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YP NET INC
Form 10KSB/A
July 08, 2003

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

AMENDMENT NO. 2
TO
FORM 10-KSB

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 2002

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.NET, INC.
(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)

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. X Yes No .

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

Registrant's revenues for its most recent fiscal year were \$13,232,743

The aggregate market value of the common stock held by non-affiliates computed
based on the closing price of such stock on January 7, 2003 was approximately
\$1,677,062.

The number of shares outstanding of the registrant's classes of common stock, as
of January 7, 2003 was 43,963,222.

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL

YP.Net, Inc., a Nevada corporation (the "Company," "we," "us," or "our"), is in the business of providing Internet-based yellow page advertising space on or through www.Yellow-Page.Net and www.YP.Net .

The Company's "yellow page" database lists approximately 18 million businesses throughout the United States. Our website enables internet users to search through these "yellow page" listings and is used by businesses and consumers attempting to locate a business and/or service provider in response to a user's specific search criteria.

As our primary source of revenue, we offer "preferred" listings to businesses for a monthly fee (currently \$17.95). The "preferred" listing provides a business with a priority placement listing over non-paying listings and is displayed in a bigger and bolder font at the beginning of, or in the first section of the user's search results - thus featuring our paying customers more prominently to user's of our website. In addition, our paying customers get a Mini-Webpage(TM) which includes a 40-word description of their business, their hours of operation and other useful information, a direct link to the paying customers website, (if they have one and it is provided by the advertiser), map, driving directions to the paying customers location and more. As of September 30th, 2002 we have approximately 106,439 "preferred" listing advertisers who have subscribed for this enhanced advertising service. This represents less than six tenths of 1% of the estimated available market for preferred listings. We market for advertisers of our "preferred" listing service ,under the name "Yellow-Page.Net, exclusively to businesses through a direct mail solicitation program. The solicitation includes a promotional incentive (ie. generally a \$3.50 check) which, if cashed by the business, automatically signs the business up for the Preferred Listing service for an initial twelve month period with automatic renewals thereafter. This easy subscription process provides a written confirmation (ie. the check) of the subscription by the newly subscribing business, which is verified by an independent third party (i.e the paying customers depositing bank). To additionally insure the intention of sign-up, the Company then mails a written confirmation card to the newly subscribing business generally within 30 days from activation. The Company also provides a 120-day cancellation period whereby the subscribing business may cancel and receive a full refund of any amounts paid to the Company.

Recently, the Company has created an outbound calling department whose function is to proactively obtain the 40-word description to be used in the Mini-Webpage(TM), as well as other information from each newly subscribing customer. This effort is expected to provide more information for potential customers searching our website to help them choose to do business with one of our Preferred Listing advertisers.

Each paying customer is billed monthly for that month's service, the vast majority of such monthly billings appear on the subscribing business's local phone bill. Management believes this ability to bill the paying customer through the paying customers phone bill is a significant competitive advantage for the Company as few independent (not owned by a telephone company) yellow page companies are authorized to bill directly on the phone bill for services rendered.

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The Company uses Dial Up Services Inc. (d/b/a Simple.Net, Inc. ("SN")), an internet service provider beneficially owned by a director (Deval Johnson) of the Company, to provide internet dial-up and other services to our customers (See Item 12. Certain Relationships and Related Transactions). SN charges the Company \$2.50 per customer per month for such internet access. The Company's monthly charge to its customers includes this internet access service. The Company and SN share the same building address but are located in different suite numbers.

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We were originally incorporated as a New Mexico company in 1969 and the Company was re-incorporated in Nevada in 1996 as Renaissance Center, Inc. Our Articles of Incorporation were restated in July 1997 and our name was changed to Renaissance International Group, Ltd. Effective July 1998, we changed our name to RIGL Corporation. In June 1999, we acquired Telco Billing, Inc. ("Telco") and commenced our current operations through this wholly-owned subsidiary. . In October 1999, we amended our Articles of Incorporation to change our corporate name to YP.Net, Inc. to better identify our company with our business focus.

From August through December 1999, we abandoned all subsidiaries previously involved in the multi-media software and medical billing and practice management areas. With the acquisition of Telco, our business focus shifted to the Internet yellow page services business and this business is currently our main source of revenue. Telco is operated as our wholly owned subsidiary.

GROWTH INITIATIVES

Primary Growth Strategies

PREFERRED LISTINGS-We currently derive almost all of our revenue from selling Preferred Listings for the search results on our website. A Preferred Listing is displayed at the beginning of search results in response to a user's specific questions. A Preferred Listing is enhanced on the display of search results and includes a "Mini-Webpage(TM)" listing where the paying customer can use up to 40 words to advertise; among other features. Our primary growth strategy is to obtain a significantly greater number of Preferred Listings given the large, estimated potential available market for such listings. As part of this strategy, the Company has re-instituted its marketing program and plans to regularly solicit its potential customer base of approximately 18 million businesses through its direct mail solicitation program. As a result of such program, the Company has increased its customer count from 91,348 at September 30, 2001 to 113,565 at September 30, 2002_

BRANDING-The Company also plans to further embark upon a substantial campaign to brand its product using the YP.Net and Yellow-Page.Net names. The Company seeks to become the "internet yellow pages of choice" to businesses and consumers performing searches.

In addition to its cross marketing and cross placement agreement(s) with other websites, the Company has signed a contract for advertising relating to Baca Racing and National Hot Rod Association ("NHRA") events which provides us with advertising on the Baca Racing vehicles as well as public relations and advertising as a sponsor of NHRA. The contract relating to Baca Racing and the National Hot Rod Association primarily involves the payment of approximately \$20,000 as a one-time fee by the Company to gain additional exposure for the Company and its services through this mode of advertising for an 18 month

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period. In addition, we are members of both the Yellow Pages Integrated Media Association (YPIMA) and the Association of Directory Publishers (ADP). As further described under "Strategic Alliances", these organizations are trade associations for yellow page publishers that promote quality of published content and advertising methods. The Company plans to take an even more active role in the year ahead

In the future, the Company also plans to substantially increase its advertising through print, media and fixed placement advertising in select markets.

SECONDARY GROWTH STRATEGIES

Secondary growth strategies include the following:

-We are developing banner advertisements and outside marketing efforts as an additional source of revenue. The Company has also recently added website design services and Internet access services for its customers.

-As more fully described under "Technology and Infrastructure", the Company recently designed its own infrastructure to manage customer searches. The new site provides quicker, more accurate searches and will allow the Company to add new features and compete in new areas such as the new generation of hand held devices ("Personal Digital Assistants", "PDA's" and "3rd generation Cell Phones"). This site relies upon our internal development of our own Proprietary Search Engine software.

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-Resulting from our Proprietary Search Engine software, management believes this software now allows the Company to easily add enhancements to its own offerings, it could also be used to develop entirely new revenue streams that could consist of; 1. Selling custom designed data lists, 2. Syndicating other yellow page companies, 3. Licensing its use for other types of search engines. The Company is not currently pursuing these initiatives at this time, nor does the Company have any plans, arrangements or agreements to do so.

-The Company has begun to offer free long-distance calling cards to certain of its direct billing customers as an inducement for such customers to pay their invoices. Management believes that this program will improve customer retention and cash receipts. This program does not and is not intended to generate revenue for the Company, but is used solely as a means to encourage prompt payment of invoices to the Company.

STRATEGIC ALLIANCES

In order to service users more effectively and to extend our Yellow-Page.Net brand to other Internet sources, we have entered into strategic relationships with business partners offering content, technology and distribution capabilities.

The Company has cross marketing and cross placement agreement(s) with other websites, including My Area Guides and Overture/Goto.com as well as others. These agreements allow the Company to increase the page views for its customers listings and also provides the customers of such cross placement websites the ability to also achieve additional page views by being listed on the YP.Net-related websites. Generally, the nature of these agreements relate to the reciprocal hosting of each others websites without any compensation to either party. However, The Company pays My Area Guides and Overture/Goto.com \$6,000 per

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month and \$24,000 per month respectively for such agreements.

Since the founding of our subsidiary Telco Billing, Inc. in 1998 and continued through its acquisition by the Company in June of 1999, we have been members of both the Yellow Pages Integrated Media Association (YPIMA) and the Association of Directory Publishers (ADP). These organizations are trade associations for yellow page publishers that promote quality of published content and advertising methods. One of the primary responsibilities of these organizations and of its members is to promote the growth of legitimate yellow page companies that provide real value to their advertisers and to the general public at large, while working to expose those companies that take advantage of consumers. The Company plans to take an even more active role in the year ahead.

In order to broaden YP.Net's user base, we have established cross-linking relationships with operators of commercial websites and Internet access providers. There are approximately 600 affiliated websites that link and direct "traffic" to YP.Net. We believe these arrangements are important to the promotion of YP.Net, particularly among new Internet users who may access the Internet through these other websites. These co-promotional arrangements typically are terminable at will. We also utilize WebDialogs in a co-promotional effort to provide automatic dialing services to our website users to allow these users to place a call to one of our Preferred Listing customers by simply clicking a button.

We have also managed revenue sharing partnerships with Amazon.com, Buy.com, Stamps.com, and TheWallStreetJournal.com and others that allow YP.Net to generate revenue by purchases made through the link on our home page. To date, the amount of revenue generated from these partnerships is immaterial, less than 1%.

WEBSITES

We own the domain name www.YP.Net and license the www.Yellow-Page.Net domain

name under a 20 year lease expiring on September 21, 2018 from Matthew & Markson, a related party (See "Certain Relationships and Related Transactions" for a complete discussion of the terms of this agreement. We maintain one site under the name www.YP.Net and direct the "traffic" from the other domain name,

www.Yellow-Page.Net to that site for Internet access. At this website, consumers

can search our listing database containing approximately 18 million United States businesses. To draw user's to our websites, we offer a number of free services including directories and maps to the business location, free e-mail accounts, nationwide 800 and 888 directory listings, white page searches, search engines for e-mail addresses of individual persons as well as stock quotes, job searches, travel services, news and weather information, movie reviews and listings, entertainment, restaurant and shopping information. In addition, currently there are approximately 600 other websites that direct traffic to our website. In order to provide extra value to our customers, the

Company expends money to various companies who provide "traffic" to our site by insuring that we will be easily found on the national search engines.

Our directory search service integrates yellow page information by utilizing

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yellow page category headings in combination with a natural word search feature to provide a user-friendly interface and navigation vehicle. We have enhanced accurate responses to user questions by utilizing category searches in the directory services. This allows users to search by specific city, state and business categories.

As previously mentioned, we currently derive almost all of our revenue from selling Preferred Listings for the search results on our website. We are developing banner advertisements and outside marketing efforts as additional sources of revenue. The Company has also recently added website design services and Internet access services to its customers.

MARKETING

Our primary marketing efforts are through direct mail solicitations that utilize a promotional incentive (ie. generally a \$3.50 check) for listing. Once the potential customer cashes the check, they become a customer of the Company, subject to the confirmation process and cancellation period of 120 days. We market exclusively to businesses and focus on businesses that use traditional published yellow page services. We utilize our database as a source for our mailing list. We have also implemented a "customer satisfaction" program (outbound calling department). Through this program, we contact each of our customers to update the customer information regarding their business and links to their Web page. The outbound calling department's function is to proactively obtain the 40-word description to be used in the Mini-Webpage(TM), as well as other information from each newly subscribing customer. This effort is expected to provide more information for potential customers searching our website to help them choose to do business with one of our Preferred Listing advertisers.

We intend to develop marketing strategies to increase the credibility and visibility of our Web page service to targeted markets. We also intend to promote value-added services and product areas. Our future success will depend on our ability to continue to integrate and distribute information services of broad appeal. Our ability to maintain and build new relationships with content providers will be critical to our success. These relationships will, in addition to increasing revenue, lower dilution by creating a source for businesses to find the services they need. If successful, our Preferred Listing customers will be able to obtain select services at discounted prices as a consequence of their listing with us. Such services may include discounts on hotels, rental cars, office supplies; among others. We are not currently offering these discounts to our customers.

TECHNOLOGY AND INFRASTRUCTURE

One of our principal strengths is our internally developed technology that we have designed specifically for handling our Internet-based data. Our technology architecture features specially designed capabilities to enhance performance, reliability and scalability of our listing data. These features consist of multiple proprietary software modules and processes that support the core internal functions of operations. The technologies include Website Design and Maintenance, Proprietary Search Engine Software, Customer Service Applications, Billing Applications, LEC Filtering Processes, Database Management and Custom List Generation. Other than the URL's previously discussed under "Websites", the Company has not pursued any patent, trademark, license or other protections on its technology and infrastructure, nor does the Company own any other intellectual property.

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WEBSITE DESIGN AND MAINTENANCE. Since the inception of Telco billing until November 1, 2002, we have relied upon outside vendors to design and maintain the infrastructure of our Website, while we retained the ability to direct how our website looked to end users. In the fourth quarter of 2002, we designed our own infrastructure to manage the customer searches, as well as the front-end look and feel that users see and use. The new site was launched on November 1, 2002

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exactly four years to the day that Telco Billing launched its very first site. The new site provides quicker, more accurate searches and will allow the Company to add new features and compete in new areas such as the new generation of hand held devices ("Personal Digital Assistants", "PDA's" and "3rd generation Cell Phones"). This site relies upon our internal development of our own Proprietary Search Engine software.

PROPRIETARY SEARCH ENGINE SOFTWARE. The launch of our "in-house" Website required the development of our own Proprietary Search Engine software. This software is based on a relational database system (RDBS) premise which uses algorithms that accurately speeds the users search to completion. Our software provides a fast, flexible, reliable system that will operate on almost any platform including Sun, Microsoft Windows, Linux and any other Unix based operating programs. The Company has not yet pursued any patent or other protection to date on its Proprietary Search Engine software. This software not only allows the Company to easily add enhancements to its own offerings, it could also be used to develop entirely new revenue streams that could consist of; 1. Selling custom designed data lists, 2. Syndicating other yellow page companies, 3. Licensing its use for other types of search engines. The Company is not currently pursuing these additional potential revenue streams. Prior to the development of our own Proprietary Search Engine software, the Company had a co-branded syndication agreement with Intelligenix Inc. d/b/a I411.com. This agreement was terminated in August 2002. Prior to the termination, I411.com hosted the Company's website and provided the search engine for the Company's website. The agreement involved monthly payments by the Company of \$17,000.

CUSTOMER SERVICE APPLICATIONS. We have designed proprietary Customer Service Applications to enable rapid object-oriented development and management of information related to our Preferred Listing customers in a variety of formats. This application, which is currently available to our customers, provides detailed notes on each account, as well as credit card and paper check payment processing. Customer Service Representatives ("CSR's") can quickly view all contact information for the subscriber, as well as Service description, pricing, letter of authorization ("LOA"), and billing history. With these functions in place, CSR's have the ability to handle every aspect of the call. However, we are finding, as we continue to grow, that it might be advisable to purchase a third party software package from a reliable vendor that can be modified for our needs. Our own software to be potentially developed, or any that is purchased, would need to incorporate an automated retrieval system that integrates with our other technologies. This integration would enable real-time updates to our database as our customer service representatives interact with and obtain data from our Preferred Listing clientele.

BILLING APPLICATIONS. We bill primarily through local exchange carriers ("LECs") that are local telephone service providers (local phone companies). Our LEC billings are routed to the LEC's and appear on our Preferred Listing customers' telephone billing statements. To a lesser extent, we directly bill some of our Preferred Listing customers using invoices or directly bill them on the customers credit card (upon request) instead of directly on their phone bill. Our billing applications technology facilitates both our LEC and direct billing

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functions.

LEC FILTERING PROCESSES. The LEC Filtering Processes are core technologies developed to enhance the applications that support our systems. By using these processes, we are able to more accurately bill our Preferred Listings through the appropriate LEC. These processes are a vital component of our ability to aggregate content from multiple sources for our billing process. Information is sorted and updated with a method of maintaining and expanding a diverse database and allows different data sources to be combined and deployed through a single uniform interface, regardless of data structure or content. This allows a single database query to produce a single result set containing data extracted from multiple databases. Database clustering in this manner reduces the dependence on single data sources, facilitates data updates, and reduces non-conforming data submitted to the LECs.

DATABASE MANAGEMENT. We have also developed a proprietary database technology to address specific requirements of our business strategy and information infrastructure services. This technology enables us to provide our services with fewer service personnel. Our database is integrated with the applications modules and the LEC filtering processes. This database consists of our current and potential customers and is updated on a real-time basis as a customer's data is received from new listings or through our customer service representatives. We utilize this database to maintain customer service and monitor the quality of service provided by our customer service personnel. We also use the database to determine new products desired by our customers. Our technology has been specifically designed to function with a high degree of efficiency within the unique operating parameters of the Internet, as opposed to commonly used database systems.

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CUSTOM LIST GENERATION. We license the database technology that consists of over 18 million business listings throughout the United States, updated quarterly. Under these licensing agreements, we are able to custom craft mailing lists that suit our customer's needs. Customers have the ability to filter their custom list against an array of attributes ranging from gross sales of the company listed, Standard Industry Classification ("SIC") code, whether or not the listing is a publicly traded company, or if the company listed is minority owned. These lists can be generated in various Open Data Base Connectivity ("ODBC") and text formats. Lists are priced by record and the criteria provided for the query. The Company licenses data bases from Acxiom Corporation and Info USA. The agreement with Acxiom Corporation involves payments of \$30,000 per year for three years. The first two years payments totalling \$60,000 were paid upon execution of the agreement. The agreement with Info USA involves a payment of \$65,000 annually for three years as well as payments totaling \$20,000 per year for quarterly updates. Effective February 1, 2003, the Company also entered into an agreement with Experian Information Solutions Inc. ("Experian") whereby the Company and Experian exchange data. Experian provides the Company with its current listings of businesses (names, addresses etc.) in the United States and the Company provides Experian with more updated current data (updated business names, addresses etc.) on such listings that the Company comes into the knowledge of as a result of its marketing and preferred customer listing solicitation efforts. There are no payments between the two companies regarding the exchange of such data.

BILLING SERVICE AGREEMENTS

In order to bill our Preferred Listing customers through their LECs, we are required to use one or more billing service integrators. These integrators have been approved by various LECs to provide billing, collection, and related

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services through the LECs. We have entered into customer billing service agreements with Integretel, Inc. ("IGT", formally "eBillit" and currently "PaymentOne") and more recently with ACI Communications, Inc. (formally known as OAN Billing, Inc.) for these services. Under these agreements, our service providers bill and collect our charges to Preferred Listing customers through LEC billings. These amounts, net of reserves for bad debt, billing adjustments, telephone company fees (3-7% of billings, depending upon the number of records submitted) and billing company fees (approximately 3% of billings), are remitted to us on a monthly basis. On August 1, 2002, the Company signed a three year agreement with IGT. This agreement automatically renews for successive terms of one year each unless either party provides 90 days written notice of its desire not to renew. The Company's agreement with ACI is effective through September 1, 2004 and automatically renews for successive one year periods unless either party notifies the other party in writing at least 90 days prior to the expiration date. Presently, we are primarily billing through these integrators and credit card processing. The Company plans to contract with a third billing service integrator during the upcoming fiscal year to reduce its dependence upon IGT.

REGULATION

Existing laws and regulations or ones that may be enacted in the future could have a material adverse effect on our business. These effects could include substantial liability including fines and criminal penalties, preclusion from offering certain products or services and the prevention or limitation of certain marketing practices. As a result of such changes, our ability to increase our business through Internet usage could also be substantially limited.

Due to the rapid growth of Internet communications, laws and regulations relating to the Internet industry have been adopted. Such laws include regulations related to user privacy, pricing, content, taxation, copyrights, distribution, and product and services quality. Concern regarding Internet user privacy has led to the introduction of federal and state legislation to protect Internet user privacy. In addition, the FTC has initiated investigations and hearings regarding Internet user privacy that could result in rules or regulations that could adversely affect our business. As a result, the adoption of new laws or regulations could limit our ability to conduct targeted advertising, or distribute or to collect user information.

QUALITY ASSURANCE & INTERNAL SELF-REGULATION

The Company believes that the best customer care can be obtained for its customers through quality assurance initiatives. The Company believes that quality assurance should entail substantial steps to insure customer satisfaction.

Unlike several of our competitors that generally utilize larger marketing staffs than the Company, the Company has found that its direct mail marketing program, which generally utilizes a \$3.50 check, is the most economical way to obtain new customers. (See **MARKETING**) This is important to the cost that we charge our customers for the product we deliver. Because we believe that our cost for obtaining new customers is lower than many of our competitors who sell yellow pages with personal visits and other more expensive methodologies, we believe we can offer our product to our customers at a cost that we believe is much lower than our competition. Our customer care and quality assurance begins well before a new customer is obtained. The Company goes to great lengths to insure that its direct mail marketing solicitations are the most effective, yet clear pieces we can create. The Company fully acknowledges that no one can write or prepare a solicitation that 100% of the people receiving it will fully understand. While

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the law only requires that your solicitation be understood by a majority of reasonable persons, the Company strives to have solicitations that everyone will

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understand. Before a solicitation is printed for general distribution, it is reviewed by various employees (Team Members) before being sent to the Company's Legal Counsel. Once approved by the Company's Legal Counsel it is sent to attorney Charles M. Stern who is also general counsel to the Yellow Pages Integrated Media Association (YPIMA), YPIMA deals with the Federal Trade Commission and various State and Local Agencies in their fight against "Bogus" Yellow Pages. Next, the potential solicitation is forwarded to our Billing integrators. After their legal review it is forwarded to the legal departments of the Local Exchange Carrier's (local phone companies) for their approval, which insures that it follows all Federal Communication Commission (FCC) guidelines as well.

Being a Yellow Page Publisher, the Company only mails to businesses in the United States, not the general public at large.

Generally, our paying customers contract for their listings with us by depositing a check (i.e. generally a \$3.50 check). This is an easy and effective way to be sure that the business you are soliciting is the one that is contracting for the services. The customers bank provides a third-party verification of the potential customer sign-up for our Preferred Listing service. Once we receive the information that the check has been cashed we activate the new customer as a preferred listing on our website. We then attempt to contact that new advertiser via the phone to update their information and obtain the 40 -word description to be used in their Mini-Web Page. This follow-up allows the new customer to inform us about what is important about their business so that people searching our site would be able to find important information about the paying customers business.

While our settlement with the FTC (See "LEGAL PROCEEDINGS") provides that we send a confirmation card, which confirms with the new subscriber that they have indeed signed up for our service within 80 days of the check being cashed, the Company has elected to send the card in about 30 days or less from the date the check is cashed. We believe this process allows the new subscribers to evaluate the value of our offerings while still allowing those customers that are unhappy (for any reason) to cancel for a full refund within the 120 day cancellation period.

For ease of contact and at almost every point of contact with customers and prospective customers, we provide a toll free 800 number for our customers to have their questions answered and to cancel service if they are dissatisfied for any reason. The call center that answers that 800# is staffed Monday through Friday by the Company from 6 am to 5 pm M.S.T. Each Customer can receive a full refund of any monies paid to the Company within the first 120 days of signing up.

The Company has recently formed a Quality Assurance Department to monitor Team Members calls with our customers to further insure customer satisfaction. This new department is in addition to the monitoring done by the Team Members Supervisors. Recently, the Company has also created an outbound calling department ("customer satisfaction program") whose function is to proactively obtain the 40-word description to be used in the Mini-Webpage(TM). Management expects this initiative will provide more information for potential customers searching our website to help them choose to do business with one of our Preferred Listing advertisers.

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COMPETITION

We operate in a highly competitive and rapidly expanding Internet services market, however our primary market sector is business-to-business services instead of a pure technology industry. We compete with online services, website operators, and advertising networks. We also compete with traditional offline media such as television, radio, and traditional yellow page directory publishers, and print share advertising. Our services also compete with numerous directory website production, and Internet information service providers. Our largest competitors are the Local Exchange Carriers (local phone companies" or "LEC's").

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The principal competitive factors of these markets include personalization of service, ease and use of directories, quality and responsiveness of search results, availability of quality content, value-added products and services, and access to end-users. We compete with the suppliers of Internet navigational and informational services, high-traffic websites and Internet access providers, and with other media for advertising listings. This competition could result in significantly lower prices for advertising and reductions in advertising revenues. Increased competition could have a material adverse effect on our business.

Many of our competitors have greater capital resources than us. These capital resources could allow our competitors to engage in advertising and other promotional activities that will enhance their brand name recognition at levels we cannot match. The LECs have brand name recognition and access to potential customers since they have existing local access customers.

We believe that since most, if not all, of our debt is paid off, the Company is producing significant cash and our direct mail marketing program is proving to be effective that we can successfully compete in this market. Management believes that it can compete effectively by continuing to provide quality services at competitive prices and by actively developing new products for customers.

Management believes that our outbound calling department's ("customer satisfaction program") whereby we contact our customers to obtain information for their Mini Webpage(TM) and if partnered with other reputable companies, could be an additional source of revenue. Management is looking for products and services to sell as part of our outbound calling efforts

EMPLOYEES

As of January 7, 2002, we employed 23 full time personnel. Our employees are not covered by any collective bargaining agreements, and we believe our relations with our employees are good.

ITEM 2. DESCRIPTION OF PROPERTY

Our corporate offices are located in Mesa, Arizona. During Fiscal 2002, we leased a 16,772 square foot facility from Mr. Art Grandlich dba McKellips Corporate Square for approximately \$120,000 annually on a long-term operating lease through June 2003. We recently negotiated a three year extension of that lease under the same terms and conditions with The Estate of Arthur G. Granlich dba McKellips Corporate Square. As part of the consideration related to our license of the Yellow-Page.Net URL, we sublease approximately 8,000 square feet of leased space to Business Executive Services, Inc. ("BESI"), for \$1.00

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annually. This agreement expires in June 2003. However, BESI has agreed to provide 80% of its space during the period January 2003 to June 2003 at no cost to the Company in exchange for the same 20% to be retained by BESI during the lease extension at no cost to BESI. This will allow the Company to more rapidly expand its outbound calling department ("customer satisfaction program"). BESI was a related party through certain common management with the Company. See "Certain Relationships and Related Transactions," below.

ITEM 3. LEGAL PROCEEDINGS

We are party to certain legal proceedings and other various claims and lawsuits in the normal course of our business, which, in the opinion of management, are not individually or collectively material to our business or financial condition.

The Federal Trade Commission ("FTC") has aggressively pursued what it perceives as deceptive practices related to direct mailer and other promotions involving the Internet and/or LEC billing type practices. We had been involved in a significant FTC enforcement action regarding these matters. On or about June 26th, 2000 the FTC filed suit, in separate actions, against not less than 10 Internet companies of which the Company was one. Almost immediately the Company reached a preliminary settlement with the FTC (on July 13th, 2000), which essentially allowed the Company to continue "business as before", pending a final resolution. However, the Board of Directors of the Company determined that since the matter in question related to the Company's direct mail solicitations that the Company would voluntarily not mail any solicitations until a final agreement was reached with the FTC.

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With no findings of wrongdoing or admissions by us, on July 30, 2001 a Final settlement was reached. The Stipulated Final Judgment and Order for Permanent Injunction and other Equitable Relief (the "Order") was filed with the United States District Court wherein the FTC and the Company agreed to this stipulation, which states a claim upon which relief may be granted against the Company, should it be violated. The Order called for the following minor changes to our business practices; We have been restrained from using the word "rebate" on our solicitations and must state that the mailer is a solicitation of goods and services, We have voluntarily agreed not to use the "walking fingers" logo on our solicitation (unless accompanied by the language "not affiliated with any local or long distance phone company") and further have extended our refund policy to our new customers from 90 days to 120 days.

Once the settlement was reached the Company tested its solicitations using all ---
of the changes required under the agreement and upon determining that they had no material impact upon the results, resumed regular mailings in October 2001. As of this date the Company has complied with all ongoing requirements under the settlement, including the provision that all management personnel read and acknowledge the Final Order to ensure compliance.

Other than this one action, The Company and the United States Federal Trade Commission have had no other issues.

The Company is or was a Plaintiff in various legal actions:

The Company had initiated various legal actions to recover shares of stock that had been issued by former management to various consultants. In all of these

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cases, management has alleged that this stock was issued to these consultants for the promise of valuable services to be rendered that were never performed. The cases and their current status are summarized below;

-YP.Net v. Elrod Maricopa County Superior Court CV2000-021154 (154,284 shares of common stock) On July 28, 1999, Elrod was hired as a consultant to the Company relating to financial and strategic matters. He was a consultant at the time the shares were transferred to him. The Company believes that Elrod did not perform in accordance with the consulting agreement. Subsequently, Elrod transferred the shares to a third party. Proceedings in this case began on November 27, 2000. All parties have agreed to enter into a tri-partite agreement on May 8, 2002 whereby the shares would be returned to the Company. The shares have not yet been returned to the Company as Elrod is disputing the terms of the settlement agreement.

-YP.Net v. Eriksson Maricopa County Superior Court CV2000-021151 (132,500 shares of common stock) On or about July 8, 1999, Eriksson was hired as a consultant to the Company relating to financial and strategic matters. He was a consultant at the time the shares were transferred to him. The Company believes that Eriksson did not perform in accordance with the consulting agreement. Subsequently, Eriksson had transferred all of these shares to third parties. Proceedings in this case began on November 27, 2000. One of those third parties, Tiger Lewis, has returned the shares transferred to them (82,500 shares). McConkie, another third party recipient of 50,000 shares had sued the Company so that he can further transfer the shares. A tri-partite agreement has been reached whereby the shares would be returned to the Company upon payment of \$6,187.50. That payment, final settlement and return of shares to the Company occurred on or about December 12, 2002.

-YP.Net v. Wolfson Maricopa County Superior Court CV2000-021152 (385,716 shares of common stock) On July 28, 1999, Wolfson was hired as a consultant to the Company relating to financial and strategic matters. He was a consultant at the time the shares were transferred to him. The Company believes that Wolfson did not perform in accordance with the consulting agreement. After agreeing to return the shares and filing a settlement agreement in court, Wolfson transferred these shares to an undisclosed third party. Proceedings in this case began on November 27, 2000. Presently, in settlement negotiations, Wolfson has agreed to provide the name of the third party and to negotiate the return of the shares to the Company. The shares have not yet been returned.

-YP.Net v. Anderson Maricopa County Superior Court CV2000-021153 (250,000 shares of common stock) On July 28, 1999, Anderson was hired as a consultant to the Company relating to financial and strategic matters. She was a consultant at the time the shares were transferred to her. The Company believes that Anderson did not perform in accordance with the consulting agreement. Proceedings in this case began on November 27, 2000. On June 10, 2002, the Company obtained judgment in its favor rescinding the original contract and all of the shares have been awarded to the Company. The shares are in the process of being transferred by the transfer agent.

-YP.Net v. Pamela J. Thompson et al. Maricopa County Superior Court CV2002-010117 On May 29th, 2002 the Company filed suit against Pamela J. Thompson, former CFO and related parties ("Thompson") in the Superior Court of Arizona alleging, among other things, that Thompson removed Company property without authorization and misappropriated Company funds. On July 10th, 2002, the Court issued a Temporary Restraining Order against Thompson enjoining them from disclosing or disseminating the Company's trade secrets, financial or confidential information and interfering in the Company's contractual obligations or contracts of the Company. The Company is seeking the return of the misappropriated funds and the Company property removed without authorization as well as the repayment of loans outstanding to the Company. The Company is

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also seeking punitive damages, attorney fees and compensatory damages. Discovery in the case is ongoing.

The Company had made a demand for arbitration against a former billing Company for the return of funds that the Company alleged was wrongfully withheld from payments by them to us. The matter was settled by payment to the Company by the billing company of \$200,000

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The Company was named as a Defendant in a lawsuit filed by Joseph and Helen Van Sickles on May 24th, 2002 (CV2002-010296) demanding immediate repayment of a promissory note for monies loaned to the Company by The Van Sickles. The Van Sickles claimed the Company owed approximately \$500,000, which amount the Company disputed. A settlement was reached and the case was dismissed with payment by the Company of \$300,000 on October 17th, 2002.

All other matters have been settled or dismissed and no other matters are pending.

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

Our annual meeting of shareholders was held on September 20, 2002, and the following matters were submitted to our shareholders to vote.

1. Resolution for the reelection of directors.
2. Resolution for 2002 Employees', Officers', and Directors' Stock Option Plan.
3. The retention of Epstein, Weber & Conover, P.L.C. as independent public auditor.
4. The transaction of such other business as may properly come before the meeting.

The following individuals were elected to serve on our Board of Directors at our annual meeting of shareholders on September 20, 2002: Angelo Tullo, Gregory B. Crane, Daniel L. Coury Sr., DeVal Johnson, and Peter Bergmann. See "Directors and Executive Officers, Promoters, and Control Persons; Compliance with Section 16(A) of the Exchange Act," below.

The firm of Epstein, Weber & Conover, P.L.C. was elected to serve as our independent auditor for the year ended September 30, 2002.

The tabulation of votes for the foregoing matters was as follows:

1. DIRECTORS

| NAME | FOR | AGAINST | ABSTAIN |
|---------------|------------|---------|---------|
| ANGELO TULLO | 31,220,721 | 603,534 | 193,975 |
| GREGORY CRANE | 31,220,721 | 603,534 | 193,975 |
| DANIEL COURY | 31,695,721 | 138,534 | 193,575 |
| PETER BERGMAN | 31,445,821 | 378,484 | 193,975 |
| DEVAL JOHNSON | 31,220,821 | 603,434 | 193,975 |

2. 2002 STOCK OPTION PLAN

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| FOR | AGAINST | ABSTAIN |
|------------|-----------|-----------|
| --- | ----- | ----- |
| 24,187,154 | 1,022,305 | 6,811,271 |

3. RETENTION OF EPSTEIN, WEBER & CONOVER, P.L.C.

| FOR | AGAINST | ABSTAIN |
|------------|---------|---------|
| --- | ----- | ----- |
| 31,469,603 | 490,150 | 58,474 |

No other business was brought before the shareholders.

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PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

OUR COMMON STOCK

Our common stock is traded in the over-the-counter market under the symbol "YPNT."

The following table sets forth the quarterly high and low bid prices per share for the common stock by the National Quotation Bureau for the last two Fiscal Years. The quotes represent inter-dealer quotations, without adjustment for retail mark-up, markdown or commission and may not represent actual transactions.

| FISCAL YEAR | QUARTER ENDED | HIGH | LOW |
|-------------|--------------------|-------|-------|
| ----- | ----- | ----- | ----- |
| 2001 | December 31, 2000 | \$.22 | \$.21 |
| | March 31, 2001 | \$.45 | \$.20 |
| | June 30, 2001 | \$.23 | \$.18 |
| | September 30, 2001 | \$.17 | \$.10 |
| 2002 | December 31, 2001 | \$.23 | \$.06 |
| | March 31, 2002 | \$.37 | \$.12 |
| | June 30, 2002 | \$.20 | \$.05 |
| | September 30, 2002 | \$.11 | \$.05 |

On January 7, 2003, there were 525 shareholders of record of our common stock. The transfer agent for our common stock is Continental Stock Transfer and Trust in New York City, New York.

Our Preferred Stock

During the year ended September 30, 2002, the Company created a new series of capital stock, the Series E Convertible Preferred Stock (See Footnote 9 to

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the financial statements).

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, 2002, the liquidation preference value of the outstanding Series E Convertible Preferred Stock was \$39,552, and dividends totaling \$494 had been accrued and paid associated with said shares

DIVIDEND POLICY

The Company has one class of outstanding Preferred Stock. The Series E preferred shares have a dividend of \$0.015 per year, payable quarterly, and a liquidation preference of \$0.30 per share. There are 131,840 shares of outstanding Series E preferred stock.

Under Nevada law, dividends on the Company's common stock may only be paid out of net profits. Prior to our acquisition of Telco, no significant revenue had been generated. We have not paid, cash dividends on our common stock. The current policy of the Board of Directors is to retain a substantial portion of earnings to provide funds for operation and expansion of our business. The declaration of dividends is subject to the discretion of the Board of Directors, which may consider such factors as our results of operations, financial condition, capital needs and acquisition strategies, among others.

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SALES OF UNREGISTERED SECURITIES

During Fiscal 2002, we issued 50,000 shares of our common stock at a value of \$0.09 per share to a marketing consultant for services rendered and 50,000 shares to Peter Bergmann for his services as a Director. Each of these sales were made pursuant to Section 4(2) under the Securities Act of 1933, to accredited investors.

During an offering period ending May 31, 2002, we exchanged an aggregate of 131,840 shares of series E preferred stock for an equal number of shares of common stock. An aggregate of 29 shareholders participated in the exchange offer which was exempt from registration pursuant to section 3(a)(9) under the Securities Act of 1933.

Subsequent to September 30, 2002, the Company issued the following shares:

- 4,000,000 shares (value of \$300,000) to Sunbelt Financial Concepts, Inc. ("Sunbelt"), for services provided to the Company. Angelo Tullo, the Company's CEO and Chairman, is President of Sunbelt;
- 1,000,000 shares (value of \$75,000) to Advertising Management and Consulting Services, Inc. ("AMCS") for services rendered to the Company. Greg Crane, Company's Vice President of Marketing and a Director, is President of AMCS;
- 1,000,000 shares (value of \$75,000) to Advanced Internet Marketing, Inc. ("AIM") for services rendered to the Company. DeVal Johnson, the Company's Secretary and Director is President of AIM; and
- 50,000 shares (value of \$3,750) to David J. Iannini, the Company's CFO, for services rendered as such.

The restricted shares were issued based upon the average bid and ask prices at the time of issuance (\$0.075 per share) and were issued in reliance on the exemption from registration provided by Section 4 (2) of the Securities Act.

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Each of the foregoing parties was a sophisticated and accredited investor who had complete access to financial and other information related to the Company. The representative of each of the foregoing entities is either an officer or director of the Company.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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OVERVIEW

We provide Internet-based yellow page listing services on our YP.Net website. We acquired Telco Billing, Inc. in June 1999 as a wholly owned subsidiary, and, as a result of this acquisition, changed our primary business focus to become an electronic yellow page directory service. Our website enables users to search for yellow page listings in the United States. We charge our customers for a Preferred Listing of their businesses on searches conducted by consumers on our website.

The Company was originally incorporated in Nevada in 1996 as Renaissance Center, Inc. Renaissance Center and Nuclear Corporation merged in 1997. Our articles of incorporation were restated in July 1997 and our name was changed to Renaissance International Group, Ltd. Our name was subsequently changed to RIGL Corporation in July 1998. With the acquisition of Telco and shift of the focus of our business, our corporate name was again changed to YP.Net, Inc., effective October 1, 1999. The new name was chosen to reflect our focus on Internet-based yellow page services.

In order to ensure the accuracy and completeness of the Company's financial information in May, 2002, the independent members of the Company's Board of Directors engaged the services of Jerrold Pierce, the former Senior Special Agent of the Criminal Investigations Division of the Internal Revenue Service for seven western states. Mr. Pierce performs unannounced inspections of the Company's financial records at least once every quarter. Mr. Pierce reports his findings directly to the independent members of the Board, and to the Board in its entirety. To date, Mr. Pierce has found no irregularities with current management

RESULTS OF OPERATIONS

Fiscal Year End September 30, 2002 Compared to Fiscal Year End September 30, 2001.

Revenue for the year ended September 30, 2002 ("Fiscal 2002") was \$13,232,743 compared to \$13,501,966 for the year ended September 30, 2001 ("Fiscal 2001"). The decrease in revenue is principally the result of a change in revenue recognition on direct billings. In Fiscal 2002, revenue on direct billings was recognized only as cash was collected in order to be more conservative. In Fiscal 2001, direct revenue was recognized upon providing the Preferred Listing service and a reserve against such revenues was established in accordance with SAB #101. Management believes that recognizing direct billings as revenue upon cash collection is more conservative than its previous methodology. Comparing Fiscal 2002 to Fiscal 2001 revenues using the current revenue recognition policy, revenue for Fiscal 2002 increased by approximately \$1,400,000 compared to Fiscal 2001 or approximately 12 % .

We utilize direct mailings as our primary marketing program and this program generates our principal revenue of the Company. Our subscribing customers

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increased to 113,565 at September 30, 2002, approximately a 24 % increase for the fiscal year.

Cost of Services for Fiscal 2002 were \$3,811,394 compared to \$6,150,085. The decrease in cost of services is due to a decrease resulting from lower dilution (ie.unbillable customer phone numbers, customer credits, LEC charge-backs) in 2002 compared to 2001 resulting from the previously mentioned improvement in the Company's LEC billing filtering process. We have been able to reduce our dilution expenses with the third party billing companies, as the Company becomes better able to track its individual subscriber billings and collections, The Company ceased its relationship with a billing company due to the higher cost of doing business with this third party biller. The Company reduced its total billing related expenses by \$3,826,000 in the year ended September 30, 2002 primarily due to its ability to challenge dilution charges made by these third party billers.

General and administrative expenses for Fiscal 2002 were \$4,754,665 compared to \$3,987,040 for Fiscal 2001. The increase was principally the result of increased staffing costs of \$953,000 and legal and professional fees of approximately \$182,000. These higher costs were partially offset by lower expense of consultants and rent expense. The Company added staff in anticipation of adding an outbound customer service group and to begin performing more of the billing process in-house.

Sales and marketing expenses for Fiscal 2002 were \$963,868 compared to \$688,349 for Fiscal 2001. The increase was principally the result of our re-instituting our marketing efforts in Fiscal 2002. The marketing expenses are attributed to our direct response marketing, which is our primary source of attracting new customers. In Fiscal 2001, the Company's management decided to cease all direct mail marketing efforts until we had entered into a final settlement agreement with the FTC. In July 2001 we entered into a settlement agreement and voluntarily complied with the order set forth by the FTC. See our Form 10-QSB for the period ended June 30, 2001.

Operating income in Fiscal 2002 was \$3,121,526 compared to \$2,073,066 in Fiscal 2001 representing an increase of approximately 50%. Income before income taxes was \$3,450,489 in Fiscal 2002 and \$3,042,728 in Fiscal 2001. Excluding gains on common shares received and retired under legal settlements (recorded

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as other income), income before income taxes in Fiscal 2002 was \$3,182,814 compared to \$1,317,698 in Fiscal 2001, an increase of over 140%. The exclusions of the settlement gains for comparison purposes is relevant because these matters are not expected to recur. The increases in both operating income and income before income taxes were the result of the substantial savings in the billing company and LEC dilution expenses and lower interest expense due to lower debt levels in Fiscal 2002. The Company is likely to continue to experience lower billing expenses as a percentage of revenue but not on the level of the gains experienced in Fiscal 2002. However, the Company intends to increase its marketing efforts in the short term resulting in higher marketing expenses.

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 \$399,833 for the year ended September 30, 2002. Annual amortization expense in future years related to

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the URL is anticipated to be approximately \$200,000-300,000

Interest expense for Fiscal 2002 was \$92,341 compared to \$571,248 for Fiscal 2001. The decrease in interest expense was a result of decreased debt due to the repayment of approximately \$800,000 of debt in Fiscal 2002.

During the year ended September 30, 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 \$1,471,000 related to these net operating losses recorded at September 30, 2001, was fully offset by a valuation allowance. That valuation allowance was eliminated and recognized as a benefit in the year ended September 30, 2002. Due to these changes, the Company recognized an income tax benefit of \$1,614,716 for the year ended September 30, 2002. At September 30, 2002 the Company has utilized all of its federal and state net operating losses.

Net profits for Fiscal 2002 were \$3,696,463 , or \$0.08 per share, compared to \$1,812,281, or \$0.04 per share for Fiscal 2001. The increase in Net income resulted from the increased subscribing customer count and associated revenue cited above with a less than corresponding increase in expenses cited above as well as the usage by the Company of remaining net operating losses which reduced the income tax provision from the previous fiscal year.

LIQUIDITY AND CAPITAL RESOURCES

Our cash balance increased to \$767,108 for Fiscal 2002 from \$683,847 for Fiscal 2001. We funded working capital requirements primarily from cash generated from operating activities and utilized cash in investing activities and financing activities, primarily through repayments of debt.

Operating Activities. Cash provided by operating activities was \$1,158,015 for Fiscal 2002 compared to \$3,880,158 for Fiscal 2001. The principal source of our operations revenue is from sales of Internet yellow page advertising. The decrease in cash provided from operations resulted from an increase in the Company's accounts receivable and customer acquisition costs due to the increased subscribing customer count resulting from our marketing solicitation program.

Investing Activities. Cash used by investing activities was \$244,077 for Fiscal 2002 compared to \$165,672 for Fiscal 2001. We purchased \$77,632 of computer equipment in Fiscal 2002 compared to \$28,520 of computer equipment in Fiscal 2001. Increased computer purchases in Fiscal 2002 resulted from growth in the customer base in Fiscal 2002 and in preparation for anticipated future growth in the customer base.

Financing Activities. Cash flows used from financing activities were \$830,677 for Fiscal 2002 compared to \$3,250,252 for Fiscal 2001. We had cash outflow of approximately \$800,000 in Fiscal 2002 relating to the repayment of debt and cash outflow in Fiscal 2001 resulting from the repayment of our credit facility relating to Matthew Markson Ltd. of \$3,199,452 . During Fiscal 2002, the Company established a Trade Acceptance Draft program with Actrade Financial Technologies which enables the Company to borrow up to \$150,000 . A trade acceptance draft ("TAD") is a draft signed by the Company made payable to the order of a vendor providing services to the Company. Actrade provides payment to the vendor and collects from the Company the amount advanced to the vendor (plus interest) under extended payment terms, generally 30,60 or 90 days. When used, the Company pays a rate of 1% 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 incurred debt in the acquisition of the license right to the Yellow-Page.Net

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URL. A total of \$4,000,000 was borrowed, \$2,000,000 from Joseph and Helen VanSickle, \$1,000,000 from shareholders of the Company and \$2,000,000 as a Note from Matthew & Markson Ltd. Management which has dedicated payments in the amount of \$100,000 per month for the payment of the VanSickle note. This note was paid in full subsequent to year end. Management had also dedicated payments to the Matthew & Markson note in the amount of \$100,000 per month, with the provision that no payment be made if we have less than 30 days operating capital reserved, or if we are in an uncured default with any of our lenders. The original note

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has been paid in full while a balance of \$115,866 remains on another note to Matthew & Markson. (see "Certain Relationships"). A total of 4,500,000 shares of our common stock were issued to secure these notes and are held in escrow.

Collections on accounts receivables are received primarily through the billing service integrators under contract to administer this billing and collection process. The billing service providers 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, the Company entered into a new agreement with its primary billing service provider, IGT, 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 2002 we paid \$2,258,006 in advertising and marketing compared to \$3,781,485 in Fiscal 2001. Management anticipates the outlays for direct-response advertising to remain consistent over the next year.

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 each of 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.

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The "Puts" were renegotiated and retired. As part of the renegotiated settlement, the Company provided a credit facility of up to \$10,000,000 to each of the former Telco shareholders (Mathew & Markson and Morris & Miller. See Item 11.), 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, 2002, the Company had advanced \$233,073 under this agreement.

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On September 20, 2002, the Company entered into Executive Consulting Agreements with Sunbelt Financial Concepts Inc. ("Sunbelt"), Advertising Management and Consulting Services, Inc. ("AMCS") and Advanced Internet Marketing Inc. ("AIM") relating to the employment of three executive managers and their respective staffs. (See Certain Relationships and Related Transactions"). As part of these agreements a Flex Compensation program was instituted. Under these agreements, each of Sunbelt, AMCS and AIM may annually draw up to \$220,000, \$50,000 and \$30,000 respectively subject to sufficient cash on hand at the Company. The amounts are increased by 10% annually and also contain a Due on Sale Clause, whereby if there is a change of control of the Company, as defined, then the respective agreements allows each to receive the greater of 30% of the amounts due under the respective agreements or 12 months worth of fees.

FUTURE OUTLOOK

For fiscal year 2003 we expect to continue our customer satisfaction program whereby we contact our existing customers for their many Mini-Webpage(TM) information and to develop and market new products. We also are generating a new revenue source to provide customer service and technical services to related and industry entities. We presently have agreements with Dial-Up Services, Inc. (dba Simple.Net) to provide both customer and technical services. Simple.Net is an Internet service provider ("ISP") beneficially owned by a director (Deval Johnson) of the Company. SN charges the Company's customers \$2.50 per month for internet access. (See Footnote 12 to the financial statements).

We have offered our customers Internet access services and are currently gaining customers weekly. Our dial-up ISP backbone provider is Simple.Net. Under our current provider's network, over 65 percent of the US's population has the ability to dial to a local point of presence. The remaining population will be allowed access through an 800 number solution. This revenue stream will prove vital in expanding our ability to reach various customer needs.

Our future success will depend on our ability to integrate continually and distribute information services of broad appeal. Our ability to maintain our relationships with content providers and to build new relationships with additional content providers is critical to our marketing plan.

FACTORS WHICH MAY AFFECT FUTURE OPERATING RESULTS

Set forth below and elsewhere in this Annual Report and in the other documents we file with SEC, including the most recent Form 10-QSB, are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in the Annual Report.

GROSS MARGINS MAY DECLINE OVER TIME: We expect that gross margins may be adversely affected because we have determined that profit margins from the electronic yellow pages offerings that we have profited from in the past have fluctuated. We have experienced a decrease in revenue from the LEC from the effects of the Competitive Local Exchange Carriers (CLEC) that are participating in providing local telephone services to customers. 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. 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 continue to look for profitable Internet opportunities; however there are no assurances that we will be successful, and presently we have no acquisitions in progress.

DEPENDENCE ON KEY PERSONNEL: Our performance is substantially dependant on the performance of our executive officers and other key employees and 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 employees could have a material adverse effect on our business, results of operations or financial condition. 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.

Since our Growth Rate may slow, operating results for a particular quarter are difficult to predict: We expect that in the future, our net sales may grow at a slower rate on a quarter-to-quarter basis than experienced in previous periods. This may be a direct cause of the projected changes to our direct marketing Pieces. See "MARKETING," above. As a consequence, operating results for a particular quarter are extremely difficult to predict. Our ability to meet financial expectations could be hampered if we are unable to correct the billing through the CLEC markets seen in the fourth quarter continue in the future. Additionally, in response to customer demand, we continue to attempt develop new products to reduce our customer attrition rates.

REGULATORY ENVIRONMENT. Existing laws and regulations and any future regulation may have a material adverse effect on our business. These effects could include substantial liability including fines and criminal penalties, preclusion from offering certain products or services and the prevention or limitation of certain marketing practices. As a result of such changes, our ability to increase our business through Internet usage could also be substantially limited.

ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
YP.NET, INC.

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INDEPENDENT AUDITORS' REPORT

To the Stockholders and Board of Directors of
YP.Net, Inc.:

We have audited the accompanying consolidated balance sheet of YP.Net, Inc. as of September 30, 2002 and the related consolidated statements of operations, stockholders' equity and cash flows for each of the two years in the period ended September 30, 2002. 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 audits in accordance with generally accepted auditing standards. 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of YP.Net, Inc. as of September 30, 2002, and the consolidated results of its operations and cash flows for each of the two years in the period ended September 30, 2002, in conformity with generally accepted accounting principles.

/s/ EPSTEIN, WEBER & CONOVER, P.L.C.
Scottsdale, Arizona
December 2, 2002

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YP.NET, INC.

CONSOLIDATED BALANCE SHEET
SEPTEMBER 30, 2002

ASSETS:

CURRENT ASSETS

| | |
|---|------------|
| Cash and cash equivalents | \$ 767,108 |
| Accounts receivable, net | 3,561,808 |
| Prepaid expenses and other current assets | 64,211 |
| | ----- |
| Total current assets | 4,393,127 |

| | |
|---|-----------|
| ACCOUNTS RECEIVABLE - long term portion | 513,485 |
| CUSTOMER ACQUISITION COSTS, net of accumulated amortization of \$718,594 | 1,418,227 |

| | |
|-----------------------------|---------|
| PROPERTY AND EQUIPMENT, net | 274,459 |
|-----------------------------|---------|

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| | | |
|---|----|------------------------------|
| DEPOSITS AND OTHER ASSETS | | 150,725 |
| INTELLECTUAL PROPERTY- URL, net of accumulated amortization of \$1,481,148 | | 3,578,542 |
| ADVANCES TO AFFILIATES | | 233,073 |
| TOTAL ASSETS | | <u>\$10,561,638</u> ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY: | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ | 195,396 |
| Accrued liabilities | | 182,797 |
| Notes payable - current portion | | 352,362 |
| Deferred income taxes | | 87,221 |
| Income taxes payable | | 486,243 |
| Total current liabilities | | <u>1,304,019</u> |
| NOTES PAYABLE - long-term portion | | 115,866 |
| DEFERRED INCOME TAXES | | 5,921 |
| Total liabilities | | <u>1,425,806</u> ----- |
| 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, 50,000,000 shares authorized, 43,531,840 issued and outstanding | | 43,532 |
| Paid in capital | | 4,287,207 |
| Treasury stock at cost | | (171,422) |
| Retained earnings | | 4,965,309 |
| Total stockholders' equity | | <u>9,135,832</u> ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | | <u>\$10,561,638</u> ===== |

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, 2002 AND SEPTEMBER 30, 2001

| | 2002 | 2001 |
|--------------|--------------|--------------|
| | ----- | ----- |
| NET REVENUES | \$13,232,743 | \$13,501,966 |

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| | | |
|---|--------------|--------------|
| OPERATING EXPENSES: | | |
| Cost of services | 3,811,394 | 6,150,085 |
| General and administrative expenses | 4,754,665 | 3,987,040 |
| Sales and marketing expenses | 963,868 | 688,349 |
| Depreciation and amortization | 581,290 | 603,426 |
| | ----- | ----- |
| Total operating expenses | 10,111,217 | 11,428,900 |
| | ----- | ----- |
| OPERATING INCOME | 3,121,526 | 2,073,066 |
| | ----- | ----- |
| OTHER (INCOME) AND EXPENSES | | |
| Interest expense and other financing costs | 92,341 | 571,248 |
| Interest income | (17,682) | (7,342) |
| Other Income | (403,622) | (1,533,568) |
| | ----- | ----- |
| Total other expense | (328,963) | (969,662) |
| | ----- | ----- |
| INCOME BEFORE INCOME TAXES | 3,450,489 | 3,042,728 |
| INCOME TAX PROVISION (BENEFIT) | (245,974) | 1,230,447 |
| | ----- | ----- |
| NET INCOME | \$ 3,696,463 | \$ 1,812,281 |
| | ===== | ===== |
| NET INCOME PER SHARE: | | |
| Basic | \$ 0.08 | \$ 0.04 |
| | ===== | ===== |
| Diluted | \$ 0.08 | \$ 0.04 |
| | ===== | ===== |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING: | | |
| Basic | 43,745,045 | 40,623,126 |
| | ===== | ===== |
| Diluted | 43,745,045 | 40,623,126 |
| | ===== | ===== |

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, 2002 AND SEPTEMBER 30, 2001

COMMON STOCK

PREFERRED A

TREASURY

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| | SHARES | AMOUNT | SHARES | AMOUNT | STOCK |
|---|-------------|----------|-------------|----------|--------------|
| | ----- | ----- | ----- | ----- | ----- |
| BALANCE OCTOBER 1, 2000 | 40,560,464 | \$40,561 | 1,500,000 | \$ 1,500 | \$ (69,822) |
| Common stock issued for consulting services | 850,000 | 850 | | | |
| Common stock received and retired under legal settlements | (1,596,784) | (1,597) | | | |
| Common stock issued for extension on debt | 4,000,000 | 4,000 | | | |
| Cancellation of preferred stock | | | (1,500,000) | (1,500) | |
| Purchase of treasury stock | | | | | (101,600) |
| Value of common stock warrants issued | | | | | |
| Net income | | | | | |
| BALANCE | ----- | ----- | ----- | ----- | ----- |
| SEPTEMBER 30, 2001 | 43,813,680 | \$43,814 | - | \$ - | \$ (171,422) |
| | ===== | ===== | ===== | ===== | ===== |

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| | TOTAL |
|---|--------------|
| | ----- |
| BALANCE OCTOBER 1, 2000 | \$ 5,198,411 |
| Common stock issued for consulting services | 148,800 |
| Common stock received and retired under legal settlements | (1,725,030) |
| Common stock issued for extension on debt | 360,000 |
| Cancellation of preferred stock | (1,500) |
| Purchase of treasury stock | (101,600) |
| Value of common stock warrants issued | 7,176 |
| Net income | 1,812,281 |
| BALANCE | |
| SEPTEMBER 30, 2001 | \$ 5,698,538 |
| | ===== |

(CONTINUED)

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

YP.NET, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE
YEARS ENDED SEPTEMBER 30, 2002 AND SEPTEMBER 30, 2001 (CONTINUED)

| | COMMON STOCK | | PREFERRED E | | TREASURY | PAY |
|---|--------------|----------|-------------|----------|-------------|--------|
| | SHARES | AMOUNT | SHARES | AMOUNT | STOCK | CAP |
| BALANCE OCTOBER 1, 2001 | 43,813,680 | \$43,814 | - | \$ - | \$(171,422) | \$4,55 |
| Common stock issued for services | 100,000 | 100 | | | | |
| Common stock received and retired under legal settlements | (250,000) | (250) | | | | (26 |
| Series E preferred stock issued in exchange for common shares | (131,840) | (132) | 131,840 | 11,206 | | (1 |
| Series E preferred stock dividends | | | | | | |
| Net income | | | | | | |
| BALANCE SEPTEMBER 30, 2002 | 43,531,840 | \$43,532 | 131,840 | \$11,206 | \$(171,422) | \$4,28 |

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

YP.NET, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE
YEARS ENDED SEPTEMBER 30, 2002 AND SEPTEMBER 30, 2001

| CASH FLOWS FROM OPERATING ACTIVITIES: | 2002 | 2001 |
|--|--------------|--------------|
| Net income | \$ 3,696,463 | \$ 1,812,281 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 581,290 | 603,426 |
| Issuance of common stock as compensation for services | 9,000 | 148,800 |
| Penalties related to acquisition debt paid by issuance of debt, warrants and stock | - | 917,967 |
| Non-cash income recognized on return of common stock related to legal settlements | (267,675) | (1,725,030) |
| Deferred income taxes | 490,101 | 268,556 |

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| | | |
|--|-------------|-------------|
| Provision for uncollectible accounts | 1,375,226 | (760,859) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (2,580,410) | 1,617,467 |
| Customer acquisition costs | (1,224,983) | 37,654 |
| Prepaid and other current assets | (44,042) | 79,060 |
| Deposits and other assets | (127,438) | (11,500) |
| Accounts payable | (119,511) | 161,089 |
| Accrued liabilities | 106,069 | (230,644) |
| Income taxes payable | (736,075) | 961,891 |
| | ----- | ----- |
| Net cash provided by operating activities | 1,158,015 | 3,880,158 |
| | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Advances made to affiliate | (116,757) | (137,152) |
| Expenditures for intellectual property | (49,688) | - |
| Purchases of equipment | (77,632) | (28,520) |
| | ----- | ----- |
| Net cash used for investing activities | (244,077) | (165,672) |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Principal repayments on borrowings from line of credit | - | (1,577,547) |
| Principal repayments on notes payable | (830,677) | (1,621,905) |
| Purchase of treasury stock | - | (50,800) |
| | ----- | ----- |
| Net cash used for financing activities | (830,677) | (3,250,252) |
| | ----- | ----- |
| INCREASE IN CASH AND CASH EQUIVALENTS | 83,261 | 464,234 |
| CASH AND CASH EQUIVALENTS, beginning of year | 683,847 | 219,613 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS, end of year | \$ 767,108 | \$ 683,847 |
| | ===== | ===== |

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, 2002 AND 2001

SUPPLEMENTAL CASH FLOW INFORMATION:

| | 2002 | 2001 |
|-------------------|----------|-----------|
| | ----- | ----- |
| Interest Paid | \$99,541 | \$421,013 |
| | ===== | ===== |
| Income taxes paid | \$ -0- | \$ -0- |
| | ===== | ===== |

SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:

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| | 2002 | 2001 |
|---|----------|-----------|
| | ----- | ----- |
| Common stock issued for services | \$ 9,000 | \$148,800 |
| | ===== | ===== |
| Note payable issued in payment of debt extension fee | \$ -0- | \$550,791 |
| | ===== | ===== |
| Value of common stock issued as payment of debt extension fee | \$ -0- | \$360,000 |
| | ===== | ===== |
| Common stock exchanged for Series E Convertible Preferred Stock | \$11,206 | \$ -0- |
| | ===== | ===== |
| Liability incurred for purchase of treasury stock | \$ -0- | \$ 50,800 |
| | ===== | ===== |

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, 2002 AND 2001

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 web site 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

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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, 2002 and September 30, 2001. Certain reclassifications have been made to the September 30, 2001 balances to conform to the 2002 presentation.

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, 2002, cash deposits exceeded those insured limits by \$563,000.

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 \$1,941,000 and \$575,000 during the years ended September 30, 2002 and 2001 respectively. The Company amortized \$719,000 and \$613,000, respectively, of these capitalized costs during the years ended September 30, 2002 and 2001.

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 \$245,000 and \$75,000 for the years ended September 30, 2002 and 2001 respectively.

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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 \$178,058 and \$156,343 for the years ended September 30, 2002 and 2001 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

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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 billings are generally included on the telephone bills of the customers. Due to billings submitted by the Company being subject to adjustment by the billing companies and the LEC's, 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. Revenues generated under billings through the LEC's were approximately \$12,311,000 and \$13,005,000 for the fiscal years ended September 30, 2002 and September 30, 2001 respectively.

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. Collections under this billing process have historically been poor. Monthly direct bill subscription fee revenue is recognized as earned within the month for which the service is provided. However, these monthly billings are adjusted to take into consideration the poor collection experience. The Company continuously reviews this estimate for reasonableness based on its collection experience. Revenues generated under direct billings were \$651,000 and \$529,000 for the years ended September 30, 2002 and 2001 respectively.

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.

Financial Instruments: Financial instruments consist primarily of cash,

accounts receivable, 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 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.

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.

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.

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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." The proforma effect of the fair value method is discussed in Note 15.

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 June 2001, the Financial

Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets. The Company will be required to adopt SFAS No. 142 at the beginning of its 2003 fiscal year. The Company is currently reviewing the impact of adoption of SFAS 142, but does not believe the adoption of such will have a material effect on the financial position and results of operations of the Company.

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In June 2001, the FASB issued Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations. The Company is currently reviewing the impact of adoption of SFAS 143, but does not believe the adoption of such will have a material effect on the financial position and results of operations of the Company.

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The Company will be required to adopt SFAS No. 144 at the beginning of its 2003 fiscal year. SFAS No. 144 supersedes SFAS 121, but carries over most of its general guidance. The Company is currently reviewing the impact of adoption of SFAS 144, but does not believe the adoption of such will have a material effect on the financial position and results of operations of the Company. However, the provisions of SFAS will be applied to long-lived assets such as the URL.

3. ACCOUNTS RECEIVABLE

The Company provides billing information to third party billing companies for the majority of its monthly billings. Billings submitted are sorted and analyzed for accuracy and completeness ("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

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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 entered into a customer billing service agreement with Integretel, Inc. Integretel provides the majority of the Company's billings, collections, and related services. The net receivable due from Integretel at September 30, 2002 was \$3,955,218, including an allowance for doubtful accounts of \$1,695,093.

At September 30, 2002, the Company still had certain amounts due from Enhanced Services Billing, Inc. (ESBI). In prior years, ESBI provided billing and collection services very similar to Integretel, discussed above, but was gradually phased out during the year. The receivable due from ESBI at September 30, 2002 of \$154,037 has been fully reserved as collectibility of the remaining amount is doubtful.

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 returns and allowances. The net subscriptions receivable at September 30, 2002 was \$108,659.

Gross accounts receivable and the aggregate related allowance was \$5,944,422 and \$1,869,129 at September 30, 2002. The following allowances on accounts receivable existed at September 30, 2002:

| | |
|---|--------------|
| Allowance for doubtful accounts | \$ 1,034,899 |
| Allowance for billing company holdbacks | 545,608 |
| Allowance for LEC holdbacks | 288,622 |
| Total | \$ 1,869,129 |
| | ===== |

The Company expensed billing fees to the LEC's and third party billing companies of \$1,718,573 and \$5,544,906 for the years ended September 30, 2002 and 2001 respectively.

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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 Universal Resource Locator (URL) Yellow-page.net.

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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, 2001, 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.

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, 2002. The URL is amortized on an accelerated basis over the twenty-year term of the licensing agreement. Amortization expense on the URL was \$403,232 and \$471,667 for the years ended September 30, 2002 and 2001 respectively.

5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at September 30, 2002:

| | |
|-------------------------------|------------|
| Leasehold improvements | \$ 332,492 |
| Furnishings and fixtures | 108,629 |
| Office and computer equipment | 256,588 |
| | ----- |
| Total | 697,709 |
| Less accumulated depreciation | (423,250) |
| | ----- |

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Property and equipment, net \$ 274,459
=====

The Company has provided certain office equipment and leasehold improvements to an affiliated entity at no cost to that affiliated entity. This arrangement was made as part of the Company's original default settlement with the prior owners of the URL discussed in Note 4. The Company retains title and control of these assets; however, they are not being used by the Company. The net book value of the office equipment and leasehold improvements being utilized by the affiliated entity was approximately \$60,000 at September 30, 2002.

6. NOTES PAYABLE AND LINE OF CREDIT

Notes payable at September 30, 2002 are comprised of the following:

| | |
|--|-----------------------------|
| Note payable to stockholders, original balance of 2,000,000, interest at 10% per annum. Repayment terms require monthly installments of \$100,000 plus interest. Due January 11, 2002. Collateralized by 2,000,000 shares of the Company's common stock. Note was paid off subsequent to September 30, 2002. | \$205,362 |
| 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. | 115,866 |
| Trade acceptance draft, interest at 12.25% per annum, due November 4, 2002. Collateralized by certain trade accounts receivable. | 147,000 468,228 ----- |
| Less current portion | 352,362 |
| Totals | \$115,866 ----- |

Subsequent to year-end, the Company settled the outstanding amount due on the note payable to stockholder resulting in an immaterial gain on extinguishment.

The note payable to the former Telco stockholders totaled \$550,000 at the beginning of the fiscal year. 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.

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The trade acceptance draft is effected similarly to factoring accounts

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receivable. The Company enters into separate financing agreements with the lender for specific accounts receivable.

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 year ended September 30, 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 \$1,471,000 related to these net operating losses recorded at September 30, 2001, was fully offset by a valuation allowance. That valuation allowance was eliminated and recognized as a benefit in the year ended September 30, 2002. Due to these changes, the Company recognized an income tax benefit of \$1,614,716 for the year ended September 30, 2002. At September 30, 2002 the Company has utilized all of its federal and state net operating losses.

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

| | 2002 | 2001 | | |
|------------------------------|--------------|-------------|--|--|
| | ----- | ----- | | |
| Current Provision | \$ 486,243 | \$ 961,891 | | |
| Deferred (Benefit) Provision | (732,217) | 268,556 | | |
| | ----- | ----- | | |
| Net income tax provision | \$ (245,974) | \$1,230,447 | | |
| | ===== | ===== | | |

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

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|--|--------------|-------|-------------|-----|
| | 2002 | | 2001 | |
| | ---- | | ---- | |
| Federal statutory rates | \$ 1,173,166 | 34% | \$1,034,527 | 34% |
| State income taxes | 241,534 | 7% | 197,777 | 6% |
| Utilization of valuation allowance | (1,471,141) | (43)% | - | - |
| Change in estimate of NOL due to structuring changes | (143,575) | (4)% | - | - |
| Other | (45,958) | (1)% | (1,857) | - |
| | ----- | | ----- | |
| Effective rate | \$ (245,974) | (7)% | \$1,230,447 | 40% |
| | ===== | | ===== | |

At September 30, 2002, deferred income tax assets totaling \$593,984 were comprised of \$494,252 and \$99,733 related to differences in book and tax bases of accounts receivable and intangible assets respectively. During the year ended September 30, 2002 the valuation allowance was reduced by \$1,471,000. There was no change in the valuation allowance in the year ended September 30, 2001.

At September 30, 2002 deferred tax liabilities of \$687,127 were comprised of \$581,473 and \$105,654 related to differences in book and tax bases of customer acquisition costs and property and equipment respectively.

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8. LEASES

The Company leases its office space and certain equipment under long-term operating leases expiring through fiscal year 2005. Rent expense under these leases was \$145,052 and \$175,464 for the years ended September 30, 2002 and 2001, respectively.

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

| | |
|-------|-----------|
| 2003 | \$138,015 |
| 2004 | 42,417 |
| 2005 | 28,278 |
| | ----- |
| Total | \$208,710 |
| | ===== |

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, 2002, the Company issued 100,000 shares of common stock to officers and directors valued at \$9,000.

During the year ended September 30, 2001, the Company issued 850,000 shares of common stock to officers, directors and consultants valued at \$148,800

Common Shares Received and Retired Under Legal Settlements

The Company made claims against numerous parties for return of common shares issued in the fiscal year ended September 30, 1999 to consultants by former management. Some of these claims resulted in litigation. During the years ended September 30, 2002 and 2001, the Company settled with seven of those parties resulting in 250,000 and 1,596,784 shares in 2002 and 2001, respectively, of the Company's common stock being returned and retired. These transactions have been recognized as other income of \$267,675 and \$1,725,030 in the accompanying statements of operations for the years ended September 30, 2002 and 2001, respectively. The rescission and return of the common stock was recorded at the value of the original transactions that were rescinded, that is, the recorded expense for the original issuance of the shares was, in effect, reversed in the years ended September 30, 2002 and 2001.

Common Stock Issued for Debt Extension

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The former holder of the Yellow-page.net. URL made a claim against the

Company in the year ended September 30, 2001. The former URL holder claimed

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that it was owed \$1,000,000 that represented a loan extension fee for an extension given in 1999. The Company disputed the claim but ultimately settled with the former URL holder. The settlement agreement required the Company to pay the former URL holder \$550,000, 4,000,000 shares of the Company's common stock and warrants for and additional 500,000 shares of the Company's common stock. 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.

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, 2002, the liquidation preference value of the outstanding Series E Convertible Preferred Stock was \$39,552, and dividends totaling \$494 had been accrued and paid associated with said shares.

Treasury Stock

During the year ended September 30, 2001, the Company acquired 254,000 shares of its common stock from a single stockholder for \$101,600. At September 30, 2002, there were 3,858,500 shares of stock held in treasury.

Other

The Company granted 1,700,000 shares of Series B preferred stock to certain employees during the year ended September 30, 1999. The Series B preferred stock has no stated dividend. The Series B preferred shares were convertible to common stock at the option of the holder. The shares were convertible at varying rates depending upon the trading price of the common stock at the time of conversion. The initial conversion rate was one share of common for each share of preferred. Conversion may not occur until certain "trigger events" occur and all rights with respect to the preferred shares terminate on November 30, 2004. "Trigger events" are defined as trading prices of the Company's common stock reaching or exceeding \$5 through \$10 per share and net income reaching or exceeding \$5,000,000. No value was assigned to the preferred shares in the accompanying balance sheet nor was any compensation expense recognized for the year ended September 30, 2001, because the preferred shares were not exercisable at the time of issuances because of the failure of the Company to meet the "trigger events". Subsequently, management has cancelled the Series B

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preferred stock and rescinded those issuances and all shares of the Series B preferred stock were returned as of September 30, 2001.

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 each of 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.

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The "Puts" were renegotiated and retired. As part of the renegotiated settlement, the Company provided a credit facility of up to \$10,000,000 to each of the former Telco shareholders (Mathew & Markson and Morris & Miller), 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 than \$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. The advance agreement has no stipulated expiration date. At September 30, 2002, the Company had advanced \$233,073 under this agreement. The interest rate on these advances was 8% at September 30, 2002. Based on the requirement for 30 days cash reserve, the Company estimates that the maximum balance that could be drawn under this agreement at September 30, 2002 is approximately \$525,000. At September 30, 2002, \$233,073 was drawn on the advance agreement.

Billing Service Agreements

The Company has entered into a customer billing service agreement with Integretel, Inc. (IGT). IGT 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, 2003, unless either party gives notice of termination 90 days prior to that renewal date. Under the agreement, IGT bills, collects and remits the proceeds to Telco net of reserves for bad debts, billing adjustments, telephone company fees and IGT 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, IGT may at its own discretion increase the reserves and holdbacks under this agreement. IGT 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 IGT. IGT may at its own discretion increase the reserves and holdbacks under this agreement.

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The Company has also entered into an agreement with ACI Billing Services, 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.

United States Federal Trade Commission (FTC)

The Company was a subject of an FTC investigation pertaining to claims made of deceptive marketing practices. The Company has reached an agreement with the FTC requiring the Company to make certain changes to mailing and promotional materials and notify certain customers that a refund of past paid service fees is available. The settlement requires the Company to notify approximately 11,000 customers. Each of those customers may receive a refund of up to \$12.50. At September 30, 2001, the Company accrued \$45,413 which was paid in the year ended September 30, 2002. Management does not believe that there will be any additional material refunds. The Company may also be required to pay certain expenses incurred in the FTC investigation. The Company intends to contest payment of these expenses but believes that if such is a requirement of any final settlement with the FTC, the amount could range from \$50,000 to \$70,000.

11. NET INCOME PER SHARE

Net loss 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 \$494 and \$ 0 preferred stock dividends in the years ended September 30, 2002 and 2001, 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 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.

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

| | 2002 | | 2001 | | |
|---------------------------|-------------|-----------|-------------|--------|-----------|
| Income | Shares | Per Share | Income | Shares | Per share |
| Net Income | \$3,696,463 | | \$1,812,281 | | |
| Preferred stock dividends | (494) | | - | | |
| | | | | | |

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| | | | | | | |
|--|-----------------------------|-------------------|-------------------------|-----------------------------|-------------------|------------------------|
| Income available to common Stockholders | \$3,695,969 ===== | | \$1,812,281 ===== | | | |
| BASIC EARNINGS PER SHARE: | | | | | | |
| Income available to common stockholders | \$3,695,969 ===== | 43,745,045 | \$ 0.08 ===== | \$1,812,281 ===== | 40,623,126 | \$ 0.0 ===== |
| Effect of dilutive securities | N/A | N/A | | N/A | N/A | |
| DILUTED EARNINGS PER SHARE | \$3,695,969 ===== | 43,745,045 | \$ 0.08 ===== | \$1,812,281 ===== | 40,623,126 | \$ 0.0 ===== |

12. RELATED PARTY TRANSACTIONS

During the years ended September 30, 2002 and 2001, 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, 2002 and 2001 were \$101,120 and \$45,000 respectively. The Company also paid entities owned or controlled by certain board members \$147,625 and \$147,000 in 2002 and 2001, respectively, for consulting services other than routine Board duties. At September 30, 2002, \$40,000 of the 2002 amount was accrued but unpaid. The Company also granted 100,000 shares of common stock to certain directors as part of their Board of Director fees for the year ended September 30, 2002.

During the year ended September 30, 2002, the Company made loans to its Chief Executive Officer and its 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 CFO totaled approximately \$200,000 and \$17,000 respectively. At September 30, 2002, the loan to the CEO was repaid and a bonus of a similar amount was paid. In May 2002, the CFO resigned. The Company believes the value of the collateral may not be sufficient to cover the outstanding loan balance. Thus, the Company has fully reserved the balance due on the loan.

At September 30, 2002, the Company had advanced \$15,000 to its CEO related to his fiscal 2003 compensation and recorded a corresponding receivable. This amount will be amortized to compensation expense during the 2003 fiscal year. During the year ended September 30, 2001, the Company paid an entity controlled by its CEO approximately \$158,000 for consulting services. During the years ended September 30, 2002 and 2001, the Company paid approximately \$70,000 and \$67,000, respectively, to an entity owned by its former CFO for other professional services. During the year ended September 30, 2002, the Company paid approximately \$27,000 to an entity owned by its former COO for certain consulting services he provided to the Company subsequent to his June 2002 termination of employment.

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

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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, 2002 and 2001, the Company paid SN approximately \$55,000 and \$68,000, respectively for said services. At September 30, 2002, \$40,963 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:

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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, 2002 and 2001, the Company recorded revenues of approximately \$300,901 and \$22,813, 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.

The principal stockholders of the Company have provided significant financing to SN in the form of interest bearing loans. Said stockholders are not involved in the management of or represented on the boards of the Company or SN.

Commercial Finance Services d/b/a/ HR Management ("CFS")

The Company leases its employees from Commercial Finance Services, Inc. d/b/a HR Management (CFS). CFS provides factoring and financing services as well as act as a professional employer organization ("PEO") for small to mid-sized companies. CFS does not provide any services to the Company, other than those of a PEO. The majority of the Company's payroll is paid via CFS. This arrangement allows the Company to offer additional employee benefits by sharing those costs with other clients of CFS. The Company pays CFS a monthly fee of \$2,800 for payroll and benefit administration.

The majority owner of CFS is Central Account Services, Inc. (CAS). CAS is partially owned by the Company's primary legal counsel (3% ownership) and its former CFO (4% ownership). The remaining ownership of CAS is unrelated to the Company. The principal stockholders of the Company have provided significant financing to CFS in the form of an interest bearing loan. Said stockholders are not involved in the management of or represented on the boards of the Company or SN.

Business Executive Services, Inc.

The Company has contracted with Business Executive Services, Inc. ("BESI"), an entity affiliated through certain common management, for processing of direct mail solicitation, welcome letters, and other customer communications. BESI subleases a portion of the Company's office space.

The Company pays a base fee of \$15,750 per month plus a fee based on a per mail piece price of \$0.015 based on the number of mail pieces prepared and

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sent. The floor amount is adjusted quarterly. During the year ended September 30, 2002, the Company paid \$176,149 to BESI related to this agreement.

A director (Greg Crane) of the Company was employed, through an employee leasing arrangement, by BESI and received a salary of approximately \$2,000 per month from BESI and bonuses in an undetermined amount. Mr. Crane is no longer employed by BESI. BESI has no ownership in the Company. The Company paid BESI \$90,000 under this arrangement.

Advertising Management & Consulting Services, Inc. -----

Advertising Management & Consulting Services Inc. ("AMCS"), 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. AMCS' president is a director of the Company.

The Company outsources the design and testing of its many direct mail pieces to AMCS for a monthly fee of \$20,000 per month. 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.

Other -----

As part of the Company's original default settlement with the prior owners of the URL discussed in Note 4, the Company has provided certain equipment and improvements to an affiliated entity at no cost to that affiliated entity. The Company retains title and control of these assets. However, the assets are not being utilized by the Company. The net book value of the office equipment and leasehold improvements being utilized by the affiliated entity was approximately \$60,000 at September 30, 2002. The Company is also providing office space to this entity for substantially below market rental rates. This entity is affiliated through commonality of certain management members.

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Advances to affiliates are summarized as follows at September 30, 2002:

| | |
|--------------------|------------|
| Sunbelt Financial | \$ 197,640 |
| | ===== |
| The Thompson Group | 16,899 |
| Mathew & Markson | 233,073 |
| Total | 447,612 |
| | ----- |
| Less allowance | (214,539) |
| Total | \$ 233,073 |
| | ----- |

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, 2002, the Company had bank balances exceeding those insured limits of \$580,000.

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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 a single third party billing company. The Company is dependent upon this billing company for collection of its accounts receivable.

14. STOCK BASED COMPENSATION

From time to time, the Company issues stock options to executives, key employees and members of the Board of Directors. The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," and continues to account for stock based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". Accordingly, no compensation cost has been recognized for stock options granted to employees. There were no options granted in the years ended September 30, 2002 and 2001 nor was there any additional vesting of options previously granted.

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.

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.

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, 2002 and 2001.

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At September 30, 2002, there were no options exercisable or outstanding. No options were granted in the years ended September 30, 2002 and 2001.

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

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| | 2002 | | 2001 | |
|---|---------|--|-----------|--|
| | | Weighted Average Exercise Price | | Weighted Average Exercise Price |
| | ----- | ----- | ----- | ----- |
| Warrants outstanding at beginning of year | 500,000 | \$ 2.12 | 350,000 | \$ 2.00 |
| Granted | -0- | | 500,000 | \$ 2.12 |
| Expired | -0- | | (350,000) | \$ 2.00 |
| 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, 2002, 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 \$3,400 and \$2,300 to the plan for the years ended September 30, 2002 and 2001.

16. OTHER INCOME

Other income for the year ended September 30, 2002, includes a gain of \$267,000 related to the rescission of a consulting contract that was entered into in a prior year (NOTE 9). Also, included 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.

* * * * *

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ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

On March 14, 2000, we reported that we replaced McGladry and Pullen LLP as our principal certified public accountants. McGladry and Pullen LLP had been engaged as the independent auditors, but had not issued any audited reports.

On March 30, 2000, we appointed King, Weber & Associates, P.C., as our independent auditors to conduct the audit of our September 30, 2000 fiscal year

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financial statements. On December 31, 2000 King, Weber & Associates, P.C. changed its corporate name to Marshall & Weber, CPA's, PLC and subsequently changed its corporate name to Weber and Company P.C. On September 18, 2001, the Company had appointed Weber & Company P. C. as our independent auditors to conduct the audit of our September 30, 2001 fiscal year financial statements. During Fiscal 2002, Weber & Company P. C. merged with Epstein & Connover P. C. to become Epstein, Weber & Connover P. L. C. On September 20, 2002 we appointed Epstein, Weber & Connover P. L. C. as our independent auditors to conduct the audit of our September 30, 2002 financial statements.

PART III

ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS, PROMOTERS, AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

DIRECTORS AND EXECUTIVE OFFICERS

The following biographical information is provided for each of the Company's Directors and Executive Officers:

ANGELO TULLO. Mr. Tullo has served as the Chairman of the Board of YP.Net since February 2000. Mr. Tullo was hired as Chief Executive Officer and President on September 10, 2000. Since December 1999, Mr. Tullo has also been the president of Sunbelt Financial Solutions, Inc., an investment banking and consultant firm in Scottsdale, Arizona. From January 1997 to December 1999, Mr. Tullo was an officer and director of American Business Funding Corp. Currently and for over twenty years, Mr. Tullo has been active as a business consultant. Mr. Tullo has actively worked with commercial financing and factoring for the past ten years. He has owned and operated factoring companies, leasing companies, consulting companies, wholesale companies, professional employment organizations, insurance agencies, heating and air-conditioning contractors, retail oil companies, real estate companies and restaurants. He is a former member of the CEO Club in New York, and current a member of the Presidential Business Roundtable Committee.

In February 2000, American Business Funding Corp. filed for protection under Chapter 11 of the Bankruptcy Code in the Federal District Court of Arizona. Mr. Tullo had previously been a director, officer and shareholder of American Business Funding prior to the time of its bankruptcy filing.

GREGORY B. CRANE. Mr. Crane has been a director of YP.Net since February, 2000 and also served as its Director of Operations from February 2000 to September 2000. Mr. Crane is the President of AMCS. AMCS provides marketing and administrative services as well as personnel to the Company. From mid 1997 to December 2002, he was a marketing consultant to BESI, a related party to the Company (See "Certain Relationships and Related Transactions"). From September 1998 to June 1999, Mr. Crane was the General Manager of Telco Billing, Inc. ("Telco"). Mr. Crane has also owned and/or operated several businesses, including residential and commercial builders, multi-state mail order, and document-preparation companies (including State Recording Services, Inc.), and was also the creator of the Yellow-Page.Net concept. Mr. Crane is a former member of the Young Entrepreneur's Organization ("YEO").

In connection with providing homestead declaration document preparation and filing services, Mr. Crane (personally) and one of these businesses (State Recording Services, Inc.) have been subject to injunctive actions brought by the states of Arizona, Florida, Texas and Washington. Mr. Crane was the President and a significant shareholder of State Recording Services, Inc. These actions generally raised legal questions concerning mailer solicitations for document preparation services. Mr. Crane and various of the state plaintiffs have entered into consent orders in connection with these actions that required the

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modification of mailers and the payment of civil penalties, restitution, and attorneys' fees. Regarding each injunctive action, the use of the mail solicitation for document preparation services was prohibited in the State of Washington and Mr. Crane satisfied a judgment rendered in December 1994 of \$500,000. Mr. Crane voluntarily entered into an agreement with the State of Florida in connection with these matters and due to an error in type size made by the printing company; Mr. Crane technically violated that order. In connection with that violation of the Florida order, Mr. Crane was subject to a judgment, dated February 1998, in the amount of approximately \$1.4 million, plus accrued interest. As of February 2003, this judgment has expired and is no longer binding on Mr. Crane under Florida law and is in the process of being vacated. The injunctive actions in Arizona and Texas were both satisfied in April 1995 for primarily attorneys fees and refund offers to customers.

Mr. Crane was also named in the action filed by the Federal Trade Commission ("FTC") against the Company and has been included in the stipulated preliminary order entered into by the FTC and us and approved by the FTC. The Stipulated Final Judgment and Order for Permanent Injunction and Other Equitable Relief by and between the FTC, Mr. Crane, Telco, us and others (the "Order") places certain restrictions on the way mail solicitations will appear. The Order has been approved by the U.S. District Court Judge and the matter is closed with no findings of wrong doing on the part of the company, its officers and directors or Mr. Crane.

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DANIEL L. COURY. Mr. Coury has served as a director of YP.Net since February 2000. For the last twelve years, Mr. Coury's principal business has been Mesa Cold Storage, Inc., which owns and operates the largest cold storage facilities in Arizona. He is also involved in the ownership and operation of various real estate interests and business ventures.

DEVAL JOHNSON. Mr. Johnson has served as a director since October 1999. Mr. Johnson was the graphics designer and director of Telco Billing from September 1998 until June 1999 when the Company acquired it. Since that time, Mr. Johnson has been responsible for the design of the in-house sales presentations and creation of the corporate logo(s) and image for YP.Net. In 2001, Mr Johnson formed his own company called Advanced Internet Marketing, Inc. to provide design and marketing services to a variety of companies and has continued to offer these services to YP.Net. In 2002, Mr. Johnson accepted the position of Vice President of Corporate Image for YP.Net. From 1995 through 1998, Mr. Johnson was a graphics designer for Print Pro, Inc. Mr. Johnson is actively involved with Website promotion, interactive design and Internet advertising. Mr. Johnson also serves as an officer and board member and is the beneficial owner of Simple.Net a national Internet service provider, a related party. See "Certain Relationships and Related Transactions".

PETER BERGMANN. Mr. Bergmann has served as a director of the Company since May 2002. Since January 1999, Mr. Bergmann has served as the President of Perfect Timing Media, Inc. ("Perfect Timing"), a television development and production company which he founded. Perfect Timing focuses primarily on family fare programming. From 1994 to 1999, Mr. Bergmann was a member of the faculty at Fairleigh Dickinson University where he inaugurated the Electronic Filmmaking and Digital Video Design program which is a distinctive program in video and computer-generated graphics technologies offering students an opportunity to study commerce and art. In 1988, Mr. Bergmann joined Major Arts, Inc., a division of Paramount Communications, Inc., as the head of its television division where he was responsible for developing projects for television production. In 1987, Mr. Bergmann served as the President of Odyssey Entertainment, Inc. where he engineered the purchase of Coast Productions, Inc., which subsequently became Odyssey Filmmakers, Inc. where he served as President.

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From 1984 through 1987, Mr. Bergmann served as President of The Film Company where he had directorial and production responsibilities for theatrical releases and projects for television. During the 14 years prior to 1984, Mr. Bergmann was employed in various capacities by the American Broadcasting Company. These positions included line producer, division head, assistant to the President, Executive Vice President and Special Assistant to the Chairman of the Board. Mr. Bergmann received his PhD from New York University.

David J. Iannini. Mr. Iannini has served as the Chief Financial Officer since August 2002. Mr. Iannini was employed by Viad Corp from July 1999 to June 2002. He was Viad Corp Treasurer and Vice President of Corporate Development . Viad Corp. is a diversified service business with operating companies involved in the financial services, convention, travel and other businesses. Viad Corp. is an SEC Reporting company. Mr. Iannini was an investment banker from August 1986 to July 1999 , primarily with Salomon Brothers, Inc. Mr. Iannini received his Masters in Business Administration, Summa Cum Laude, from the Anderson Graduate School of Management at U.C.L.A. Prior to his graduate studies, he worked with a Big Five accounting firm and is a C.P.A. Mr. Iannini received his Bachelors of Science degree, Magna Cum Laude, in Accounting from Boston College in 1981.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based solely on review of reports under Section 16(a) of the Securities Exchange Act of 1934, as amended, that were filed by executive officers and directors and beneficial owners of 10% or more of our common stock during the fiscal year ended September 2002, to the best of the Company's knowledge, except as follows, all 16(a) filing requirements have been made through the fiscal year ended September 30, 2001, and September 30, 2002. This information is based on a review of Section 16(a) reports furnished to us and other information.

| Name | # of Reports |
|----------------|--------------|
| ---- | ----- |
| Angelo Tullo | 4 |
| Greg Crane | 5 |
| DeVal Johnson | 3 |
| Dan Coury | 1 |
| Peter Bergmann | 1 |
| David Iannini | 1 |

ITEM 10. EXECUTIVE COMPENSATION

DIRECTORS AND EXECUTIVE OFFICERS

The directors and executive officers of YP.Net, their ages and positions are as follows:

| NAME | AGE | POSITIONS HELD(1) |
|----------------------|-----|--|
| ----- | --- | ----- |
| Angelo Tullo | 47 | Chairman of the Board, Director, Chief Executive Officer and President |
| Gregory B. Crane | 38 | Vice President and Director |
| DeVal Johnson | 36 | Vice President, Secretary and Director |
| David J. Iannini, | 43 | Chief Financial Officer |
| Daniel L. Coury, Sr. | 48 | Director |

Peter Bergmann

54 Director