YP CORP
Form 10KSB/A
December 01, 2005

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-KSB/A
(Amendment No. 3)

(Mark one)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 2003

o TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition period from ________ to ____________

Commission File Number: 0-24217

YP CORP.
(Name of Small Business Issuer in its Charter)

NEVADA (State or other jurisdiction of incorporation or organization)	85-0206668 (IRS Employer Identification No.)
4840 EAST JASMINE STREET, SUITE 105, MESA, ARIZONA (Address of principal executive offices)	85205 (Zip Code)

(480) 654-9646
(Issuer's telephone number)

Securities registered under Section 12(b) of the Exchange Act: NONE

Securities registered under Section 12(g) of the Exchange Act:

COMMON STOCK, $.001 PAR VALUE
(Title of Class)

YP.NET, INC.
(Former Name)

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 o.

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB o.

Registrant's revenues for its most recent fiscal year were $30,767,444.

The aggregate market value of the common stock held by non-affiliates computed based on the closing price of such stock on December 26, 2003 was approximately $29,600,000.

The number of shares outstanding of the registrant's classes of common stock, as of December 26, 2003 was 48,560,802.

Transitional Small Business Disclosure Format: Yes o No x

DOCUMENTS INCORPORATED BY REFERENCE: None.

EXPLANATORY NOTE

This Amendment on Form 10-KSB/A (this “Amendment”) amends the Annual Report on Form 10-KSB for the year ended September 30, 2003, as originally filed by YP Corp. on December 31, 2003 (the “Original Filing”), and as amended by Amendment No. 1 on Form 10-KSB/A filed on January 30, 2004, and further amended by Amendment No. 2 on Form 10-KSB/A filed on September 23, 2004, solely for the purpose of revising Part II, Items 6, 7 and 8A to amend and restate the disclosure with respect to our accounting for shares issued to, and subsequently recovered from, certain non-performing consultants during 1999 and 2000. The historical financial statements generated by predecessor management reflected an expense upon issuance of the shares and a reversal of this expense when it was deemed (through a settlement agreement or judgment) that these shares would be returned. However, after further analysis and consultation with the Securities and Exchange Commission, it was determined to be inappropriate to recognize the initial expense and its subsequent reversal as no services were rendered by these consultants. Instead, the issuance of these shares will be reflected as temporary equity, together with a related receivable, until the shares were returned. The net decrease to cumulative after-tax income of approximately $510,000 relates to shares issued in 1999 that were expected to be returned but, for various reasons, cannot be obtained. Such amounts will continue to be reflected as expense in the year granted and our revised statements will no longer reflect the reversal of this expense.

In addition, in connection with the filing of this Amendment and pursuant to the rules of the Securities and Exchange Commission, we are including with this Amendment a currently dated consent of our independent public accountants and certain currently dated certifications.

Except as described above, no other changes have been made to the Original Filing. This Amendment continues to speak as of the date of the Original Filing, and, except a specifically stated herein, we have not updated the disclosures contained in this Amendment to reflect any events that occurred at a date subsequent to the filing of the Original Filing. The filing of this Form 10-KSB/A is not a representation that any statements contained in items of the Original Filing other than that information being amended are true or complete as of any date subsequent to the date of the Original Filing. The filing of this Form 10-KSB/A shall not be deemed an admission that the Original Filing or the amendments made thereto, when made, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement not misleading.

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PART II

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS

For a description of our significant accounting policies and an understanding of the significant factors that influenced our performance during the fiscal year ended September 30, 2003, this "Management's Discussion and Analysis" should be read in conjunction with the Consolidated Financial Statements, including the related notes, appearing in Item 7 of this Annual Report.

Forward-Looking Statements

This portion of this Annual Report on Form 10-KSB, includes statements that constitute "forward-looking statements." These forward-looking statements are often characterized by the terms "may," "believes," "projects," "expects," or "anticipates and do not reflect historical facts. Specific forward-looking statements contained in this portion of the Annual Report include, but are not limited to: (i) our expectation that legal costs relating to the litigation involving our CEO will not be significant after December 31, 2003; (ii) our projection that capital expenditures will not increase at the same rate in the future; (iii) our anticipation of the cessation of advances to affiliates and the beginning to pay a cash dividend on our common stock in fiscal 2004; (iv) our belief that our direct mail marketing costs in fiscal 2004 will be consistent with our expenditures in fiscal 2003; and (v) our expectation that initial costs incurred in our branding initiative will not immediately result in financial benefit to the Company.

Forward-looking statements involve risks, uncertainties and other factors, which may cause our actual results, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. Factors and risks that could affect our results and achievements and cause them to materially differ from those contained in the forward-looking statements include those identified in the section below titled "Certain Risk Factors Affecting Our Business," as well as other factors that we are currently unable to identify or quantify, but may exist in the future.

In addition, the foregoing factors may affect generally our business, results of operations and financial position. Forward-looking statements speak only as of the date the statement was made. We do not undertake and specifically decline any obligation to update any forward-looking statements.

Executive Overview

Business Summary

We use a business model similar to print Yellow Page publishers. We publish basic directory listings, free of charge, exclusively on the Internet. Like Yellow Page publishers, we generate virtually all of our revenues from those advertisers that desire increased exposure for their businesses by purchasing our Internet Advertising Package', or IAP. Our basic listings contain the business name, address and phone number for almost 18 million U.S. businesses. We strive to maintain a listing for almost every business in America in this format.

To generate revenues, certain advertisers pay us a monthly fee for our IAP in the same manner that advertisers pay additional fees to traditional print Yellow Page providers for enhanced advertisement font, location or display. The IAP includes a Mini-Webpage', map directions, a toll-free calling feature, a link to the advertiser's own webpage and, at no additional charge, a priority or preferred placement on our website. The users of our website(s) are prospective customers for our advertisers.

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We also offer other ancillary services and products that currently account for less than 5% of our revenue. These ancillary services and products include website design and hosting, and dial-up Internet access.

Sales and Marketing

We employ a direct mail marketing program to solicit our IAP advertisers. Currently, our direct mail marketing program includes a promotional incentive in the form of a $3.25 activation check that a solicited business simply deposits with its bank to activate the service and become an IAP advertiser on a monthly basis. As a method of third-party verification, the potential IAP advertiser’s bank verifies that the depositing party is in fact the solicited business. Upon notice of activation by the IAP advertiser’s bank, we contact the business to confirm the order. Within 30 days of activation, we also send a confirmation card to the business. We offer a cancellation period of 120 days with a full refund. Our direct mail marketing program complies with and, in many instances, exceeds the United States Federal Trade Commission, or “FTC,” requirements as established by an agreement between our company and the FTC.

IAP advertisers

In September 2003, we revised the method by which we count our IAP advertisers. We now differentiate between “paying IAP advertisers” and “activated IAP advertisers.” Paying IAP advertisers, as the name implies, are those advertisers that are actually currently paying for the IAP service. The terms activated IAP advertisers or activated advertisers are broader and more inclusive terms. They include those advertisers that currently are paying for the IAP service, as well as those advertisers that either have signed-up for the IAP service but have not yet been billed or have been billed but have not yet remitted to us their fees.

We believe that the new methodology is more accurate and can be more consistently applied to each period. We also believe that tracking and disclosing the numbers of our activated IAP advertisers, in addition to our paying IAP advertisers, provides greater clarity into our business by providing an indication or forecast of how many activated IAP advertisers may eventually become paying IAP advertisers. Our average retention rate for paying IAP advertisers is approximately 29 months, which, in turn, approaches the average operating life expectancy of 36 months for a small business in the U.S., according to the U.S. Small Business Administration.

Methods of Billing

We bill most of our IAP advertisers on their local telephone bill through their Local Exchange Carrier, or “LEC.” We are one of only a few independent Internet advertisers that are permitted to utilize this unique and cost-efficient method of billing. By billing our IAP advertisers on their local telephone bill, we believe we are able to realize a greater average rate of collection than direct invoice-billing. The amount and frequency of collections on invoice-billed IAP advertisers historically has been significantly lower than for IAP advertisers billed on their monthly telephone bill. Accordingly, our revenues can be negatively impacted if the billing method used to bill a IAP advertiser converts from monthly telephone bill invoicing to direct invoicing.

We are not permitted to bill our IAP advertisers through Competitive Local Exchange Carriers, or CLECs. Recently, the CLEC’s have been participating in providing local telephone services to IAP advertisers at an increasing rate. We have begun to address this problem and we are implementing data filters to reduce the effects of the CLEC’s. We have also sought other billing methods to reduce the adverse effects of the CLEC billings, including Automated Clearing House, or ACH, which is direct debit from the IAP advertiser’s bank account and credit cards. ACH billing now accounts for approximately 12% of our total billings and has reduced our dependency on LEC billing. We expect this trend to continue and escalate.

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Accounting Policies and Procedures

We bill our services monthly and recognize revenue for services billed in that month. We utilize outside billing companies, or billing aggregators, to transmit billing data, much of which is forwarded to the LECs for inclusion on the IAP advertiser's monthly local telephone bill. Because we have a 120-day cancellation policy on new advertiser sign-ups, we accrue for such refunds as a liability and net such anticipated refunds against revenue to report a net revenue number in our financial statements.

The billing aggregators and, subsequently, the LECs filter all billings that we submit to them. We recognize as revenue and accounts receivable the net billings accepted by the LECs. The billing aggregators remit payments to us on the basis of cash that the billing aggregators ultimately receive from the LECs. The billing aggregators and LECs charge fees for their services, which generally are 3% to 7% each on a monthly basis. These fees, in turn, are netted against the gross accounts receivable balance. The billing aggregators and LECs also apply holdbacks to the remittances for potentially uncollectible accounts. These holdbacks and fees result in significant dilution to our gross billings and, therefore, may significantly affect our cash flow.

Due to the periods of time for which adjustments may be reported by the LECs and the billing aggregators, we estimate and accrue for dilution and fees reported subsequent to year-end for initial billings related to services provided for periods within the fiscal year. Dilution amounts will vary due to numerous factors. Accordingly, we may not be certain as to the actual amounts of dilution on any specific billing submittal until several months after that submittal. We estimate the amount of these fees and holdbacks based on historical experience and subsequent information received from the billing aggregators. We also estimate uncollectible account balances and provide an allowance for such estimates.

We process our billings through two primary billing aggregators—PaymentOne, Inc. and ACI Communications, Inc. PaymentOne provides the majority of our billings, collections, and related services.

With respect to our alternative billing methods, we recognize revenue for ACH billings when they are accepted. We recognize revenue for direct-invoice billings based on estimated future collections on such billings. We continuously review these estimates for reasonableness based on our collection experience.

Subscription receivables that result from direct-invoice billing are valued and reported at the estimated future collection amount. Determining the expected collections requires an estimation of both uncollectible accounts and refunds.

Our cost of services is comprised, primarily, of variable costs and expenses, including the following, which are reported in both cost of services and sales and marketing expenses:

- allowances for bad debt, which are based upon historical experience and reevaluated monthly;
- billing fees, such as the fees charged by our billing aggregators and the Local Exchange Carriers;

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- billing aggregator inquiry fees, which generally are 1% on a monthly basis;
- dilution resulting from fees and holdbacks due to items such as wrong telephone numbers and other indications of uncollectibility;
- Internet expenses, such as dial-up expenses; and
- direct mailer marketing costs and the amortization of such costs.

Our general and administrative expenses are comprised, primarily, of fixed costs, including compensation expenses, which generally equate to 5% to 10% of net revenue, as well as other expenses, such as lease payments, telephone, professional fees, and office supplies. We recognize revenue for direct-invoice billings based on estimated future collections on such billings. We continuously review these estimates for reasonableness based on our collection experience.

Critical Accounting Estimates and Assumptions

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires our management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. As such, in accordance with the use of accounting principles generally accepted in the United States of America, our actual realized results may differ from management's initial estimates as reported. A summary of our significant accounting policies are detailed in the notes to the financial statements which are an integral component of this filing.

The following summarizes critical estimates made by management in the preparation of the financial statements:

- ***Revenue Recognition:***

Our revenue is generated by customer subscriptions for directory and advertising services. Our billing and collection procedures include significant involvement of outside parties. We obtain customers through direct mail advertising. When a customer subscribes to our service we create an electronic customer file, which is the basis for the billing. We submit gross billings electronically to third party billing aggregators. These billing aggregators compile and format the information submitted to us and forward the billing records to appropriate LECs. The billing for our service flows through to monthly bills of the individual LEC customers. The LECs collect our billing and remit amounts to the billing aggregators who in turn remit funds to us. Within this process, there are numerous adjustments, charges and holdbacks implemented by the billing aggregators and LEC's.

o Customer refunds. We have a customer refund policy that allows the customer to request a refund if they are not satisfied with the service within the first 120 days of the subscription. We accrue for refunds based on historical experience of refunds as a percentage of new billings in that 120-day period. Estimated refunds are reserved and charged to net revenue.

Additionally, there are customers who may not pay the fee for our services even though we believe they are valid subscribers. We review the trend of non-paying customers and include a reserve as a charge to revenue for estimated non-paying customers.

o Unbillable records. We recognize revenue during the month for which the service is provided based on net billings accepted by the billing aggregators. The billing aggregators may reject and return billing records to us if there is no immediate match in their database as a valid “Billing Telephone Number” (“BTN”). We analyze the trend of accepted vs. rejected billing records. Only accepted records are recognized as revenue. We then analyze the reasons for a record being rejected and then attempt to correct the record for resubmittal. Because there may be a period of 30-60 days to obtain information from the billing aggregators that identify BTNs, we estimate that amount when billed and those billings are excluded from revenue.

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- o Direct bill customers. We bill many subscribers directly. Our collection rate on these billings is significantly lower than those processed through the LECs. We track collections on direct billed customers and recognize revenue from those customers based on the historical collection rates. Our recent collection experience on these billings is approximately 10% to 12%.

- o Dilution and Related Reserves. We reserve for future fees, chargebacks and holdbacks charged by the LECs and third party billing aggregators that are related. Because there may be a period of time from when the billings are initiated and fees and holdbacks are adjusted and processed by the billing aggregators, we estimate those fees based on contractual agreements with the billing aggregators and historical experience. Fees and expenses charged by the LECs and billing aggregators are charged to cost of services and netted against gross accounts receivable. Total dilution has approximated 25% to 30% of gross billings.

· ***Allowance for Doubtful Accounts:***

Cash is received through the process discussed above. We have contractual advance rates with our third party billing aggregators. The billing aggregators report to us their holdbacks. These holdbacks include those submitted by the LECs. Some of these holdbacks may take 12-18 months to collect and “true-up” with the billing aggregators. We estimate an allowance for doubtful accounts on the basis of information provided by the billing aggregators. This information is an indicator of timely payments made by our subscribers. At September 30, 2003, the allowance for doubtful accounts was approximately 30% of gross accounts receivable.

· ***Carrying Value of Intellectual Property:***

The carrying value of our intellectual property at September 30, 2003, relates primarily to the purchase of the Yellow-Page.Net Universal Resource Locator (“URL”) from Telco Billing. The URL is recorded at its $5,000,000 purchase price less accumulated amortization of $1,820,517. We have estimated the useful life of this asset to be 20 years.

We believe that based on our current income and cash flow, the carrying value of the URL is not impaired at September 30, 2003. We believe our customers use this URL for maintaining their subscriptions to the Company’s service. The Company has had an unaffiliated, independent third party appraiser perform a valuation of the URL. That valuation also supports the conclusion that the value is not impaired at September 30, 2003.

· ***Capitalization of Direct Response Advertising Costs and Amortization Thereof:***

The Company purchases mailing lists and sends advertising materials to prospective subscribers from those mailing lists. Customers subscribe to the services by positively responding to those advertising materials, which serve as the contract for the subscription. The Company capitalizes and amortizes the costs of direct-response advertising on a straight-line basis over eighteen months, the estimated average period of retention for new customers. We believe that when a customer is retained through the 120-day refund period, long term retention is longer than be 18 month amortization period. However, due to attrition in the first months of a new subscription, the amortization period has been determined to the 18 months. The carrying value of $3,243,241 includes the gross cost of approximately $6,157,017 less amortization of $2,913,776.

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· ***Income Taxes:***

Management evaluates the probability of the utilization of the deferred income tax assets. The Company has estimated a $1,641,000 deferred income tax asset at September 30, 2003. Of that amount, $979,000 related to net operating loss carryforwards at September 30, 2003. Management determined that because the Company has been generating taxable income it was appropriate to recognize the deferred income tax asset related to the net operating loss carryforward. Management is required to make judgments and estimates related to the timing and utilization of net operating loss carryforwards, utilization of other deferred income tax assets, applicable tax rates and feasible tax planning strategies.

Future Outlook

We expect to make progress on a number of initiatives over the next six to twelve months, including the following:

- attempt to get listed on a national exchange or quotation system;
- add additional independent directors to our Board of Directors;
- establish an audit committee that fully complies with the requirements of Sarbanes-Oxley and the exchanges;
- engage a national auditing firm;
- obtain broader, more sophisticated and more reliable research coverage; and
- roll out our national branding campaign through various mediums of advertisement, including, Internet, billboard, radio and cable television in select markets to be determined. We have recently engaged a marketing firm. We expect to use approximately $2,000,000 on this campaign over the next 18 months. This may have a negative impact on our margins. However, to mitigate any adverse impact, management intends to attempt to incur these expenses gradually to be commensurate with anticipated increases in revenues resulting from the branding campaign.

Recent Developments

Litigation by others against our Chairman and CEO

By order of the Board of Directors, we have been funding the litigation defense of our Chairman and CEO, Angelo Tullo, as it related to claims made by New Horizon Capital, LLC (“New Horizon”), the successor in interest to American Business Funding Corp. These claims were not adverse to the Company. However, the Board of Directors determined that clearing Mr. Tullo’s name was important to our future success because of the results he has achieved on behalf of our investors.

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In December 2003, New Horizon agreed to have the litigation against Mr. Tullo dismissed. New Horizon was ordered by the judge to pay, and has paid, $10,000 to Mr. Tullo's lawyers as compensation for certain expert witness fees that were to be paid by Mr. Tullo.

We will finish paying for the expenses relative to this case in the second quarter of fiscal 2004 and no further significant expenses are expected to be incurred after December 31, 2003.

Termination of the Revolving Loan Agreements With Our Major Shareholders—Mathew and Markson and Morris & Miller, LTD ("M&M's")

As part of the original acquisition of our subsidiary, Telco Billing, from the M&Ms, we provided them with the right to "put" back to us their shares of Company common stock under certain circumstances. We subsequently entered into a new arrangement with the M&Ms, whereby their "put" rights were terminated in exchange for the establishment of revolving lines of credit. Under these lines of credit, we agreed to lend up to $10 million to each of the M&Ms, subject to certain limitations.

In December 2003, we entered into an agreement with the M&M's to terminate the revolving lines of credit previously provided to them. Under this termination agreement, which is effective as of April 9, 2004, we are to make final advancements to the M&Ms of approximately $1,300,000. The aggregate of all advances made by the Company to these shareholders is to be repaid to the Company at the end of three years, along with accrued interest.

The schedule of final advances that we are to make to the M&Ms under the termination agreement are as follows:

Morris & Miller, Ltd.

$275,000 on January 30, 2004
$300,000 on February 27, 2004
$500,000 on March 31, 2004
Sufficient funds to pay 3 years interest on April 9, 2004

Mathew and Markson, Ltd.

$50,000 on January 30, 2004
$100,000 on February 27, 2004
$75,000 on March 31, 2004
Sufficient funds to pay 3 years interest on April 9, 2004

Within ten days after April 9, 2004, the M&M's will prepay all of the interest on their loans for the next 36 months. We will continue to retain pledged stock as collateral for the repayment of all such loans, which, by agreement, mature December 2006.

As part of this new agreement, we have also agreed to pay a quarterly dividend of not less than $.01 per share beginning April 30, 2004 for the period ended March 31, 2004. We believe this is in the best interests of all of our shareholders.

Termination of Our Relationship with Simple.Net.

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On December 29, 2003, we entered into a separation agreement with Simple.Net, a company beneficially owned by our Director and Corporate Secretary DeVal Johnson, which becomes effective January 31, 2004.

Prior to this agreement, we purchased Internet Dial Up access from Simple.net and performed various services for Simple.Net for a fee. These services included Customer Service support for Simple.Net's customers and Technology Support and Billing assistance. At the time the contract(s) were entered into, this was beneficial to us because we did not have sufficient dial-up customers to avoid a minimum fee to the backbone providers, which are companies that own the cable and copper wire cables necessary to provide the service. As our customer base has grown, we are now able to economically enter into our own wholesale contract and in fact have with GlobalPOPs.

In addition, at this time, our revenues from the customer support and technology assistance was essentially the same as that currently paid to Simple.Net to provide the dial up service. We will not be affected by the loss in revenue from Simple.Net as the new contract from GlobalPOPs, which now has no minimum guarantees, is low enough to offset the difference.

Results of Operations

Fiscal Year End September 30, 2003 Compared to Fiscal Year End September 30, 2002.

Net revenue for the year ended September 30, 2003 ("Fiscal 2003") was $30,767,444 compared to $12,618,126 for the year ended September 30, 2002 ("Fiscal 2002") representing an increase of approximately 144%. This increase in net revenue is the result of three factors: an increase in the number of our IAP Advertisers, the conversion of certain Advertisers from direct bill invoice to monthly telephone billing and an increase in our monthly pricing. These three factors are discussed further below.

Our IAP Advertiser count increased to 255,376 at September 30, 2003 compared to 113,565 at September 30, 2002, an increase of approximately 125%. Relating to the conversion of certain Advertisers to monthly telephone billing, in August, 2003, we analyzed our database of IAP Advertisers that were being billed via direct monthly invoice to determine which of these Advertisers were eligible to be billed on their monthly telephone bill. As a result of this analysis, we determined that 46,717 Advertisers were eligible for monthly telephone billing. As previously described under **"Billing"** and in the Financial Statement footnotes, our revenue recognition and collections are significantly higher when Advertisers are billed on their monthly telephone bills rather than through direct invoice. Relating to our price increase, we now charge $21.95 monthly versus $17.95 previously for new IAP Advertisers. In addition, the monthly charge to existing IAP Advertisers was increased to $24.95 monthly upon the first anniversary of their listing. This price increase was instituted on March 20, 2003.

We recently revised the method by which we count our customers. We believe that the new methodology is more accurate and can be more consistently applied to each period. We believe that the disclosure of customer counts including total Activated customers and paying customers provides the most insight into our business.

Activated customers include those Advertisers that are currently paying for the IAP service, as well as those Advertisers that have signed-up for the IAP service but have not necessarily been billed and begun their payment for the service. Based upon these revisions, we had 255,376 Activated IAP customers at September 30, 2003, 235,162 Activated IAP customers at June 30, 2003, 222,092, Activated IAP customers at March 31, 2003 and 168,980 Activated IAP customers at December 31, 2002.

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Regarding Paying customers, the Company had 221,537 Paying customers at September 31, 2003, 167,000 Paying customers at June 30, 2003, 151,173 paying customers at March 31, 2003 and 137,346 Paying customers at December 31, 2002.

Cost of services for Fiscal 2003 was $8,473,768 compared to $3,497,678, an increase of 142%. The increase in cost of services is due to the increased IAP customer count, as well as the increase in our direct mail solicitation effort whereby we are currently mailing, on average, approximately 1 million mailers to businesses each month. Cost of services as a percent of net revenue was approximately 27% for Fiscal 2003 compared to 28% for Fiscal 2002. Gross margins improved to 73% in Fiscal 2003 compared to 72% in Fiscal 2002. The improvement in gross margin results from the leveraging of certain fixed costs, included in cost of services, over a larger customer base.

General and administrative expenses for Fiscal 2003 were $8,657,690 compared to $4,754,665 for Fiscal 2002, an increase of approximately 82%. General and administrative expenses increased due to an increase in costs and employees relating to our previously-described growth in IAP Advertisers, the establishment in Fiscal 2003 of our Quality Assurance and Outbound departments as well as an increase in certain officers' compensation relating to employment contracts with such officers. In addition, during Fiscal 2003, the Company paid $410,054 for the costs of defending a civil action filed against its CEO and Chairman pursuant to a Board of Directors resolution. The action involved a business in which the CEO was formerly involved. The Board believed that it was important and in our best interests and in the best interests of our shareholders to resolve this matter as soon as possible. As described under "Recent Developments," this matter has now been resolved and we no longer expect to incur significant legal costs after December 31, 2003 relating to this matter. Excluding the previously described legal costs, general and administrative expenses increased approximately 67% in Fiscal 2003 over Fiscal 2003. As a percent of net revenue, general and administrative expenses were approximately 28% in Fiscal 2003 compared to approximately 38 % in Fiscal 2002. Excluding the previously-described legal costs, general and administrative expenses as a percent of net revenue was approximately 26% in Fiscal 2003 compared to 38% in Fiscal 2002.

Sales and marketing expenses for Fiscal 2003 were $3,868,643 compared to $963,868 for Fiscal 2002, an increase of approximately 300%. The increase was principally the result of our re-instituting our marketing efforts in the latter part of Fiscal 2002 with the full annual cost of such effort in Fiscal 2003. The marketing expenses are attributed to our direct response marketing, which is our primary source of attracting new Advertisers. As a percent of net revenue, sales and marketing expense was approximately 13% in Fiscal 2003 versus approximately 8% in Fiscal 2002.

Depreciation and amortization was $660,475 in Fiscal 2003 compared to $581,290 in Fiscal 2002, an increase of approximately 14%. This increase was primarily the result of a substantial upgrade of our information technology systems as well as hardware purchased relating to the establishment of our Quality Assurance and Outbound marketing departments. These efforts involved capital expenditures of $736,955 in Fiscal 2003 compared to 77,632 in Fiscal 2002. We do not anticipate capital expenditures to grow at this same rate in the future. In addition, amortization increased in Fiscal 2003 as a result of our agreement with OnRamp Access, Inc. to license the YP.Com Uniform Resource Locator ("URL").

The cost of the Yellow-Page.Net URL was capitalized at its cost of $5,000,000.
The URL is amortized on an accelerated basis over the twenty-year term of the licensing agreement. Amortization expense on the URL was $351,933 for the year ended September 30, 2003. Annual amortization expense in future years related to this URL is anticipated to be approximately $350,000-450,000.

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Operating income in Fiscal 2003 was $9,106,890 compared to $2,820,625 in fiscal 2002 representing an increase of approximately 223%. As a percent of net revenue, operating income was approximately 30 % in Fiscal 2003 versus approximately 22% in Fiscal 2002. The increase in operating income resulted from the previously mentioned increases in net revenue as well as the leveraging of part of our fixed costs, included in cost of services and general and administrative expenses, over a larger customer base

Interest expense for Fiscal 2003 was $19,728 compared to $92,341 for Fiscal 2002. The decrease in interest expense was a result of decreased debt due to the repayment of approximately $800,000 of debt in Fiscal 2002.

Interest income was $108,995 in Fiscal 2003 compared to $17,682 in Fiscal 2002 resulting from our increased profitability and cash.

Other expense (income) was a net of $291,002 in income in Fiscal 2003 versus $436,848 of income in Fiscal 2002. The primary components of other income are technical and service income from Simple.net ($618,612 and $300,900, in Fiscal 2003 and 2002, respectively), offset by legal expenses incurred relating to stock settlements of $240,935 in Fiscal 2003.

Income before income taxes was $9,487,159 in Fiscal 2003 and $3,182,814 in Fiscal 2002, representing an increase of approximately 198%. As a percent of net revenue, income before income taxes was 31% in Fiscal 2003 compared to 25% in Fiscal 2002.

The income tax provision was $1,871,293 in Fiscal 2003 compared to an income tax benefit of $342,082 in Fiscal 2002. The increase in the income tax provision is the result of our increased profitability in Fiscal 2003 offset by the use of our net operating loss carryforwards. During Fiscal 2003 and 2002, our structured certain transactions related to its merger with Telco that allowed the Company to utilize net operating losses that were previously believed to be unavailable or limited under the change of control rules of Internal Revenue Code 382.

Net income for Fiscal 2003 was $7,615,866, or $0.17 per share, compared to $2,840,732 or $0.06 per share for Fiscal 2002, an increase in net profit of approximately 114% despite a much higher tax provision in Fiscal 2003. The increase in net income resulted from the increased IAP Advertiser count and associated revenue cited above with a less than corresponding increase in expenses cited above offset by the greater tax provision in Fiscal 2003. Net profit as a percent of revenue increased to approximately 25% in Fiscal 2003 from 23%% in Fiscal 2002.

Liquidity and Capital Resources

Our cash balance increased to $2,378,848 for Fiscal 2003 from $767,108 for Fiscal 2002. We funded working capital requirements primarily from cash generated from operating activities and utilized cash in investing activities and financing activities.

Operating Activities. Cash provided by operating activities was $4,762,238 for Fiscal 2003 compared to $1,158,015 for Fiscal 2002. The principal source of our operations revenue is from sales of Internet Yellow Page advertising. The increase in cash provided from operations resulted from an increase in net profit offset by an increase in our accounts receivable, deferred income taxes and customer acquisition costs which also increased as a result of our increased profitability and the continuation of our direct mail marketing solicitation effort.

Investing Activities. Cash used by investing activities was $2,798,500 for Fiscal 2003 compared to $244,077 for Fiscal 2002. Advances to affiliates increased to $1,893,131 in Fiscal 2003 compared to $116,757 in Fiscal 2002. As described under "Recent Developments," advances to affiliates are expected to cease in Fiscal 2004. We intend to institute a quarterly $0.01 per share dividend on our common stock at that time. In Fiscal 2003, we purchased

$736,955 of equipment compared to $77,632 in Fiscal 2002. Increased computer purchases in Fiscal 2003 resulted from the previously described upgrade to our information technology systems as well as the establishment of our Quality Assurance and Outbound efforts. We do expect capital expenditures to increase at this same growth rate in the future. Expenditures for intellectual property increased to $261,545 in Fiscal 2003 compared to $49,688 in Fiscal 2002. This increase primarily resulted from the licensing of the YP.Com URL from OnRamp Access, Inc.

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Financing Activities. Cash flows used from financing activities were $351,998 for Fiscal 2003 compared to $830,677 for Fiscal 2002. Regarding debt proceeds, we borrowed $378,169 in Fiscal 2003 from two credit facilities. These credit facilities are maintained primarily for safety and security back-up purposes as our cash flow is generally more than sufficient to maintain and grow the business. In Fiscal 2003, we established a Trade Acceptance Draft program with Actrade Financial Technologies ("Actrade"), which enables us to borrow up to $150,000. A trade acceptance draft ("TAD") is a draft signed by us and made payable to the order of a vendor providing us services. AcTrade provides payment to the vendor and collects from us the amount advanced to the vendor (plus interest) under extended payment terms, generally 30, 60 or 90 days. When used, we pay a rate of one percent per month of the amount of the TAD. There is no term to the agreement with Actrade and either party may terminate the agreement at any time.

We understand that AcTrade is currently in Chapter 11 bankruptcy. Therefore, the availability of this facility is uncertain. During Fiscal 2003, we signed an unsecured credit facility of $250,000 with Bank of the Southwest. The facility is for one year and interest on borrowings, if any, will be an interest rate of 0.5% above the Prime Rate, as defined. During recent discussions with the Bank of the Southwest, it was indicated to us that this credit facility will not be renewed as a result of their desire to focus on relationships with private rather than public companies. In Fiscal 2004, we expect to pursue other credit facilities to replace the aforementioned credit facilities.

We incurred debt in the acquisition of the license right to the Yellow-Page.Net URL. A total of $4,000,000 was borrowed, $2,000,000 from Joseph and Helen Van Sickle, $1,000,000 from our shareholders and $2,000,000 as a Note from Mathew & Markson Ltd. We had dedicated payments in the amount of $100,000 per month for the payment of the Van Sickle note, which was paid in full in early Fiscal 2003. The original note has been paid in full while a balance of $115,866 remains on another note to Mathew & Markson.

We had cash outflow of $685,167 in Fiscal 2003 relating to the repayment of borrowing on our credit facilities and the payment of $160,000 on the remaining Van Sickle note and cash outflow of $830,677 in Fiscal 2002 resulting from the repayment of our credit facility relating to Mathew & Markson Ltd.

As previously described, collections on accounts receivables are received primarily through the billing service aggregators under contract to administer this billing and collection process. The billing service aggregators generally do not remit funds until they are collected. The billing companies maintain holdbacks for refunds and other uncertainties. Generally, cash is collected and remitted to us over a 90 to 120 day period subsequent to the billing dates. In August 2002, we entered into a new agreement with its primary billing service provider, PaymentOne, whereby cash is remitted to us on a sixty day timetable beginning November 2002.

We market our products primarily through the use of direct mailers to businesses throughout the United States. We generally pay for these marketing costs when incurred and amortize the costs of direct-response advertising on a straight-line basis over eighteen months. The amortization lives are based on estimated attrition rates. During Fiscal 2003, we paid $4,738,790 in advertising and marketing compared to $1,941,037 in Fiscal 2002. We anticipate the outlays for direct-response advertising to remain consistent over the next year.

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We have an agreement with two of our largest shareholders, Morris & miller, Ltd. and Mathew and Markson, Ltd., which is memorialized in a third Amendment to the original Stock Purchase Agreement. This agreement cancels the prior revolving lines of credit with these parties effective April 9, 2004 upon the payment of the following final specific advances to each of them:

Morris & Miller, Ltd.

$275,000 on January 30, 2004
$300,000 on February 27, 2004
$500,000 on March 31, 2004
Sufficient funds to pay 3 years interest on April 9, 2004

Mathew and Markson, Ltd.

$50,000 on January 30, 2004
$100,000 on February 27, 2004
$75,000 on March 31, 2004
Sufficient funds to pay 3 years interest on April 9, 2004

Prior to December 31, 2003, our Board of Directors created YP Charities, an Internal Revenue Code 501(c)(3) corporation, established to make charitable contributions to worthy causes on our behalf and to encourage other companies that are good corporate citizens to do the same. YP Charities is not a subsidiary of the Company. It is a non-member, non-profit entity controlled and run exclusively by the board of directors of YP Charities, which is currently comprised of certain officers and directors of the Company. As of this filing, we have not remitted any amounts to YP Charities but plan to contribute $100,000 during fiscal 2004.

Certain Risk Factors Affecting Our Business

Our business is subject to numerous risks, including those discussed below. If any of the events described in these risks occurs, our business, financial condition and results of operations could be seriously harmed.

Risks Related to Our Business

We have a relatively limited operating history upon which investors can evaluate the likelihood of our success.

We have been engaged in the Internet-based Yellow Pages industry through our subsidiary, Telco Billing, since 1997. As a result, an investor in our securities must consider the uncertainties, expenses, and difficulties frequently encountered by companies such as ours that are in the early stages of development. Investors should consider the likelihood of our future success to be highly speculative in light of our relatively limited operating history, as well as the challenges, limited resources, expenses, risks, and complications frequently encountered by similarly situated companies in the early stages of development, particularly companies in new and rapidly evolving markets such as Internet Yellow Pages. To address these risks and to sustain profitability, we must, among other things:

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- maintain and increase our base of advertisers;
- increase the number of users who visit our web sites for online directory services;
- implement and successfully execute our business and marketing strategy;
- continue to develop and upgrade our technology;
- continually update and improve our service offerings and features;
- provide superior IAP advertiser service;
- respond to industry and competitive developments;
- successfully manage our growth while controlling expenses; and
- attract, retain, and motivate qualified personnel.

We may not be successful in addressing these risks. If we are unable to do so, our business, prospects, financial condition, and results of operations would be materially and adversely affected.

Our success depends upon our ability to establish and maintain relationships with our advertisers.

Our ability to generate revenue depends upon our ability to maintain relationships with our existing advertisers, to attract new advertisers to sign up for revenue-generating services, and to generate traffic to our advertisers' websites. We primarily use direct marketing efforts to attract new advertisers. These direct marketing efforts may not produce satisfactory results in the future. We attempt to maintain relationships with our advertisers through IAP advertiser service and delivery of traffic to their businesses. An inability to either attract additional advertisers to use our service or to maintain relationships with our advertisers could have a material adverse effect on our business, prospects, financial condition, and results of operations.

If we do not introduce new or enhanced offerings to our advertisers and users, we may be unable to attract and retain those advertisers and users, which would significantly impede our ability to generate revenue.

We will need to introduce new or enhanced products and services in order to attract and retain advertisers and users and remain competitive. Our industry has been characterized by rapid technological change, changes in advertiser and user requirements and preferences, and frequent new product and service introductions embodying new technologies. These changes could render our technology, systems, and website obsolete. We may experience difficulties that could delay or prevent us from introducing new products and services. If we do not periodically enhance our existing products and services, develop new technologies that address our advertisers' and users' needs and preferences, or respond to emerging technological advances and industry standards and practices on a timely and cost-effective basis, our products and services may not be attractive to advertisers and users, which would significantly impede our revenue growth. In addition, our reputation and our brand could be damaged if any new product or service introduction is not favorably received.

Our revenue may decline over time.

We have experienced a decrease in revenue from the Local Exchange Carriers (LEC) from the effects of the Competitive Local Exchange Carriers (CLEC) that are participating in providing local telephone services to IAP advertisers. We have begun to address this problem and we are implementing data filters to reduce the effects of the CLECs. We have also sought other billing methods to reduce the adverse effects of the CLEC billings. These other billing methods may be cheaper or more expensive than our current LEC billing and we have not yet determined if they will be less or more effective. We cannot provide any assurances that our efforts will be successful and may experience future decreases in revenue.

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Our quarterly results of operations could fluctuate due to factors outside of our control, which may cause corresponding fluctuations in the price of our securities.

Our net sales may grow at a slower rate on a quarter-to-quarter basis than we have experienced in recent periods. Factors that could cause our results of operations to fluctuate in the future include the following:

- fluctuating demand for our services, which may depend on a number of factors including:
  - changes in economic conditions and our IAP advertisers' profitability,
  - varying IAP advertiser response rates to our direct marketing efforts,
  - our ability to complete direct mailing solicitations on a timely basis each month,
  - changes in our direct marketing efforts,
  - IAP advertiser refunds or cancellations, and
  - our ability to continue to bill IAP advertisers on their monthly telephone bills, ACH or credit card rather than through direct invoicing;
- timing of new service or product introductions and market acceptance of new or enhanced versions of our services or products;
- our ability to develop and implement new services and technologies in a timely fashion to meet market demand;
- price competition or pricing changes by us or our competitors;
- new product offerings or other actions by our competitors;
- month-to-month variations in the billing and receipt of amounts from Local Exchange Carriers (LEC), such that billing and revenues may fall into the subsequent fiscal quarter;
- the ability of our check processing service providers to continue to process and provide billing information regarding our solicitation checks;
- the amount and timing of expenditures for expansion of our operations, including the hiring of new employees, capital expenditures, and related costs;
- technical difficulties or failures affecting our systems or the Internet in general;
- a decline in Internet traffic at our website;
- the cost of acquiring, and the availability of, information for our database of potential advertisers; and
- the fact that our expenses are only partially based on our expectations regarding future revenue and are largely fixed in nature, particularly in the short term.

The fluctuation of our quarterly operating results, as well as other factors, could cause the market price of our securities to fluctuate significantly in the future. Some of these factors include:

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- the announcement of new IAP advertisers or strategic alliances or the loss of significant IAP advertisers or strategic alliances;
- announcements by our competitors;
- sales or purchases of our securities by officers, directors and insiders;
- government regulation;
- announcements regarding restructuring, borrowing arrangements, technological innovations, departures of key officers, directors or employees, or the introduction of new products;
- political or economic events and governmental actions affecting Internet operations or businesses; and
- general market conditions and other factors, including factors unrelated to our operating performance or that of our competitors.

Investors in our securities should be willing to incur the risk of such price fluctuations.

Our ability to efficiently process new advertiser sign-ups and to bill our advertisers monthly depends upon our check processing service providers and billing aggregators, respectively.

We currently use three check processing companies to provide us with advertiser information at the point of sign-up for our Internet Advertising Package. One of these processors has indicated that it will be outsourcing this function in the future. Therefore, we have refrained from sending new business to this check processor. Our ability to gather information to bill our advertisers at the point of sign-up could be adversely affected if one or more of these providers experiences a disruption in its operations or ceases to do business with us.

We also depend upon our billing aggregators to efficiently bill and collect monies from the Local Exchange Carriers (LEC) relating to the LEC's billing and collection of our monthly charges from advertisers. We currently have agreements with two billing aggregators. Any disruption in our billing aggregators' ability to perform these functions could adversely affect our financial condition and results of operations.

The loss of our ability to bill IAP advertisers through Local Exchange Carriers on the IAP advertisers' telephone bills would adversely impact our results of operations.

Our business model depends heavily upon our ability to bill advertisers on their telephone bills through their respective Local Exchange Carriers (LEC). The existence of the LECs is the result of Federal legislation. In the same manner, Congress could pass future legislation that obviates the existence of or the need for the LECs. Additionally, regulatory agencies could limit or prevent our ability to use the LECs to bill our advertisers. Finally, the introduction of and advancement of new technologies, such as WiFi technology or other wireless-related technologies, could render unnecessary the existence of fixed telecommunication lines, which, accordingly, would again obviate the need for and access to the LECs. Our inability to use the LECs to bill our advertisers through their monthly telephone bills would have a material adverse impact on our results of operations.

We depend upon third parties to provide certain services and software, and our business may suffer if the relationships upon which we depend fail to produce the expected benefits or are terminated.

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We currently outsource to third parties certain of the services that we provide, including the work of producing usable templates for and hosting of the QuickSites, website templates known as Ezsites, and wholesale Internet access. These relationships may not provide us benefits that outweigh the costs of the relationships. If any strategic supplier demands a greater portion of revenue derived from the services it provides or increases charges for its services, we may decide to terminate or refuse to renew that relationship, even if it previously had been profitable or otherwise beneficial. If we lose a significant strategic supplier, we may be unable to replace that relationship with other strategic relationships with comparable revenue potential. The loss or termination of any strategic relationship with one of these third-party suppliers could significantly impair our ability to provide services to our advertisers and users.

We depend upon third-party software to operate certain of our services. The failure of this software to perform as expected would have a material adverse effect on our business. Additionally, although we believe that several alternative sources for this software are available, any failure to obtain and maintain the rights to use such software would have a material adverse effect on our business, prospects, financial condition and results of operations. We also depend upon third parties to provide services that allow us to connect to the Internet with sufficient capacity and bandwidth so that our business can function properly and our websites can handle current and anticipated traffic. Any restrictions or interruption in our connection to the Internet would have a material adverse effect on our business, prospects, financial condition, and results of operations.

The market for our services is uncertain and is still evolving.

Internet Yellow Pages services are evolving rapidly and are characterized by an increasing number of market entrants. Our future revenues and profits will depend substantially upon the widespread acceptance and the use of the Internet and other online services as an effective medium of commerce by merchants and consumers. Rapid growth in the use of and interest in the Internet may not continue on a lasting basis, which may negatively impact Internet-based businesses such as ours. In addition, advertisers and users may not adopt or continue to use Internet-base Yellow Pages services and other online services that we may offer in the future. The demand and market acceptance for recently introduced services generally is subject to a high level of uncertainty.

Most potential advertisers have only limited, if any, experience advertising on the Internet and have not devoted a significant portion of their advertising expenditures to Internet advertising. Advertisers may find Internet Yellow Pages advertising to be less effective for meeting their business needs than traditional methods of Yellow Pages or other advertising and marketing. Our business, prospects, financial condition or results of operations will be materially and adversely affected if potential advertisers do not adopt Internet Yellow Pages as an important component of their advertising expenditures.

We may not be able to secure additional capital to expand our operations.

Although we currently have no material long-term needs for capital expenditures, we will likely be required to make increased capital expenditures to fund our anticipated growth of operations, infrastructure, and personnel. We currently anticipate that our cash on hand, together with cash flows from operations, will be sufficient to meet our anticipated liquidity needs for working capital and capital expenditures over the next 12 months. In the future, however, we may seek additional capital through the issuance of debt or equity depending upon our results of operations, market conditions or unforeseen needs or opportunities. Our future liquidity and capital requirements will depend on numerous factors, including the following:

· the pace of expansion of our operations;

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- our need to respond to competitive pressures; and

- future acquisitions of complementary products, technologies or businesses.

Our forecast of the period of time through which our financial resources will be adequate to support our operations is a forward-looking statement that involves risks and uncertainties and actual results could vary materially as a result of the factors described above. As we require additional capital resources, we may seek to sell additional equity or debt securities or draw on our existing bank line of credit. Debt financing must be repaid at maturity, regardless of whether or not we have sufficient cash resources available at that time to repay the debt. The sale of additional equity or convertible debt securities could result in additional dilution to existing stockholders. We cannot provide assurance that any financing arrangements will be available in amounts or on terms acceptable to us, if at all.

We must manage our growth and maintain procedures and controls on our business.

We have rapidly and significantly expanded our operations and we anticipate further significant expansion to accommodate the expected growth in our IAP advertiser base and market opportunities. We have increased the number of our personnel from the inception of our operations to the present. This expansion has placed, and is expected to continue to place, a significant strain on our management and operational resources. As a result, we may not be able to effectively manage our resources, coordinate our efforts, supervise our personnel or otherwise successfully manage our resources. We have recently added a number of key managerial, technical, and operations personnel and we expect to add additional key personnel in the future. We also plan to continue to increase our personnel base. These additional personnel may further strain our management resources.

The rapid growth of our business could in the future strain our ability to meet IAP advertiser demands and manage our IAP advertiser relationships. This could result in the loss of IAP advertisers and harm our business reputation.

In order to manage the expected growth of our operations and personnel, we must continue maintaining and improving or replacing existing operational, accounting, and information systems, procedures, and controls. Further, we must manage effectively our relationships with our IAP advertisers, as well as other third parties necessary to our business. Our business could be adversely affected if we are unable to manage growth effectively.

We depend upon our executive officers and key personnel.

Our performance depends substantially on the performance of our executive officers and other key personnel. The success of our business in the future will depend on our ability to attract, train, retain and motivate high quality personnel, especially highly qualified technical and managerial personnel. The loss of services of any executive officers or key personnel could have a material adverse effect on our business, results of operations or financial condition. We do not maintain key person life insurance on the lives of any of our executive officers or key personnel.

Competition for talented personnel is intense, and there is no assurance that we will be able to continue to attract, train, retain or motivate other highly qualified technical and managerial personnel in the future. In addition, market conditions may require us to pay higher compensation to qualified management and technical personnel than we currently anticipate. Any inability to attract and retain qualified management and technical personnel in the future could have a material adverse effect on our business, prospects, financial condition, and results of operations.

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Our business is subject to a strict regulatory environment.

Existing laws and regulations and any future regulation may have a material adverse effect on our business. For example, we believe that our direct marketing programs meet or exceed existing requirements of the United States Federal Trade Commission (FTC). Any changes to FTC requirements or changes in our direct or other marketing practices, however, could result in our marketing practices failing to comply with FTC regulations. As a result, we could be subject to substantial liability in the future, including fines and criminal penalties, preclusion from offering certain products or services, and the prevention or limitation of certain marketing practices.

We face intense competition, including from companies with greater resources, which could adversely affect our growth and could lead to decreased revenues.

Several companies, including Verizon, Yahoo and Microsoft, currently market Internet Yellow Pages services that directly compete with our services and products. We may not compete effectively with existing and potential competitors for several reasons, including the following:

- some competitors have longer operating histories and greater financial and other resources than we have and are in better financial condition than we are;

- some competitors have better name recognition, as well as larger, more established, and more extensive marketing, IAP advertiser service, and IAP advertiser support capabilities than we have;

- some competitors may supply a broader range of services, enabling them to serve more or all of their IAP advertisers' needs. This could limit our sales and strengthen our competitors' existing relationships with their IAP advertisers, including our current and potential IAP advertisers;

- some competitors may be able to better adapt to changing market conditions and IAP advertiser demand; and

- barriers to entry are not significant. As a result, other companies that are not currently involved in the Internet-based Yellow Pages advertising business may enter the market or develop technology that reduces the need for our services.

Increased competitive pressure could lead to reduced market share, as well as lower prices and reduced margins for our services. If we experience reductions in our revenue for any reason, our margins may continue to decline, which would adversely affect our results of operations. We cannot assure you that we will be able to compete successfully in the future.

We may face risks as we expand our business into international markets.

We currently are exploring opportunities to offer our services in other English-speaking countries. We have limited experience in developing and marketing our services internationally, and we may not be able to successfully execute our business model in markets outside the United States. We will face a number of risks inherent in doing business in international markets, including the following:

- international markets typically experience lower levels of Internet usage and Internet advertising than the United States, which could result in lower-than-expected demand for our services;

- unexpected changes in regulatory requirements;

- potentially adverse tax consequences;

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- difficulties in staffing and managing foreign operations;
- changing economic conditions;
- exposures to different legal standards, particularly with respect to intellectual property and distribution of information over the Internet;
- burdens of complying with a variety of foreign laws; and
- fluctuations in currency exchange rates.

To the extent that international operations represent a significant portion of our business in the future, our business could suffer if any of these risks occur.

We may be unable to promote and maintain our brands.

We believe that establishing and maintaining the brand identities of our Internet Yellow Pages services is a critical aspect of attracting and expanding a base of advertisers and users. Promotion and enhancement of our brands will depend largely on our success in continuing to provide high quality service. If advertisers and users do not perceive our existing services to be of high quality, or if we introduce new services or enter into new business ventures that are not favorably received by advertisers and users, we will risk diluting our brand identities and decreasing their attractiveness to existing and potential IAP advertisers.

We may not be able to adequately protect our intellectual property rights.

Our success depends both on our internally developed technology and our third party technology. We rely on a variety of trademarks, service marks, and designs to promote our brand names and identity. We also rely on a combination of contractual provisions, confidentiality procedures, and trademark, copyright, trade secrecy, unfair competition, and other intellectual property laws to protect the proprietary aspects of our products and services. Legal standards relating to the validity, enforceability, and scope of the protection of certain intellectual property rights in Internet-related industries are uncertain and still evolving. The steps we take to protect our intellectual property rights may not be adequate to protect our intellectual property and may not prevent our competitors from gaining access to our intellectual property and proprietary information. In addition, we cannot provide assurance that courts will always uphold our intellectual property rights or enforce the contractual arrangements that we have entered into to protect our proprietary technology.

Third parties may infringe or misappropriate our copyrights, trademarks, service marks, trade dress, and other proprietary rights. Any such infringement or misappropriation could have a material adverse effect on our business, prospects, financial condition, and results of operations. In addition, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights is unclear. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our trademarks and other proprietary rights, which may result in the dilution of the brand identity of our services.

We may decide to initiate litigation in order to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of our proprietary rights. Any such litigation could result in substantial expense, may reduce our profits, and may not adequately protect our intellectual property rights. In addition, we may be exposed to future litigation by third parties based on claims that our products or services infringe their intellectual property rights. Any such claim or litigation against us, whether or not successful, could result in substantial costs and harm our reputation. In addition, such claims or litigation could force us to do one or more of the following:

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- cease selling or using any of our products that incorporate the challenged intellectual property, which would adversely affect our revenue;

- obtain a license from the holder of the intellectual property right alleged to have been infringed, which license may not be available on reasonable terms, if at all; and

- redesign or, in the case of trademark claims, rename our products or services to avoid infringing the intellectual property rights of third parties, which may not be possible and in any event could be costly and time-consuming.

Even if we were to prevail, such claims or litigation could be time-consuming and expensive to prosecute or defend, and could result in the diversion of our management's time and attention. These expenses and diversion of managerial resources could have a material adverse effect on our business, prospects, financial condition, and results of operations.

Current capacity constraints may require us to expand our infrastructure and IAP advertiser support capabilities.

Our ability to provide high-quality Internet Yellow Pages services largely depends upon the efficient and uninterrupted operation of our computer and communications systems. We may be required to expand our technology, infrastructure, and IAP advertiser support capabilities in order to accommodate any significant increases in the numbers of advertisers and users of our web sites. We may not be able to project accurately the rate or timing of increases, if any, in the use of our services or expand and upgrade our systems and infrastructure to accommodate these increases in a timely manner. If we do not expand and upgrade our infrastructure in a timely manner, we could experience temporary capacity constraints that may cause unanticipated system disruptions, slower response times, and lower levels of IAP advertiser service. Our inability to upgrade and expand our infrastructure and IAP advertiser support capabilities as required could impair the reputation of our brand and our services, reduce the volume of users able to access our website, and diminish the attractiveness of our service offerings to our advertisers.

Any expansion of our infrastructure may require us to make significant upfront expenditures for servers, routers, computer equipment, and additional Internet and intranet equipment, as well as to increase bandwidth for Internet connectivity. Any such expansion or enhancement will need to be completed and integrated without system disruptions. An inability to expand our infrastructure or IAP advertiser service capabilities either internally or through third parties, if and when necessary, would materially adversely affect our business, prospects, financial condition, and results of operations.

Risks Related to the Internet

We may not be able to adapt as the Internet, Internet Yellow Pages services, and IAP advertiser demands continue to evolve.

Our failure to respond in a timely manner to changing market conditions or client requirements could have a material adverse effect on our business, prospects, financial condition, and results of operations. The Internet, e-commerce, and the Internet Yellow Pages industry are characterized by:

- rapid technological change;

- changes in advertiser and user requirements and preferences;

- frequent new product and service introductions embodying new technologies; and

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- the emergence of new industry standards and practices that could render our existing service offerings, technology, and hardware and software infrastructure obsolete.

In order to compete successfully in the future, we must

- enhance our existing services and develop new services and technology that address the increasingly sophisticated and varied needs of our prospective or current IAP advertisers;
- license, develop or acquire technologies useful in our business on a timely basis; and
- respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

Our future success will depend on continued growth in the use of the Internet.

Because Internet Yellow Pages is a new and rapidly evolving industry, the ultimate demand and market acceptance for our services will be subject to a high level of uncertainty. Significant issues concerning the commercial use of the Internet and online service technologies, including security, reliability, cost, ease of use, and quality of service, remain unresolved and may inhibit the growth of Internet business solutions that use these technologies. In addition, the Internet or other online services could lose their viability due to delays in the development or adoption of new standards and protocols required to handle increased levels of Internet activity, or due to increased governmental regulation. Our business, prospects, financial condition, and results of operations would be materially and adversely affected if the use of Internet Yellow Pages and other online services does not continue to grow or grows more slowly than we expect.

We will be required to keep pace with rapid technological change in the Internet industry.

In order to remain competitive, we will be required continually to enhance and improve the functionality and features of our existing services, which could require us to invest significant capital. If our competitors introduce new products and services embodying new technologies, or if new industry standards and practices emerge, our existing services, technologies, and systems may become obsolete. We may not have the funds or technical know-how to upgrade our services, technology, and systems. If we face material delays in introducing new services, products, and enhancements, our advertisers and users, may forego the use of our services and select those of our competitors, in which event our business, prospects, financial condition and results of operations could be materially and adversely affected.

Regulation of the Internet may adversely affect our business.

Due to the increasing popularity and use of the Internet and online services such as online Yellow Pages, federal, state, local, and foreign governments may adopt laws and regulations, or amend existing laws and regulations, with respect to the Internet and other online services. These laws and regulations may affect issues such as user privacy, pricing, content, taxation, copyrights, distribution, and quality of products and services. The laws governing the Internet remain largely unsettled, even in areas where legislation has been enacted. It may take years to determine whether and how existing laws, such as those governing intellectual property, privacy, libel, and taxation, apply to the Internet and Internet advertising and directory services. In addition, the growth and development of the market for electronic commerce may prompt calls for more stringent consumer protection laws, both in the United States and abroad, that may impose additional burdens on companies conducting business over the Internet. Any new legislation could hinder the growth in use of the Internet generally or in our industry and could impose additional burdens on companies conducting business online, which could, in turn, decrease the demand for our services, increase our cost of doing business, or otherwise have a material adverse effect on our business, prospects, financial condition, and results of operations.

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We may not be able to obtain Internet domain names that we would like to have.

We believe that our existing Internet domain names are an extremely important part of our business. We may desire, or it may be necessary in the future, to use these or other domain names in the United States and abroad. Various Internet regulatory bodies regulate the acquisition and maintenance of domain names in the United States and other countries. These regulations are subject to change. Governing bodies may establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may be unable to acquire or maintain relevant domain names in all countries in which we plan to conduct business in the future.

The extent to which laws protecting trademarks and similar proprietary rights will be extended to protect domain names currently is not clear. We therefore may be unable to prevent competitors from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our domain names, trademarks, trade names, and other proprietary rights. We cannot provide assurance that potential users and advertisers will not confuse our domain names, trademarks, and trade names with other similar names and marks. If that confusion occurs, we may lose business to a competitor and some advertisers and users may have negative experiences with other companies that those advertisers and users erroneously associate with us. The inability to acquire and maintain domain names that we desire to use in our business, and the use of confusingly similar domain names by our competitors, could have a material adverse affect on our business, prospects, financial conditions, and results of operations in the future.

Our business could be negatively impacted if the security of the Internet becomes compromised.

To the extent that our activities involve the storage and transmission of proprietary information about our advertisers or users, security breaches could damage our reputation and expose us to a risk of loss or litigation and possible liability. We may be required to expend significant capital and other resources to protect against security breaches or to minimize problems caused by security breaches. Our security measures may not prevent security breaches. Our failure to prevent these security breaches or a misappropriation of proprietary information may have a material adverse effect on our business, prospects, financial condition, and results of operations.

Our technical systems could be vulnerable to online security risks, service interruptions or damage to our systems.

Our systems and operations may be vulnerable to damage or interruption from fire, floods, power loss, telecommunications failures, break-ins, sabotage, computer viruses, penetration of our network by unauthorized computer users and “hackers,” natural disaster, and similar events. Preventing, alleviating, or eliminating computer viruses and other service-related or security problems may require interruptions, delays or cessation of service. We may need to expend significant resources protecting against the threat of security breaches or alleviating potential or actual service interruptions. The occurrence of such unanticipated problems or security breaches could cause material interruptions or delays in our business, loss of data, or misappropriation of proprietary or IAP advertiser-related information or could render us unable to provide services to our IAP advertisers for an indeterminate length of time. The occurrence of any or all of these events could materially and adversely affect our business, prospects, financial condition, and results of operations.

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If we are sued for content distributed through, or linked to by, our website or those of our advertisers, we may be required to spend substantial resources to defend ourselves and could be required to pay monetary damages.

We aggregate and distribute third-party data and other content over the Internet. In addition, third-party websites are accessible through our website or those of our advertisers. As a result, we could be subject to legal claims for defamation, negligence, intellectual property infringement, and product or service liability. Other claims may be based on errors or false or misleading information provided on or through our website or websites of our directory licensees. Other claims may be based on links to sexually explicit websites and sexually explicit advertisements. We may need to expend substantial resources to investigate and defend these claims, regardless of whether we successfully defend against them. While we carry general business insurance, the amount of coverage we maintain may not be adequate. In addition, implementing measures to reduce our exposure to this liability may require us to spend substantial resources and limit the attractiveness of our content to users.

Risks Related to Our Securities

Stock prices of technology companies have declined precipitously at times in the past and the trading price of our common stock is likely to be volatile, which could result in substantial losses to investors.

The trading price of our common stock has risen significantly over the past twelve months and could continue to be volatile in response to factors including the following, many of which are beyond our control:

- decreased demand in the Internet services sector;
- variations in our operating results;
- announcements of technological innovations or new services by us or our competitors;
- changes in expectations of our future financial performance, including financial estimates by securities analysts and investors;
- our failure to meet analysts’ expectations;
- changes in operating and stock price performance of other technology companies similar to us;
- conditions or trends in the technology industry;
- additions or departures of key personnel; and
- future sales of our common stock.

Domestic and international stock markets often experience significant price and volume fluctuations that are unrelated to the operating performance of companies with securities trading in those markets. These fluctuations, as well as political events, terrorist attacks, threatened or actual war, and general economic conditions unrelated to our performance, may adversely affect the price of our common stock. In the past, securities holders of other companies often have initiated securities class action litigation against those companies following periods of volatility in the market price of those companies’ securities. If the market price of our stock fluctuates and our stockholders initiate this type of litigation, we could incur substantial costs and experience a diversion of our management’s attention and resources, regardless of the outcome. This could materially and adversely affect our business, prospects, financial condition, and results of operations.

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Certain provisions of Nevada law and in our charter may prevent or delay a change of control of our company.

We are subject to the Nevada anti-takeover laws regulating corporate takeovers. These anti-takeover laws prevent Nevada corporations from engaging in a merger, consolidation, sales of its stock or assets, and certain other transactions with any stockholder, including all affiliates and associates of the stockholder, who owns 10% or more of the corporation's outstanding voting stock, for three years following the date that the stockholder acquired 10% or more of the corporation's voting stock except in certain situations. In addition, our amended and restated articles of incorporation and bylaws include a number of provisions that may deter or impede hostile takeovers or changes of control or management. These provisions include the following:

- our board is classified into three classes of directors as nearly equal in size as possible, with staggered three year-terms;

- the authority of our board to issue up to 5,000,000 shares of serial preferred stock and to determine the price, rights, preferences, and privileges of these shares, without stockholder approval;

- all stockholder actions must be effected at a duly called meeting of stockholders and not by written consent unless such action or proposal is first approved by our board of directors;

- special meetings of the stockholders may be called only by the Chairman of the Board, the Chief Executive Officer, or the President of our company; and

- cumulative voting is not allowed in the election of our directors.

These provisions of Nevada law and our articles and bylaws could prohibit or delay mergers or other takeover or change of control of our company and may discourage attempts by other companies to acquire us, even if such a transaction would be beneficial to our stockholders.

Our common stock may be subject to the "penny stock" rules as promulgated under the Exchange Act.

In the event that no exclusion from the definition of "penny stock" under the Exchange Act is available, then any broker engaging in a transaction in our common stock will be required to provide its IAP advertisers with a risk disclosure document, disclosure of market quotations, if any, disclosure of the compensation of the broker-dealer and its sales person in the transaction, and monthly account statements showing the market values of our securities held in the IAP advertiser's accounts. The bid and offer quotation and compensation information must be provided prior to effecting the transaction and must be contained on the IAP advertiser's confirmation of sale. Certain brokers are less willing to engage in transactions involving "penny stocks" as a result of the additional disclosure requirements described above, which may make it more difficult for holders of our common stock to dispose of their shares.

ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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YP.NET, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board
of Directors of YP Corp.:

We have audited the accompanying consolidated balance sheet of YP Corp. and subsidiaries as of September 30, 2003 and the related statements of operations, stockholders' equity and cash flows for the each of the two years in the period then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the auditing standards generally accepted in the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of YP Corp. and subsidiaries as of September 30, 2003, and the consolidated results of its operations and cash flows for each of the two years in the period ended September 30, 2003, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, the Company restated its financial statements for the years ended September 30, 2003 and 2002.

/s/ Epstein, Weber & Conover, PLC
Scottsdale, Arizona
December 5, 2003
(except for the restatement of financial statements
described in Note 1, for which the date is November 18,
2005)

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YP.NET, INC.

CONSOLIDATED BALANCE SHEET
SEPTEMBER 30, 2003

ASSETS:		
CURRENT ASSETS		
Cash and cash equivalents	$	2,378,848
Accounts receivable, net		7,328,624
Prepaid expenses and other current assets		154,276
Deferred tax asset		1,400,637
Total current assets		11,262,385
ACCOUNTS RECEIVABLE - long term portion		1,123,505
CUSTOMER ACQUISITION COSTS, net of accumulated amortization of $2,913,776		3,243,241
PROPERTY AND EQUIPMENT, net		731,142
DEPOSITS AND OTHER ASSETS		148,310
INTELLECTUAL PROPERTY- URL, net of accumulated amortization of $1,868,283		3,512,952
ADVANCES TO AFFILIATES		2,126,204
DEFERRED INCOME TAXES		239,952
TOTAL ASSETS	$	22,387,691
LIABILITIES AND STOCKHOLDERS' EQUITY:		
CURRENT LIABILITIES:		
Accounts payable	$	428,423
Accrued liabilities		1,413,245
Notes payable - current portion		115,868
Income taxes payable		2,689,312
Total current liabilities		4,646,848
Total liabilities		4,646,848
STOCKHOLDERS' EQUITY:		
Series E convertible preferred stock, $.001 par value, 200,000 shares authorized, 131,840 issued and outstanding, liquidation preference $39,552		11,206
Common stock, $.001 par value, 100,000,000 shares authorized, 55,265,136 issued, 49,348,287 outstanding		49,348
Paid in capital		9,359,866
Deferred stock compensation		(3,840,843)
Treasury stock at cost		(216,422)
Retained earnings		12,377,688
Total stockholders' equity		17,740,843
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	22,387,691

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

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YP.NET, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED SEPTEMBER 30, 2003 AND SEPTEMBER 30, 2002

	2003	2002
NET REVENUES	$ 30,767,444	$ 12,618,126
OPERATING EXPENSES:		
Cost of services	8,473,746	3,497,678
General and administrative expenses	8,657,690	4,754,665
Sales and marketing expenses	3,868,643	963,868
Depreciation and amortization	660,475	581,290
Total operating expenses	21,660,554	9,797,501
OPERATING INCOME	9,106,890	2,820,625
OTHER (INCOME) AND EXPENSES		
Interest expense and other financing costs	19,728	92,341
Interest income	(108,995)	(17,682)
Other expense/(income)	(291,002)	(436,848)
Total other income	(380,269)	(362,189)
INCOME BEFORE INCOME TAXES	9,487,159	3,182,814
INCOME TAX PROVISION (BENEFIT)	1,871,293	342,082
NET INCOME	$ 7,615,866	$ 2,840,732
NET INCOME PER SHARE:		
Basic	$ 0.17	$ 0.06
Diluted	$ 0.17	$ 0.06
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic	45,591,590	41,753,464
Diluted	45,591,590	41,753,464

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

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YP.NET, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE YEARS ENDED SEPTEMBER 30, 2003 AND SEPTEMBER 30, 2002

	Common Stock		Preferred E		Treasury	Paid-in	Retained	
	Shares	Amount	Shares	Amount	Stock	Capital	Earnings	Total
BALANCE OCTOBER 1, 2001	40,801,449	$ 40,802	-	$ -	$ (171,422)	$ 4,595,609	$ 1,923,562	$ 6,388,551
Common stock issued for services	100,000	100				8,900		9,000
Series E preferred stock issued in exchange for common shares	(131,840)	(132)	131,840	11,206		(11,074)		-
Series E preferred stock dividends							(494)	(494)
Net income							2,840,732	2,840,732
BALANCE SEPTEMBER 30, 2002	40,769,609	$ 40,770	131,840	$ 11,206	$ (171,422)	$ 4,593,435	$ 4,763,800	$ 9,237,789

(CONTINUED)

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

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE YEARS ENDED SEPTEMBER 30, 2003 AND SEPTEMBER 30, 2002 (continued)

	Common Stock Shares	Common Stock Amount	Preferred E Shares	Preferred E Amount	Treasury Stock	Paid-in Capital	Deferred Compensation	Retained Earnings	Tot
BALANCE OCTOBER 1, 2002	40,769,609	$ 40,770	131,840	$ 11,206	$ (171,422)	$ 4,593,435	$ -	$ 4,763,800	$ 9,23
Common stock issued for services	7,005,678	7,006				712,678			71
Common stock issued for URL	100,000	100				59,900			6
Purchase of treasury stock	(500,000)	(500)			(45,000)	500			(4
Series E preferred stock dividends								(1,978)	(
Common stock issued in restricted stock plan	1,973,000	1,973				3,993,352	(3,995,325)		
Amortization of deferred stock compensation							154,482		15
Net income								7,615,866	7,61
BALANCE SEPTEMBER 30, 2003	49,348,287	$ 49,349	131,840	$ 11,206	$ (216,422)	$ 9,359,865	$ (3,840,843)	$ 12,377,688	$ 17,74

(CONTINUED)

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

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YP.NET, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2003 AND SEPTEMBER 30, 2002

CASH FLOWS FROM OPERATING ACTIVITIES:	2003	2002
Net income	$ 7,615,866	$ 2,840,732
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	660,475	581,290
Amortization of deferred stock compensation	154,482	
Issuance of common stock as compensation for services	719,684	9,000
Gain on settlement of debt	(45,362)	-
Deferred income taxes	(1,631,774)	1,078,157
Loss on disposal of equipment	6,932	
Provision for uncollectible accounts	1,688,058	1,375,226
Changes in assets and liabilities:		
Accounts receivable	(6,064,894)	(2,580,410)
Customer acquisition costs	(1,825,014)	(1,224,983)
Prepaid and other current assets	(183,196)	(44,042)
Deposits and other assets	2,415	(127,438)
Accounts payable	233,027	(119,511)
Accrued liabilities	1,228,470	106,069
Income taxes payable	2,203,069	(736,075)
Net cash provided by operating activities	4,762,238	1,158,015
CASH FLOWS FROM INVESTING ACTIVITIES:		
Advances made to affiliate	(1,800,000)	(116,757)
Expenditures for intellectual property	(261,545)	(49,688)
Purchases of equipment	(736,955)	(77,632)
Net cash used for investing activities	(2,798,500)	(244,077)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from debt	378,169	-
Principal repayments on notes payable	(685,167)	(830,677)
Purchase of treasury stock	(45,000)	-
Net cash used for financing activities	(351,998)	(830,677)
INCREASE IN CASH AND CASH EQUIVALENTS	1,611,740	83,261
CASH AND CASH EQUIVALENTS, beginning of year	767,108	683,847
CASH AND CASH EQUIVALENTS, end of year	$ 2,378,848	$ 767,108

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

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YP.NET, INC.

CONSOLIDATED STATEMENT OF CASH FLOWS, (continued)
FOR THE YEARS ENDED SEPTEMBER 30, 2003 and 2001

SUPPLEMENTAL CASH FLOW INFORMATION:

		2003		**2002**
Interest Paid	$	11,258	$	99,541
Income taxes paid	$	1,300,000	$	-0-

SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:

		2003		**2002**
Common stock issued for services	$	719,684	$	9,000
Common stock issued to purchase intellectual property	$	60,000	$	-0-
Common stock exchanged for Series E Convertible Preferred Stock	$	- 0 -	$	11,206

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

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YP.NET, INC.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2003 AND 2002**

1. ORGANIZATION AND BASIS OF PRESENTATION

YP.Net, Inc. (the "Company"), formally RIGL Corporation, had previously attempted to develop software solutions for medical practice billing and administration. The Company had made acquisitions of companies performing medical practice billing services as test sites for its software and as business opportunities. The Company was not successful in implementing its medical practice billing and administration software products and looked to other business opportunities. The Company acquired Telco Billing Inc. ("Telco") in June 1999, through the issuance of 17,000,000 shares of the Company's common stock. Prior to its acquisition of Telco, RIGL had not generated significant or sufficient revenue from planned operations.

Telco was formed in April 1998, to provide advertising and directory listings for businesses on its Internet website in a *"Yellow Page"* format. Telco provides those services to its subscribers for a monthly fee. These services are provided primarily to businesses throughout the United States. Telco became a wholly owned subsidiary of YP.Net, Inc. after the June 16, 1999 acquisition.

At the time that the transaction was agreed to, the Company had 12,567,770 common shares issued and outstanding. As a result of the merger transaction with Telco, there were 29,567,770 common shares outstanding, and the former Telco stockholders held approximately 57% of the Company's voting stock. For financial accounting purposes, the acquisition was a reverse acquisition of the Company by Telco, under the purchase method of accounting, and was treated as a recapitalization with Telco as the acquirer. Consistent with reverse acquisition accounting: (i) all of Telco's assets, liabilities, and accumulated deficit were reflected at their combined historical cost (as the accounting acquirer) and (ii) the preexisting outstanding shares of the Company (the accounting acquiree) were reflected at their net asset value as if issued on June 16, 1999.

The accompanying financial statements represent the consolidated financial position and results of operations of the Company and include the accounts and results of operations of the Company and Telco, its wholly owned subsidiary, for the years ended September 30, 2003 and September 30, 2002. Certain reclassifications have been made to the September 30, 2002 balances to conform to the 2003 presentation. These reclassifications to the 2002 financial statements include:

- Customer refunds of $313,716 in 2002 have been reclassified by moving them from cost of services to netting them in revenue. As a result of better reporting by the third party billing aggregator, these refunds were specifically identified when they were previously included as a general charge back by the billing aggregator.

- It was determined that $300,901 of revenue generated by providing services to an affiliate, Simple.net, which encompassed loaning personnel to the affiliate on a contract basis, did not represent customer revenue in the Company's product line and that those related billings should therefore be excluded from customer revenue. The Company reduced revenue as previously reported by $300,901 and reclassified that amount in other income.

- It was discovered in the year ended September 30, 2003, that 3,081,500 shares of issued common stock had been improperly included in the outstanding shares. These shares were actually treasury shares and therefore should be excluded from the number of shares outstanding. The Company corrected the error by reclassifying the par value of those shares of $3,082 from the common stock account to the paid in capital account. The incorrect number of treasury shares also had the effect of incorrectly reporting the weighted average shares outstanding for purposes of the earnings per share calculation. The weighted average shares outstanding was previously reported as 44,024,329 and has been corrected to 41,753,464. The effect of the corrected weighted average shares outstanding on the basic and diluted earnings per share for the year ended September 30, 2002 was an increase from $0.06 to $0.07.

Restatement of Financial Statements

Subsequent to the issuance of the Company's financial statements as of September 30, 2003, and the year then ended, the Company determined that the accounting for its common stock issued to, and subsequently recovered from, certain non-performing consultants during 1999 and 2000 should not have been expensed when originally issued as had been previously reported. The subsequent recovery of these shares was recorded as an item in other income at the same value at which they were originally issued. It has been determined to be inappropriate to recognize the initial expense and its subsequent reversal as no services were rendered by these consultants. Instead, the issuance of these shares will be reflected as temporary equity, together with a related receivable, until the shares were returned. The change in accounting for the recovery of the shares has the effect in the year ended September 30, 2003 of a decrease in net income of $308,025 from $7,923,891 to $7,615,866 and a decrease in the net income per share from per share from $0.18 to $0.17.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents: This includes all short-term highly liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less. At times cash deposits may exceed government insured limits. At September 30, 2003, cash deposits exceeded those insured limits by $2,255,000.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Telco Billing, Inc. All significant intercompany accounts and transactions are eliminated.

Customer Acquisition Costs: These costs represent the direct response marketing costs that are incurred as the primary method by which customers subscribe to the Company's services. The Company purchases mailing lists and sends advertising materials to prospective subscribers from those lists. Customers subscribe to the services by positively responding to those advertising materials, which serve as the contract for the subscription. The Company capitalizes and amortizes the costs of direct-response advertising on a straight-line basis over eighteen months, the estimated average period of retention for new customers. The Company capitalized costs of $4,739,000 and $1,941,000 during the years ended September 30, 2003 and 2002 respectively. The Company amortized $2,914,000 and $719,000, respectively, of these capitalized costs during the years ended September 30, 2003 and 2002. The Company also analyzes these capitalized costs for impairment and believes that there was no impairment of the carrying cost at September 30, 2003 on the basis of customer retention and revenue generated per customer.

The Company also incurs advertising costs that are not considered direct-response advertising. These other advertising costs are expensed when incurred. These advertising expenses were $955,000 and $248,000 for the years ended September 30, 2003 and 2002 respectively.

Property and Equipment: Property and equipment is stated at cost less accumulated depreciation. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets ranging from 3 to 5 years. Depreciation expense was $273,340 and $178,058 for the years ended September 30, 2003 and 2002 respectively.

Revenue Recognition: The Company's revenue is generated by customer subscriptions of directory and advertising services. Revenue is billed and recognized monthly for services subscribed in that specific month. The Company utilizes outside billing companies to transmit billing data, much of which is forwarded to Local Exchange Carriers ("LEC's") that provide local telephone service. Monthly subscription fees are generally included on the telephone bills of the customers. The Company recognizes revenue based on net billings accepted by the LEC's. Due to the periods of time for which adjustments may be reported by the LEC's and the billing companies, the Company estimates and accrues for dilution and fees reported subsequent to year-end for initial billings related to services provided for periods within the fiscal year. Customer refunds are recorded as an offset to gross revenue.

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Revenue for billings to certain customers whom are billed directly by the Company and not through the LEC's, is recognized based on estimated future collections. The Company continuously reviews this estimate for reasonableness based on its collection experience.

Income Taxes: The Company provides for income taxes based on the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes,* which, among other things, requires that recognition of deferred income taxes be measured by the provisions of enacted tax laws in effect at the date of financial statements.

Net Income Per Share: Net income per share is calculated using the weighted average number of shares of common stock outstanding during the year. The Company has adopted the provisions of SFAS No. 128, *Earnings Per Share*.

Financial Instruments: Financial instruments consist primarily of cash, accounts receivable, advances to affiliates and obligations under accounts payable, accrued expenses and notes payable. The carrying amounts of cash, accounts receivable, accounts payable, accrued expenses and notes payable approximate fair value because of the short maturity of those instruments. The carrying amount of the advances to affiliates approximates fair value because the Company charges what it believes are market rate interest rates for comparable credit risk instruments. The Company has applied certain assumptions in estimating these fair values. The use of different assumptions or methodologies may have a material effect on the estimates of fair values.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant estimates made in connection with the accompanying financial statements include the estimate of dilution and fees associated with LEC billings and the estimated reserve for doubtful accounts receivable.

Stock-Based Compensation: Statements of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, ("SFAS 123") established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation. In accordance with SFAS 123, the Company has elected to continue accounting for stock based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees."

From time to time, the Company issues stock options to executives, key employees and members of the Board of Directors. Generally, when the Company grants stock options to employees, there is no intrinsic value of those options on the date of grant. Accordingly, no compensation cost has been recognized for stock options granted to employees. There were no options granted in the years ended September 30, 2003 and 2002 nor was there any additional vesting of options previously granted. Because no options were granted during the years ended September 30, 2003 and 2002, there is no presentation of pro forma information regarding net income.

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The Company accounts for stock awards issued to nonemployees in accordance with the provisions of SFAS 123 and Emerging Issues Task Force ("EITF") Issue No. 96-18 *Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services*. Under SFAS 123 and EITF 96-18, stock awards to nonemployees are accounted for at their fair value as determined under Black-Scholes option pricing model.

Temporary Equity: During fiscal 1999 and 2000, the Company issued 925,000 shares and 600,000 shares, respectively, to consultants and other third parties whereupon it was subsequently determined that the consultants did not perform under the terms of the related agreements. The Company has pursued legal action against the consultants and third parties and ultimately such shares were retrieved. The value of such shares, totaling $1,689,239, was not recorded as expense but rather was reflected as temporary equity, together with a related receivable until such times that the shares were retrieved. No such shares were outstanding at September 30, 2003.

Impairment of Long-lived Assets: The Company assesses long-lived assets for impairment in accordance with the provisions of SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of.* SFAS 121 requires that the Company assess the value of a long-lived asset whenever there is an indication that its carrying amount may not be recoverable. Recoverability of the asset is determined by comparing the forecasted undiscounted cash flows generated by said asset to its carrying value. The amount of impairment loss, if any, is measured as the difference between the net book value of the asset and its estimated fair value.

Recently Issued Accounting Pronouncements: In July 2002, the FASB issued SFAS No. 146, *"Accounting for Costs Associated With Exit or Disposal Activities"*. This Standard requires costs associated with exit or disposal activities to be recognized when they are incurred. The Company estimates the impact of adopting these new rules will not be material.

In October 2002, the FASB issued SFAS No. 147, *"Acquisitions of Certain Financial Institutions."* SFAS No. 147 is effective October 1, 2002. The adoption of SFAS No. 147 did not have a material effect on the Company's financial statements.

In April 2003, the FASB issued SFAS No. 149, *"Amendment of Statement 133 on Derivative Instruments and Hedging Activities,"* effective for contracts entered into or modified after June 30, 2003. This amendment clarifies when a contract meets the characteristics of a derivative, clarifies when a derivate contains a financing component and amends certain other existing pronouncements. The Company believes the adoption of SFAS No. 149 will not have a material effect on the Company's financial statements.

In May 2003, the FASB issued SFAS No. 150, *"Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity."* SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. SFAS No. 150 requires the classification as a liability of any financial instruments with a mandatory redemption feature, an obligation to repurchase equity shares, or a conditional obligation based on the issuance of a variable number of its equity shares. The Company does not have any financial instruments with a mandatory redemption feature. The Company believes the adoption of SFAS No. 150 will not have a material effect on the Company's financial statements.

In November 2002, the FASB issued FASB Interpretation No. 45, *"Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others"* (FIN 45). FIN 45 clarifies the requirements for a guarantor's accounting for and disclosure of certain guarantees issued and outstanding. The initial recognition and initial measurement provisions of FIN 45 are applicable to guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for financial statements for periods ending after December 15, 2002. The adoption of FIN 45 did not have a significant impact on the Company's financial statements. See Note 10.

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In January 2003, the FASB issued FIN No. 46, *"Consolidation of Variable Interest Entities"* (FIN 46). FIN No. 46 states that companies that have exposure to the economic risks and potential rewards from another entity's assets and activities have a controlling financial interest in a variable interest entity and should consolidate the entity, despite the absence of clear control through a voting equity interest. The consolidation requirements apply to all variable interest entities created after January 31, 2003. For variable interest entities that existed prior to February 1, 2003, the consolidation requirements are effective for annual or interim periods beginning after June 15, 2003. Disclosure of significant variable interest entities is required in all financial statements issued after January 31, 2003, regardless of when the variable interest was created. The Company is presently reviewing arrangements to determine if any variable interest entities exist but does not anticipate the adoption of FIN 46 will have a significant impact on the Company's financial statements.

3. ACCOUNTS RECEIVABLE

The Company provides billing information to third party billing companies for the majority of its monthly billings. Billings submitted are "filtered" by these billing companies and the LEC's. Net accepted billings are recognized as revenue and accounts receivable. The billing companies remit payments to the Company on the basis of cash ultimately received from the LEC's by those billing companies. The billing companies and LEC's charge fees for their services, which are netted against the gross accounts receivable balance. The billing companies also apply holdbacks to the remittances for potentially uncollectible accounts. These dilution amounts will vary due to numerous factors and the Company may not be certain as to the actual amounts of dilution on any specific billing submittal until several months after that submittal. The Company estimates the amount of these charges and holdbacks based on historical experience and subsequent information received from the billing companies. The Company also estimates uncollectible account balances and provides an allowance for such estimates. The billing companies retain certain holdbacks that may not be collected by the Company for a period extending beyond one year. These balances have been classified as long-term assets in the accompanying balance sheet.

The Company experiences significant dilution of its gross billings by the billing companies. The Company negotiates collections with the billing companies on the basis of the contracted terms and historical experience. The Company's cash flow may be affected by holdbacks, fees, and other matters, which are determined by the LEC's and the billing companies. The Company processes its billings through two primary billing companies.

EBillit, Inc. ("EBI") provides the majority of the Company's billings, collections, and related services. The net receivable due from EBillit at September 30, 2003 was $6,457,998, net of an allowance for doubtful accounts of $2,269,027. The net receivable from EBI at September 30, 2003, represents approximately 76% of the Company's total net accounts receivable at September 30, 2003.

Subscription receivables that are directly billed by the Company are valued and reported at the estimated future collection amount. Determining the expected collections requires an estimation of both uncollectible accounts and refunds. The net subscriptions receivable at September 30, 2003 was $214,994.

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Accounts receivable at September 30, 2003 is summarized as follows:

	Current	Long-Term	Total
Gross accounts receivable	$ 10,317,029	$ 1,518,251	$ 11,835,280
Allowance for doubtful accounts	(2,988,405)	(394,746)	(3,383,151)
Net	$ 7,328,624	$ 1,123,505	$ 8,452,129

Certain receivables have been classified as long-term because issues arise whereby the billing companies change holdback terms and collection experience is such that collection can extend beyond one year.

The allowance for doubtful accounts is attributable to the following categories at September 30, 2003:

Holdback reserves of Local Exchange Carriers	$ 2,221,441
Reserves held by active third party billing aggregators	757,673
Reserves held by inactive third party billing aggregator	154,037
Reserve for refunds	250,000
	$ 3,383,151

4. INTELLECTUAL PROPERTY

In connection with the Company's acquisition of Telco, the Company was required to provide accelerated payment of license fees for the use of the Internet domain name or **U**niversal **R**esource **L**ocator (URL) *Yellow-page. net*. Telco had previously entered into a 20-year license agreement for the use of the URL with one of its two 50% stockholders. The original license agreement required annual payments of $400,000. However, the agreement stated that upon a change in control of Telco, a $5,000,000 accelerated payment is required to maintain the rights under the licensing agreement. The URL holder agreed to discount the accelerated payments from $8,000,000 to $5,000,000 at the time of the acquisition. The Company agreed to make that payment upon effecting the acquisition of Telco.

The Company made a $3,000,000 cash payment and issued a note payable for $2,000,000 to acquire the licensing rights of the URL. The Company also issued 2,000,000 shares of its common stock to be held as collateral on the note. The note payable was originally due on July 15, 1999. The Company failed to make the $2,000,000 payment when due. The repayment terms were renegotiated to extend the due date to January 15, 2000. The Company was required to pay an extension fee of $200,000 at that time. The Company again renegotiated the repayment terms on April 26, 2000, to a demand note, with monthly installments of $100,000, subject to all operating requirements, which, management believes, have subsequently been met by the Company.

In the year ended September 30, 2002, the former URL holder claimed that it was due additional amounts for the prior loan extensions. The Company reached a settlement with the former URL holder that required the Company to issue to the former URL holder, 4,000,000 shares of the Company's common stock, warrants to purchase 500,000 shares of the Company's common stock and a note payable for $550,000. The Company recorded an expense of approximately $917,000 related to the settlement representing the principal amount of the note payable, $360,000 as the fair value of the 4,000,000 common shares and $7,176 as the fair value of the warrants. The value of the common stock was determined on the basis of the quoted trading price of the shares on the date of the agreement. The fair value of the warrants was determined on the using the Black-Scholes option pricing model.

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The URL is recorded at its cost net of accumulated amortization. Management believes that the Company's business is dependent on its ability to utilize this URL given the recognition of the *Yellow page* term. Also, its current customer base relies on the recognition of this term and URL as a basis for maintaining the subscriptions to the Company's service. Management believes that the current revenue and cash flow generated through use of *Yellow-page.net* supports the carrying of the asset. The Company periodically analyzes the carrying value of this asset to determine if impairment has occurred. No such impairments were identified during the year ended September 30, 2003. The URL is amortized on an accelerated basis over the twenty-year term of the licensing agreement. Amortization expense on the URL was $387,135 and $403,232 for the years ended September 30, 2003 and 2002 respectively.

During the year ended September 30, 2003, the Company acquired a three year license for the domain name, "YP.com" for $250,000 cash and 100,000 shares of the Company's common stock valued at $60,000.

The following summarizes the estimated future amortization expense related to intangible assets:

Years ended September 30,		
2004	$	431,022
2005		398,528
2006		343,986
2007		236,212
2008		213,035
Thereafter		1,890,169
Total	$	3,512,952

5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at September 30, 2003:

Leasehold improvements	$	376,287
Furnishings and fixtures		167,706
Office and computer equipment		857,869
Total		1,401,862
Less accumulated depreciation		(670,720)
Property and equipment, net	$	731,142

6. NOTES PAYABLE AND LINE OF CREDIT

Notes payable at September 30, 2003 are comprised of the following:

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Note payable to former Telco stockholders, original balance of $550,000, interest at 10.5% per annum. Repayment terms require monthly installments of principal and interest of $19,045 beginning December 15, 2002. Stated maturity September 25, 2004. Collateralized by all assets of the Company.	$115,868

The note payable to the former Telco stockholders totaled $550,000 at the beginning of the fiscal year ending September 30, 2002. In accordance with instructions that the Company received from said stockholders, the Company has made payments to third parties on behalf of the stockholders and applied those payments as reductions to the note payable. Said stockholders are not a part of management or on the Board of Directors of the Company. Payments on the note were accelerated at the option of the Company. Although the note calls for monthly payments of $19,045, the Company would not be required to make another payment until February 2004 under the original repayment provisions of the note. The full remaining balance of $115,866 is due in the year ended September 30, 2004.

7. PROVISION FOR INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

During the years ended September 30, 2003 and 2002, the Company structured certain transactions related to its merger with Telco that allowed the Company to utilize net operating losses that were previously believed to be unavailable or limited under the change of control rules of Internal Revenue Code 382. The deferred income tax asset of approximately $1,463,000 related to these net operating losses recorded at September 30, 2001, was partially offset by a valuation allowance of approximately $773,000. The Company also amended prior year tax returns reflecting a higher net operating loss carryforward that had initially been estimated. The additional net operating loss carryforwards previously not recognized resulted in an income tax benefit of $979,000 that was utilized to offset some of the income tax provision for the year ended September 30, 2003. Additionally, as a result of these changes and the elimination of the valuation allowance an income tax benefit of approximately $917,000 was recognized during the year ended September 30, 2002. At September 30, 2003 the Company had a federal net operating loss carryforward of $2,880,000 and no state net operating losses. Those operating loss carryforwards expire in 2019 and 2020.

Income taxes for years ended September 30, is summarized as follows:

	2003	2002
Current Provision	$ 3,337,208	$ 376,582
Deferred (Benefit) Provision	(1,465,915)	77,836
Net income tax provision	$ 1,871,293	$ 454,418

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A reconciliation of the differences between the effective and statutory income tax rates for years ended September 30, is as follows:

	2003		2002	
Federal statutory rates	$ 3,226,019	34%	$ 1,082,228	34%
State income taxes	114,807	1%	222,811	7%
Utilization of valuation allowance	-	-	(661,088)	(43)%
Change in estimate of NOL due to changes in structuring and state income tax rates used	(1,465,381)	(15)%	(143,575)	(4)%
Other	(4,153)	-	(45,958)	(1)%
Effective rate	$ 1,871,293	20%	$ (454,418)	(7)%

At September 30, 2003, deferred income tax assets and liabilities were comprised of:

Deferred Income Tax Assets:	
Book/tax differences in accounts receivable	$ 1,184,103
Deferred and stock-based compensation	640,347
Book/tax differences in intangible assets	72,140
Net operating loss carryforward	979,138
Total deferred income tax asset	2,875,728
Deferred Income Tax Liabilities:	
Book/tax differences in depreciation	100,006
Book/tax differences in customer acquisition costs	1,135,134
Total deferred income tax liability	1,235,140
Net income tax asset	$ 1,640,588

During the year ended September 30, 2003, the Company moved certain operations and revenue generating assets to a state without corporate income taxes thereby reducing the statutory rate used for state income taxes.

During the year ended September 30, 2002, the valuation allowance was reduced by approximately $773,000.

8. LEASES

The Company leases its office space and certain equipment under long-term operating leases expiring through fiscal year 2006. Rent expense under these leases was $222,418 and $145,052 for the years ended September 30, 2003 and 2002, respectively.

Future minimum annual lease payments under operating lease agreements for years ended September 30 are as follows:

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2004	$	427,597
2005		383,679
2006		292,125
Total	$	1,103,401

9. STOCKHOLDERS’ EQUITY

Common Stock Issued for Services

The Company has historically granted shares of its common stock to officers, directors and consultants as payment for services rendered. The value of those shares was determined based on the trading value of the stock at the dates on which the agreements were made for the services. During the year ended September 30, 2003, the Company issued 6,300,000 shares of common stock to officers and directors, or entities controlled by those individuals, valued at $478,750. Additionally, shares were granted under the Company’s Restricted Stock Plan (see Note 14).

During the year ended September 30, 2002, the Company issued 100,000 shares of common stock to officers, directors and consultants valued at $9,000

Common Stock Issued for URL

During the year ended September 30, 2003, the Company acquired a three year license for the domain name, “YP.com” for $250,000 cash and 100,000 shares of the Company’s common stock valued at $60,000.

Series E Convertible Preferred Stock

During the year ended September 30, 2002, the Company created a new series of capital stock, the Series E Convertible Preferred Stock. The Company authorized 200,000, $0.001 par value shares. The shares carry a $0.30 per share liquidation preference and accrue dividends at the rate of 5% per annum on the liquidation preference per share, payable quarterly from legally available funds. If such funds are not available, dividends shall continue to accumulate until they can be paid from legally available funds. Holders of the preferred shares shall be entitled, after two years from issuance, to convert them into common shares on a one-to-one basis together with payment of $0.45 per converted share.

During the year ended September 30, 2002, pursuant to an existing tender offer, holders of 131,840 shares of the Company’s common stock exchanged said shares for an equal number of the Series E Convertible Preferred shares, at the then $0.085 market value of the common stock. As of September 30, 2003, the liquidation preference value of the outstanding Series E Convertible Preferred Stock was $39,552, and dividends totaling $2,472 had been accrued associated with said shares.

Treasury Stock

During the year ended September 30, 2003, the Company acquired 500,000 shares of its common stock from a former consultant to the Company for $45,000, which was the approximate trading value of those shares at the time the settlement was reached.

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10. COMMITMENTS AND CONTINGENCIES

Telco Billing

The acquisition of Telco by the Company called for the issuance of 17,000,000 new shares of stock in exchange of the existing shares of Telco. As part of that agreement, the Company gave the former shareholders the right to “Put” back to the Company certain shares of stock at a minimum stock price of 80% of the current trading price with a minimum strike price of $1.00. The net effect of which was that the former Telco shareholders could require the Company to repurchase shares of stock of the Company at a minimum cost of $10,000,000. The agreement required the Company to attain certain market share levels.

The “Put” feature has renegotiated and retired. As part of the renegotiated settlement, the Company provided a credit facility of up to $20,000,000 to the former Telco shareholders, collateralized by the stock held by these shareholders, with interest at least 0.25 points higher than the Company’s average cost of borrowing. Additional covenants warrant that no more that $1,000,000 can be advanced at any point in time and no advances can be made in excess with out allowing at least 30 days operating cash reserves or if the Company is in an uncured default with any of its lenders. At September 30, 2003, the Company had advanced $2,126,204 under this agreement. The former Telco shareholders have been making interest payments on the advances but, as allowed under the agreement, have not made any principal repayments.

Subsequent to September 30, 2003, the Company and the former Telco shareholders agreed to amend the arrangement whereby the Company will be required to advance only an additional $1,300,000 through April 2004 and the ability to draw on that facility will cease at that time. However, the Company made a commitment in connection with that amendment to begin paying dividends to all of its common stockholders in the fiscal year ended September 30, 2004.

Billing Service Agreements

The Company has entered into a customer billing service agreement with EBillit, Inc. (EBI). EBI provides billing and collection and related services associated to the telecommunications industry. The agreement term is for two years, automatically renewable in two-year increments unless appropriate notice to terminate is given by either party. The agreement will automatically renew on September 1, 2005, unless either party gives notice of termination 90 days prior to that renewal date. Under the agreement, EBI bills, collects and remits the proceeds to Telco net of reserves for bad debts, billing adjustments, telephone company fees and EBI fees. If either the Company’s transaction volume decreases by 25% from the preceding month, less than 75% of the traffic is billable to major telephone companies, EBI may at its own discretion increase the reserves and holdbacks under this agreement. EBI handles all billing information and collection of receivables. The Company’s cash receipts on trade accounts receivable are dependent upon estimates pertaining to holdbacks and other factors as determined by EBI. EBI may at its own discretion increase the reserves and holdbacks under this agreement.

The Company has also entered into an agreement with ACI Communications, Inc. ACI provides billing and collection and related services associated to the telecommunications industry.

These agreements with the billing companies provide significant control to the billing companies over cash receipts and ultimate remittances to the Company. The Company estimates the net realizable value of its accounts receivable on historical experience and information provided by the billing companies reflecting holdbacks and reserves taken by the billing companies and LEC’s.

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Line of Credit Facilities

The Company has a line of credit arrangement with a financial institution for a total of $250,000. Interest on borrowings is at the prime rate plus 0.5% The facility expires in May 2004. There were no outstanding borrowings under this arrangement at September 30, 2003.

The Company also has a facility to borrow from a financial institution that allows borrowings based on qualifying trade accounts receivable. The advances made under the arrangement are made on a basis of individually negotiated transactions. The advances are generally short-term, being repaid within 30 to 60 days. Advances are limited to $150,000 and accrued interest at an effective rate of 1% per month. There is no specified expiration date on the facility. There were no outstanding borrowings under this arrangement at September 30, 2003.

Other

The Company's Board of Directors has committed the Company to pay for the costs of defending a civil action filed against its CEO and Chairman. The action involves a business that the CEO was formerly involved in. The Company and at least one officer have received subpoenas in connection with this matter and the Board believes that it is important to help resolve this matter as soon as possible. The Board action includes the payment of legal and other fees for any other officers and directors that may become involved in this civil action. Through September 30, 2003, the Company has paid $732,500 on behalf of its CEO relative to this matter. This amount is presented as compensation expense within general and administrative expenses in the accompanying statement of operations for the year ended September 30, 2003. The Company believes that all civil actions against the CEO related to this matter have been dismissed subsequent to September 30, 2003. However, additional legal costs will be incurred to address all matters in finalizing this issue and, at this time, the Company cannot estimate what additional costs may be incurred to continue covering the costs related to this matter, but all such costs shall be deemed to be additional compensation to the CEO. There can be no assurance that the Company may not be named a defendant in this action in the future.

The Company has entered into "Executive Consulting Agreements" with four entities controlled by four of the Company's officers individually. These agreements call for fees to be paid for the services provided by these individuals as officers of the Company as well as their respective staffs. These agreements are not personal service contracts of these officers individually. The agreements extend through 2007 and require annual performance bonuses that aggregate up to approximately $320,000 depending upon available cash and meeting of certain performance criteria.

The Company is named as a defendant in proceedings that including alleged wrongful discharge of certain former employees and a purported class action proceeding related to the Company's mailings of marketing materials. The Company intends to defend these actions and does not believe that these claims have merit nor will the resolution of such have a material adverse effect on the Company's financial condition and results of operations.

The Company has entered into several agreements with third parties to distribute and enhance the services its provides to its customers. These agreements have terms for up to three years and call for payments of approximately $110,000 per month. Generally these agreements are cancelable within 30 to 60 days upon written notice from either party.

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11. NET INCOME PER SHARE

Net income per share is calculated using the weighted average number of shares of common stock outstanding during the year. Preferred stock dividends are subtracted from the net income to determine the amount available to common shareholders. There were $1,978 and $494 preferred stock dividends in the years ended September 30, 2003 and 2002, respectively. Warrants to purchase 500,000 shares of common stock were excluded from the calculation for the year ended September 30, 2002. The exercise price of those warrants was greater than the average trading value of the common stock and therefore inclusion of such would be anti-dilutive. Also excluded from the calculation were 131,840 shares of Series E Convertible Preferred Stock issued during the year ended September 30, 2002, which are considered anti-dilutive due to the cash payment required by the holders of the securities at the time of conversion.

The following presents the computation of basic and diluted loss per share from continuing operations:

	2003			2002		
	Income	Shares	Per Share	Income	Shares	Per share
Net Income	$ 7,615,866			$ 2,840,731		
Preferred stock dividends	(1,978)			(494)		
Income available to common Stockholders	$ 7,613,888			$ 2,840,237		
Basic Earnings Per Share:						
Income available to common stockholders	$ 7,613,888	45,591,590	$ 0.17	$ 2,840,237	41,753,464	$ 0.07
Effect of dilutive securities	N/A			N/A	N/A	
Diluted Earnings Per Share	$ 7,613,888	45,591,590	$ 0.17	$ 2,840,237	41,753,464	$ 0.07

12. RELATED PARTY TRANSACTIONS

During the years ended September 30, 2003 and 2002, the Company entered into the related party transactions with Board members, officers and affiliated entities as described below:

Directors & Officers

Board of Director fees for the years ended September 30, 2003 and 2002 were $160,000 and $101,120 respectively. These amounts are in addition to the amounts discussed below. At September 30, 2002, $40,000 of the 2002 amount was accrued but unpaid. The Company also granted 50,000 shares of common stock to a director as part of their Board of Director fees for the year ended September 30, 2002.

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During the year ended September 30, 2002, the Company had made loans to its Chief Executive Officer and its former Chief Financial Officer. The Board of Directors approved the loans as part of the officers' respective compensation packages. The loans carried an 8% interest rate and were collateralized by shares of Company common stock owned by the officers' valued at the greater of $1.00 per share or the current market price of the shares. The loans to the CEO and former CFO totaled approximately $200,000 and $17,000 respectively. At September 30, 2002, the loan to the CEO was repaid. In May 2002, the former CFO resigned.

The CEO, Executive Vice President of Marketing, Corporate Secretary/Vice President of Corporate Image and CFO are paid for their services and those of their respective staffs through separate entities controlled by these individuals which pre-date their association with the Company. The following describes the compensation paid to these entities.

Sunbelt Financial Concepts, Inc.

Sunbelt Financial Concepts, Inc. ("Sunbelt") provides the services of the Chairman and CEO and his staff to the Company.

Sunbelt provides the strategic and overall planning as well as the operations management to the Company. Sunbelt's team is experienced in all areas of management and administration.

During the year ended September 30, 2003, the Company paid a total of approximately $1,933,000 to Sunbelt. That amount includes $410,054 as reimbursement of legal fees incurred by Sunbelt related to the personal legal matters discussed in Note 10. Also included in that amount is $597,000 in fees for services rendered by Sunbelt. Additionally, the CEO and Sunbelt were awarded grants of the Company's common stock valued at approximately $603,000. Approximately $443,322 (including the taxes on these amounts) of the total remains accrued at September 30, 2003.

Advertising Management Specialists, Inc.

Advertising Management Specialists, Inc. ("AMS") provides the services of the Executive Vice President of Marketing, a Director of the Company, and his staff to the Company. AMS is a marketing and advertising company experienced in designing Direct Marketing Pieces, insuring compliance with regulatory authorities for those pieces and designing new products that can be mass marketed through the mail. AMS' president is a director of the Company.

The Company outsources the design and testing of its many direct mail pieces to AMS for a fee. AMS is also solely responsible for the new products that have been added to the Company's website and is working on new mass-market products to offer the Company's customers.

Total amount paid and accrued to this director and AMS during the year ended September 30, 2003 was $957,000. Of that amount, $477,000 was compensation for services and a stock award valued at $480,000. Of the total, $125,816 is accrued at September 30, 2003.

Advanced Internet Marketing, Inc.

Advanced Internet Marketing, Inc. ("AIM") provides the services of the Vice President of Corporate Image, a Director of the Company, and his staff to the Company. The Company outsources the design and marketing of it's website on the World Wide Web to AIM. AIM's team of designers are experienced in all areas of web design and has created all of the Company's logos and images for branding.

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The total amount paid and accrued to AIM during the year ended September 30, 2003 was $754,750. Of that amount, $74,750 was compensation for services and a stock award valued at $480,000. Of the total, $98,294 is accrued at September 30, 2003.

MAR & Associates

The services of the Company's Chief Financial Officer and his staff are paid to MAR & Associates ("MAR"). The total amount paid and accrued to MAR during the year ended September 30, 2003 was $851,000. Of that amount, $215,000 was compensation for services and a stock award valued at $636,000. Of the total, $46,198 is accrued at September 30, 2003.

Other

The Company made additional advances to former Telco shareholders of $1,800,000 during the year ended September 30, 2003. Interest earned on these advances was $92,245 for the year ended September 30, 2003. Advances to affiliates are summarized as follows at September 30, 2003:

Morris & Miller	$ 1,089,485
Mathew & Markson	1,036,719
Total	$ 2,126,204

On December 22, 2003, the Company entered into an agreement with the former Telco shareholders that terminates the line of credit agreement effective April 9, 2004.

Simple.Net, Inc. ("SN")

The Company has contracted with Simple.Net, Inc. ("SN"), an internet service provider owned by a director of the Company, to provide internet dial-up and other services to its customers. SN has sold said services to the Company at below market rate prices from time to time. During the years ended September 30, 2003 and 2002, the Company paid SN approximately $419,000 and $55,000, respectively for said services. At September 30, 2003, $80,000 due SN was accrued in accounts payable.

In addition, SN pays a monthly fee to the Company for technical support and customer service provided to SN's customers by the Company's employees. The Company charges SN for these services according to a per customer pricing formula:

Customer Service & Management Agreement fees are calculated by number of customer records of SN multiplied by a base cost of $1.02.

Technical Support fees are calculated by number of customer records of SN multiplied by a base cost of 60 cents.

For the years ended September 30, 2003 and 2002, the Company recorded revenues of approximately $618,611 and $300,901, respectively, from SN for these services.

Prior to July 2002, the Company provided accounting functions to SN for a $2,500 monthly fee. This arrangement was canceled in July 2002.

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13. CONCENTRATION OF CREDIT RISK

The Company maintains cash balances at banks in Arizona. Accounts are insured by the Federal Deposit Insurance Corporation up to $100,000. At September 30, 2003, the Company had bank balances exceeding those insured limits of $2,255,000.

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily trade accounts receivable. The trade accounts receivable are due primarily from business customers over widespread geographical locations within the LEC billing areas across the United States. The Company historically has experienced significant dilution and customer credits due to billing difficulties and uncollectible trade accounts receivable. The Company estimates and provides an allowance for uncollectible accounts receivable. The handling and processing of cash receipts pertaining to trade accounts receivable is maintained primarily by two third party billing companies. The Company is dependent upon these billing companies for collection of its accounts receivable. As discussed in Note 3, the net receivable due from a single billing services provider at September 30, 2003 was $6,457,998, net of an allowance for doubtful accounts of $2,269,027. The net receivable from that billing services provider at September 30, 2003, represents approximately 76% of the Company’s total net accounts receivable at September 30, 2003.

14. STOCK BASED COMPENSATION

During the year ended September 30, 2002, the Company’s shareholders approved the 2002 Employees, Officers & Directors Stock Option Plan (the 2002 Plan). Under the 2002 Plan, the total number of shares of common stock that may be granted is 3,000,000. The Plan provides that shares granted come from the Corporation’s authorized but unissued common stock. The price of the options granted under this plan shall not be less than 100% of the fair market value, or in the case of a grant to a principal shareholder, not less than 110% of the fair market value of such common shares at the date of grant. The options expire 10 years from the date of grant. At September 30, 2002, no stock options had been granted under the 2002 Plan.

During the year ended September 30, 2003, the Company’s Board of Directors and a majority of it shareholders voted to terminate the 2002 Plan and approved the Company’s 2003 Stock Plan ("2003 Plan"). The 3,000,000 shares of Company common stock previously allocated to the 2002 Plan were re-allocated to the 2003 Plan. Substantially all Company employees are eligible to participate in the plan. On August 12, 2003, 2,048,000 shares authorized under the 2003 Plan were granted in the form of Restricted Stock. These shares of Restricted Stock were granted to the Company’s service providers as well as the Company’s executives. Of the 2,048,000 shares of Restricted Stock granted, 1,049,000 shares vest at the end of three years, an additional 599,000 shares vest either at the end of ten years or upon the Company’s common stock attaining an average bid and ask price of $10 per share for three consecutive trading days and an additional 400,000 shares vest upon the common stock attaining various average bid and ask prices with 80,000 shares vesting for each $1 price increase at prices beginning from $5 per share up to $9 per share. The vesting of all shares of Restricted Stock accelerates upon a Change of Control, as defined in the 2003 Plan. The value of the shares granted was $2.02 per share, the trading value of the shares on the grant date. The Company deferred the expense and is recognizing the expense over the vesting periods. During the year ended September 30, 2003, the Company expensed $154,482 under the 2003 Plan. Of the 2,048,000 granted in August 2003, 75,000 of those shares were forfeited unvested as of September 30, 2003.

Under the Employee Incentive Stock Option Plan approved by the stockholders in 1998, the total number of shares of common stock that may be granted is 1,500,000. The plan provides that shares granted come from the Corporation’s authorized but unissued common stock. The price of the options granted pursuant to this plan shall not be less than 100 percent of the fair market value of the shares on the date of grant. The options expire from five to ten years from date of grant. At September 30, 2002, the Company had granted an aggregate of 1,212,000 options under this plan, all of which had expired as of September 30, 2001.

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In addition to the Employee Incentive Stock Option Plan, the Company will occasionally grant options to consultants and members of the board of directors under specific stock option agreements. There were no such options granted in the years ended September 30, 2003 and 2002.

At September 30, 2003, there were no options exercisable or outstanding. No options were granted in the years ended September 30, 2003 and 2002.

The Company has issued warrants in connection with certain debt and equity transactions. Warrants outstanding are summarized as follows:

	2003		Weighted Average Exercise Price	2002		Weighted Average Exercise Price
Warrants outstanding at beginning of year	500,000	$	2.12	500,000	$	2.12
Granted	-0-			-0-		
Expired	-0-			-0-		
Exercised	-0-			-0-		
Outstanding at September 30,	500,000	$	2.12	500,000	$	2.12

The warrants granted in the year ended September 30, 2001 were issued in connection with the settlement with the former URL holder (NOTE 4). The exercise prices of the warrants range from $1.00 to $3.00. The fair values of these warrants were estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

Dividend yield	None
Volatility	0.491
Risk free interest rate	4.18%
Expected asset life	2.5 years

The 500,000 warrants outstanding at September 30, 2003, expire in September 2006.

15. EMPLOYEE BENEFIT PLAN

The Company maintains a 401(k) profit sharing plan for its employees. Employees are eligible to participate in the plan upon reaching age 21 and completion of three months of service. The Company made contributions of $5,427 and $3,400 to the plan for the years ended September 30, 2003 and 2002, respectively.

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16. OTHER INCOME

Other income for the year ended September 30, 2003 includes $618,000 of income earned from an affiliate for technical services provided to that affiliate. The total income is reduced by expenses incurred in other legal settlements. Also, in the year ended September 30, 2002, is a gain of $130,000, net of legal costs, resulting from the settlement of a dispute with one of the Company's former billing companies.

17. QUARTERLY FINANCIAL DATA (UNAUDITED)

Subsequent to filing the interim financial statements included on Form 10-QSB for the periods ending December 31, 2001, March 31, 2002, June 30, 2002, December 31, 2002, March 31, 2003, and June 30, 2003, the Company has changed its accounting treatment of shares issued to non-performing consultants. The previously filed interim statements reflected an expense upon issuance of the shares and a reversal of this expense when it was deemed (through a settlement agreement or judgment) that these shares would be returned. However, after further analysis and consultation with the Securities and Exchange Commission, it was determined to be inappropriate to recognize the initial expense and its subsequent reversal as no services were rendered by these consultants. Instead, the issuance of these shares will be reflected as temporary equity, together with a related receivable, until the shares were returned. Such treatment is described in Note 2.

The following table sets forth the impact of this change on the following three month periods:

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	Quarter Ended December 31, 2002	Quarter Ended March 30, 2003	Quarter Ended June 30, 2003	Quarter Ended September 30, 2003
Quarterly Data Per 10-Q Filings				
Net revenues	$ 5,741,455	$ 6,849,044	$ 8,013,845	na
Gross profit	3,919,305	5,000,078	5,952,616	na
Net income	1,092,892	1,504,921	1,676,830	na
Earnings per share information:				
Basic	$ 0.02	$ 0.03	$ 0.04	na
Diluted	$ 0.02	$ 0.03	$ 0.04	na
Revised Quarterly Data				
Net revenues	$ 5,741,455	$ 6,849,044	$ 8,013,845	$ 10,163,100
Gross profit	3,803,327	5,000,078	5,952,616	7,537,677
Net income	1,017,506	1,504,921	1,676,830	3,416,609
Earnings per share information:				
Basic	$ 0.02	$ 0.03	$ 0.04	$ 0.07
Diluted	$ 0.02	$ 0.03	$ 0.04	$ 0.07

	Quarter Ended December 31, 2001	Quarter Ended March 30, 2002	Quarter Ended June 30, 2002	Quarter Ended September 30, 2002
Quarterly Data Per 10-Q Filings				
Net revenues	$ 2,992,993	$ 2,839,438	$ 3,416,953	na
Gross profit	1,808,716	2,106,037	2,248,557	na
Net income	306,349	620,288	798,742	na
Earnings per share information:				
Basic	$ 0.01	$ 0.01	$ 0.02	na
Diluted	$ 0.01	$ 0.01	$ 0.02	na
Revised Quarterly Data				
Net revenues	$ 2,992,993	$ 2,839,438	$ 3,416,953	$ 3,368,742
Gross profit	1,808,716	2,106,036	2,248,557	2,957,139
Net income	306,349	620,286	640,728	1,273,369
Earnings per share information:				
Basic	$ 0.01	$ 0.01	$ 0.01	$ 0.03
Diluted	$ 0.01	$ 0.01	$ 0.01	$ 0.03

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ITEM 8A. CONTROLS AND PROCEDURES

Disclosure controls are procedures that are designed with an objective of ensuring that information required to be disclosed in our periodic reports filed with the Securities and Exchange Commission, such as this Annual Report on Form 10-KSB, is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Disclosure controls are also designed with an objective of ensuring that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, in order to allow timely consideration regarding required disclosures.

The evaluation of our disclosure controls by our principal executive officer and principal financial officer included a review of the controls' objectives and design, the operation of the controls, and the effect of the controls on the information presented in this Annual Report. Our management, including our chief executive officer and chief financial officer, does not expect that disclosure controls can or will prevent or detect all errors and all fraud, if any. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Also, projections of any evaluation of the disclosure controls and procedures to future periods are subject to the risk that the disclosure controls and procedures may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on their review and evaluation as of a date within 90 days of the filing of this Form 10-KSB, and subject to the inherent limitations all as described above, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective. They are not aware of any significant changes in our disclosure controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Subsequent Review of Disclosure Controls

Subsequent to the foregoing conclusions, we concluded that shares granted to consultants in 1999 and 2000, most of which were subsequently recovered for nonperformance of services from 2001 to 2003, required different accounting treatment than was previously applied. This discovery has lead us to amend and restate our previously issued financial statements and other financial information for the fiscal year and quarter to date periods for the fiscal years ended September 30, 1999 through September 30, 2004.

At the time of filing the Original Filing, which was filed on December 31, 2003, our management was not aware of the internal control weaknesses relating to the accounting for shares issued to non-performing consultants. Subsequent to the filing of the Original Filing and after considering these internal control weaknesses, our chief executive officer and chief financial officer reevaluated the effectiveness of our disclosure controls and procedures as of September 30, 2003 for this Form 10-KSB/A. Based upon this reevaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were not effective as of September 30, 2003.

The historical financial statements generated by predecessor management reflected an expense upon issuance of the non-performing consultant shares and a reversal of this expense when it was deemed (through a settlement agreement or judgment) that these shares would be returned. However, after further analysis, it was determined to be inappropriate to recognize the initial expense and its subsequent reversal as no services were rendered by these consultants. Instead, the issuance of these shares will be reflected as temporary equity, together with a related receivable, until the shares were returned. Such amounts will continue to be reflected as expense in the year granted and our revised statements will no longer reflect the reversal of this expense.

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PART III

ITEM 13. EXHIBITS

The following exhibits are either attached hereto.

Exhibit Number	Description
23	Consent of Epstein, Weber and Conover P.L.C
31	Certification pursuant to SEC Release No. 33-8238, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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.

Dated: November 30, 2005

/s/ Peter J. Bergmann
Peter J. Bergmann, Chief Executive Officer