

Cost of revenues consists of amortization of software development costs, cost of licenses and cost of services. Amortization of software development costs increased by \$1,000 or 2%, from \$61,000 for three months ended March 31, 2000 to \$62,000 for the three months ended March 31, 2001, representing 39% and 16% of license revenues, respectively.

Cost of licenses consist of software media (disks), documentation, product packaging, production costs and product royalties. Cost of licenses increased by \$8,000 or 133%, from \$6,000 for the three months ended March 31, 2000 to \$14,000 for the three months ended March 31, 2001, each representing 4% of license revenues. Cost of licenses as a percentage of license revenues may fluctuate from period to period due to changes in product mix, changes in the number or size of transactions recorded in a given period or an increase or decrease in licenses of products which would require the Company to pay royalties to third parties.

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Cost of services consists of salaries, benefits and overhead associated with the technical support of maintenance contracts. Cost of services increased by \$34,000 or 121%, from \$28,000 for the three months ended March 31, 2000 to \$62,000 for the three months ended March 31, 2001, representing 80% and 102% of service revenues, respectively. The increase in cost of services in dollar amount and as a percentage of service revenues resulted primarily from increased personnel costs to support the projected sales growth. Cost of services as a percentage of service revenues may fluctuate from period to period due to changes in support headcount and related benefit costs.

Gross profit was \$97,000 for the three months ended March 31, 2000 compared to a gross profit of \$319,000 for the three months ended March 31, 2001, representing 51% and 70% of revenues, respectively. The increase in gross

profit was primarily due to the increase in license revenue.

Product development consists of salaries, benefits, bonuses, travel and related costs of the Company's product development personnel, including consulting fees, the costs of computer equipment used in product and technology development. Product development expense increased \$319,000 or 109%, from \$293,000 for three months ended March 31, 2000 to \$612,000 for the three months ended March 31, 2001, representing 153% and 133% of revenues, respectively. Total product development costs, including capitalized costs of \$100,000 for the three months ended March 31, 2000 and \$125,000 for the three months ended March 31, 2001, were \$393,000 and \$737,000 for the three months ended March 31, 2000 and March 31, 2001, respectively. The increase in total product development costs was due primarily to the use of outside programmers services of \$220,000 and non cash warrant compensation of \$109,000.

Selling and marketing expenses consist primarily of salaries, including commissions, benefits, bonuses, travel, advertising, public relations, consultants and trade shows. Selling and marketing expenses increased by \$408,000 or 84%, from \$488,000 for the three months ended March 31, 2000 to \$896,000 for the three months ended March 31, 2001, representing 254% and 196% of revenues, respectively. The increase in selling and marketing expenses was due primarily to an increase of \$382,000 in personnel costs and travel expenditures related to the hiring of a sales force and personnel hired in 2000 which replaced the use of outside consultants in public relations and marketing.

General and administrative expenses include employee costs, including salary, benefits, travel and other related expenses associated with management, finance and accounting operations, and legal and other professional services provided to the Company. General and administrative expenses decreased by \$23,000, from \$517,000 for the three months ended March 31, 2000 to \$494,000 for the three months ended March 31, 2001, representing 269% and 108% of revenues, respectively. Increases in financing costs of \$39,000, non-cash charges of \$54,000 relating to the amortization of the value of warrants granted to outside consultants in November 2000, and an increase in rent of \$22,000 which was offset by decreases in investor relations expenses of \$52,000, telecommunication costs of \$13,000, professional fees of \$44,000 and non-cash charges of \$26,000 relating to the amortization of the value of stock options granted to the Company's Chief Executive Officer in May 1998.

Net interest income increased by \$8,000 or 24%, from \$33,000 for the three months ended March 31, 2000 to \$41,000 for the three months ended March 31, 2001, representing 17% and 9% of revenues, respectively. The Company completed a Series D Preferred Stock, warrant and promissory note financing on December 22, 1999 and recorded interest expense of \$30,000 related to offering of the promissory notes for the three months ended March 31, 2000 and \$13,000 for the three months ended March 31, 2001.

Income from discontinued operations decreased by \$1,398,000 or 69%, from \$2,028,000 for the three months ended March 31, 2000 to \$630,000 for the three months ended March 31, 2001. Income from discontinued operations for the three months ended March 31, 2001 was due to the payment of \$1,000,000 for retention of all the employees of the professional services group for a period of one year less the \$140,000 retention bonus due the employees of the professional services group and a non-cash charge of \$230,000 relating to the issuance of non-qualified options which were granted on November 8, 2000 at fair market value but were contingent upon the closing of the transaction which resulted in an additional charge for the three months ended March 31, 2001. Additional purchase price of \$115,000 plus interest was still being held in escrow at March 31, 2001 and was received by the Company in April 2001. In connection with such sale, the Company has agreed not to offer any professional or consulting services competitive with those services offered by purchaser for a period of two years from the closing date.

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No provision for or benefit from federal, state or foreign income taxes was recorded for three months ended March 31, 2000 or March 31, 2001 because the Company incurred net operating losses and fully reserved its deferred tax assets as their future realization could not be determined.

As a result of the foregoing, the Company had net income of \$860,000 for the three months ended March 31, 2000 compared with a net loss of \$1,012,000 for the three months ended March 31, 2001.

Liquidity and Capital Resources

The Company's capital requirements have been and will continue to be significant, and its cash requirements have been exceeding its cash flow from operations. At March 31, 2001, the Company had \$3,638,000 of cash and cash equivalents and working capital of \$2,388,000. The Company has financed its operations primarily through private sales of equity and debt securities, the sale of its professional services division on February 10, 2000. Net cash used in operating activities from continuing operations was \$1,077,000 during the three months ended March 31, 2000 and net cash used in operating activities from continuing operations was \$1,496,000 during the three months ended March 31, 2001. Net cash used in operating activities from continuing operations for the three months ended March 31, 2000 was primarily attributable to the net loss from continuing operations of \$1,168,000 and by an increase in accounts receivable of \$87,000 which was partially offset by an increase in depreciation and amortization of \$90,000, the issuance of common stock and warrants for services rendered of \$43,000 and an increase in accrued interest payable of \$30,000. Net cash used in operating activities from continuing operations for three months ended March 31, 2001 was primarily attributable to the net loss from continuing operations of \$1,642,000, an increase in accounts receivable of \$196,000, and a decrease in accounts payable, accrued expenses and other current liabilities of \$50,000, which was partially offset by the amortization and expense of compensatory stock options and warrants for services rendered of \$180,000, depreciation and amortization expense of \$96,000, an increase in accrued interest payable of \$13,000 and an increase in deferred revenue of \$43,000.

In February 2000, the Company sold its professional services business and received proceeds of \$2.7 million. In February 2001, the Company received an additional \$1,000,000 from the sale and received an additional \$115,000 from escrow in April 2001. The Company's operating activities during the three months ended March 31, 2001 were financed primarily with the funds raised in 2000 and the \$1,000,000 received in 2001. The Company does not currently have a line of credit from a commercial bank or other institution.

The Company anticipates, based on currently proposed plans and assumptions (including the timetable of, costs and expenses associated with, and success of, its marketing efforts), that its current cash balance approximately \$3,638,000 as of March 31, 2001 together with certain revenue assumptions from operations, will be sufficient to satisfy the Company's operations and capital requirements through December 2001. There can be no assurance, however, that such funds will not be expended prior thereto. In the event the Company's plans change, or its assumptions change, or prove to be inaccurate (due to unanticipated expenses, difficulties, delays or otherwise), the Company may have insufficient funds to support its operations prior to December 31, 2001. In April 2001, the Company instituted certain measures to reduce its overhead. In addition, the Company is currently seeking financing; however, it does not have any definitive arrangements with respect to any additional financing. Consequently, additional financing may not be available to the Company if needed, on commercially reasonable terms or at all. The inability of the Company to obtain additional financing could have a material adverse effect on the Company, requiring it to curtail and possibly cease its operations. In addition, any additional equity financing may involve substantial dilution to the interests of the Company's then existing stockholders.

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Fluctuations in Operating Results

The Company anticipates significant quarterly fluctuations in its operating results in the future. The Company generally ships orders for commercial products as they are received and, as a result, does not have any material backlog. As a result, quarterly revenues and operating results depend on the volume and timing of orders received during the quarter, which are difficult to forecast. Operating results may fluctuate on a quarterly basis due to factors such as the demand for the Company's products, purchasing patterns and budgeting cycles of customers, the introduction of new products and product enhancements by the Company or its competitors, market acceptance of new products introduced by the Company or its competitors and the size, timing, cancellation or delay of customer orders, including cancellation or delay in anticipation of new product introduction or enhancement. Therefore, comparisons of quarterly operating results may not be meaningful and should not be relied

upon, nor will they necessarily reflect the Company's future performance. Because of the foregoing factors, it is likely that in some future quarters the Company's operating results will be below the expectations of public market analysts and investors. In such event, the price of the Common Stock would likely be materially adversely affected.

The sales cycle for the Company's products can be lengthy and generally commences at the time a prospective customer demonstrates an interest in licensing a CYBERWALLPLUS solution, typically includes a 28-day free evaluation period and ends upon execution of a purchase order by the customer. The length of the sales cycle varies depending on the type and sophistication of the customer and the complexity of the operating system.

Year 2000 Issue

The Company did not incur material costs with respect to potential software issues associated with the Year 2000.

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PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS.

None.

Item 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

On January 15, 2001 and March 15, 2001, the Company issued three year warrants to Lipman Capital Group, Inc. to purchase 20,000 shares of the Company's common stock at \$7.50 per share and \$10.00 per share, respectively. Such warrants were issued in consideration of public relations services related to the agreement. On April 12, 2001, the Company issued Sage Alliance, Inc. (and or its consultants) five year warrants to purchase 179,706 shares of the Company's common stock at \$2.03 per share. Such warrants were issued in consideration for programming services rendered.

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

The exhibits in the following table have been filed as part of this Quarterly Report on Form 10-QSB:

None

b). Reports of Form 8-K.

No reports on Form 8-K were filed during the three (3) months ended March 31, 2001

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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.

NETWORK-1 SECURITY SOLUTIONS, INC.

By: /s/ Avi A. Fogel

Avi A. Fogel, President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Murray P. Fish

Murray P. Fish
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: May 21, 2001

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