PARAGON POLARIS STRATAGIES COM INC
Form 10QSB
June 20, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

[X] Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended MARCH 31, 2003

[ ] Transition Report pursuant to 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period to

Commission File Number 000-33163

ICOWORKS, INC.

(Exact name of small Business Issuer as specified in its charter)

NEVADA	76-0609444
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

SUITE 1700, 1111 WEST GEORGIA STREET VANCOUVER, BRITISH COLUMBIA, CANADA	V6E 4M3
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number, including area code: 604-681-1754

FORMER NAME: PARAGON POLARIS STRATEGIES.COM INC.

FORMER FISCAL YEAR: DECEMBER 31

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days [ ] Yes [X] No

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 12,886,398 SHARES OF $.001 PAR VALUE COMMON STOCK OUTSTANDING AS OF JUNE 13, 2003.

PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

2

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)

CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)

(Unaudited)

MARCH 31, 2003

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
CONSOLIDATED BALANCE SHEET
(Expressed in U.S. Dollars)
(Unaudited)

	March 31, 2003
ASSETS	
Current assets	
Cash	$ 132,645
Available-for-sale equity securities	8,530
Accounts receivable	61,802
Income taxes recoverable	920
Inventory	2,218,326
Prepaid expenses	92,462
Deferred bonus	-
Deferred tax asset less valuation allowance	-

Total current assets	2,514,685
Property and equipment	88,584
Deferred financing costs	304,554
Intangible asset	296,835
Total assets	$3,204,658

- continued -

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

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
CONSOLIDATED BALANCE SHEET
(Expressed in U.S. Dollars)
(Unaudited)

	March 31, 2003
Continued	
LIABILITIES AND DEFICIENCY IN ASSETS	
Current liabilities	
Accounts payable and accrued liabilities	$ 2,810,856
Due to related parties	785,329
Total current liabilities	3,681,185
Commitments and contingencies	
Minority interest	(71,127)
Deficiency in assets	
Common stock	
Authorized	
100,000,000 common shares with a par value of $0.001	

Issued and outstanding 12,886,398 common shares	12,886
Additional paid-in capital	2,484,817
Accumulated other comprehensive loss	(8,730)
Accumulated deficit	(2,809,372)
Total deficiency in assets	(320,399)
Total liabilities and deficiency in assets	$ 3,204,658

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

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
CONSOLIDATED STATEMENTS OF OPERATIONS
(Expressed in U.S. Dollars)
(Unaudited)

	Three Month Period Ended March 31, 2003	Three Month Period Ended March 31, 2002	Nine Month Period Ended March 31, 2003	Nine Month Period Ended March 31, 2002
SALES	$ 722,754	$ 542,131	$ 1,397,887	$ 629,143
COST OF SALES	666,506	289,305	1,035,730	352,056
GROSS MARGIN	56,248	252,826	362,157	277,087
EXPENSES				
Amortization of customer list	44,526	44,526	133,576	59,367
Amortization of deferred bonus	18,896	-	56,686	-
Depreciation	20,606	-	32,166	-
General and administrative	568,380	415,870	1,207,726	563,909
	652,408	460,396	1,430,154	623,276
Loss before minority interest in net loss of subsidiaries	(596,160)	(207,570)	(1,067,997)	(346,189)

MINORITY INTEREST IN NET LOSS OF SUBSIDIARIES	(71,127)	-	(71,127)	-
Loss before other items and income taxes	(525,033)	(207,570)	(996,870)	(346,189)
OTHER INCOME (EXPENSES)				
Foreign exchange loss	(172)	-	(172)	-
Interest income	7,356	17	7,858	168
Gain on settlement of accounts payable	-	-	-	55,000
Gain on sale of assets	11,551	-	7,367	-
Loss on sale of available-for-sale equity securities	(8,588)	-	-	-
Total other income, net	10,147	17	15,053	55,168
Loss before income taxes	(514,886)	(207,553)	(981,817)	(291,021)
INCOME TAX BENEFITS	(3,792)	-	(3,792)	-
Net loss	$ (511,094)	$ (207,553)	$ (978,025)	$ (291,021)
Basic and diluted net loss per share	$ (0.05)	$ (0.04)	$ (0.14)	$ (0.05)
Weighted average number of common shares outstanding	9,495,064	5,531,461	6,937,219	5,321,399

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

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Expressed in U.S. Dollars)
(Unaudited)

	Nine Month Period Ended March 31, 2003	Nine Month Period Ended March 31, 2002
Net loss	$(978,025)	$(291,021)
Change in cumulative translation		

adjustment	(8,677)	(6,507)
Comprehensive loss	$(986,702)	$(297,528)

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

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in U.S. Dollars)
(Unaudited)

	Nine Month Period Ended March 31, 2003	Nine Month Period Ended March 31, 2002
CASH FROM OPERATING ACTIVITIES		
Net loss	$ (978,025)	$(291,021)
Items not involving cash:		
Accrued management fees due to a related party	153,000	102,000
Amortization of customer list	133,576	-
Amortization of deferred bonus	56,686	-
Depreciation	32,166	59,365
Foreign exchange gain	-	(6,506)
Gain on settlement of accounts payable	-	(55,000)
Minority interest in net loss of subsidiaries	(71,127)	-
Reversal of contingent liability	-	(63,530)
Shares issued for consulting services	-	42,200
Shares issued for financing fees	-	4,200
Impairment of property and equipment	-	1,215
Changes in non-cash working capital items:		
(Increase) decrease in accounts receivable	43,896	(60,882)
Decrease in income taxes recoverable	21,868	-
(Increase) decrease in inventory	(2,208,631)	4,726
Increase in prepaid expenses	(87,001)	(2,716)
Increase (decrease) in accounts payable and accrued liabilities	2,509,308	(276,226)
Net cash used in operating activities	(394,285)	(542,175)
CASH FROM INVESTING ACTIVITIES		
Cash acquired on purchase of subsidiaries	-	270,958

Sale of available-for-sale equity securities	1,299	-
Purchase of subsidiary	-	(115,000)
Purchase of property and equipment	(50,010)	(11,371)
Net cash used in investing activities	(48,781)	(144,587)

- continued -

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

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in U.S. Dollars)
(Unaudited)

	Nine Month Period Ended March 31, 2003	Nine Month Period Ended March 31, 2002
Continued...		
CASH FROM FINANCING ACTIVITIES		
Issuance of common stock, net of issuance costs	91,086	1,110,100
Increase (decrease) in due to related parties	350,101	(496,347)
Net cash provided by financing activities	441,187	613,753
Change in cash during the period	(1,879)	216,155
Cash, beginning of period	134,524	1,269
Cash, end of period	$132,645	$ 217,433
Cash paid during the period for interest	$ -	$ -

Cash paid during the period for income taxes	$ -	$ -

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

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

1. HISTORY AND ORGANIZATION OF THE COMPANY

Icoworks, Inc. (formerly Paragon Polaris Strategies.com Inc.) (the "Company") was incorporated in the State of Nevada on May 27, 1999. On July 1, 1999, the Company acquired limited rights to distribute and produce an oxygen enriched water product for fish farming, aquaculture, mariculture, poultry raising and for treating animal waste from dairies, feedlots of all kinds and for other similar uses. The rights to use this technology were subsequently withdrawn by agreement with the owner and the Company subsequently acquired a three year license to market and sell vitamins, minerals, nutritional supplements from Vitamineralherb.com Inc. This business was abandoned by the Company.

On February 20, 2003, the Company acquired 56% of the issued and outstanding capital stock of Icoworks Holdings, Inc. ("Icoworks Holdings") consisting of 3,593,199 shares from several non-U.S. stockholders. As consideration, the Company issued 7,186,398 common shares to the former non-U.S. stockholders of Icoworks Holdings and control of the combined companies passed to the former non-U.S. stockholders of Icoworks Holdings. The acquisition was accounted for as a business combination (Note 4).

The consolidated statements of operations, stockholders' equity (deficiency) and cash flows of the Company prior to February 20, 2003 are those of Icoworks Holdings. The Company's consolidated date of incorporation is considered to be February 27, 1998, the date of inception of Icoworks Holdings. Following the acquisition, the Company changed its name from Paragon Polaris Strategies.com Inc. to Icoworks, Inc.

Icoworks Holdings is a Nevada incorporated company whose principal business activity consists of the conduct of customized auctions for corporate assets such as wholesale and retail inventories, used industrial equipment and other related goods. During the year ended June 30, 2002 and prior to the acquisition of the Company, Icoworks Holdings purchased all the issued and outstanding

capital stock of two companies, Icoworks Services Ltd. and DM International Appraisals & Consulting Ltd. (Note 5). Icoworks Holdings also has two other subsidiaries, being Icoworks Eastern Ltd. and Icoworks Joint Venture Ltd.

Interim reporting

The accompanying unaudited consolidated financial statements have been prepared by the Company in accordance with the rules and regulations of Regulation S-B as promulgated by the Securities and Exchange Commission. In the opinion of management, the accompanying unaudited financial statements contain all adjustments necessary (consisting of normal recurring accruals) to present fairly the financial information contained therein. The accompanying unaudited financial statements do not include all disclosures required by generally accepted accounting principles in the United States of America. The results of operations for the three and nine month periods ended March 31, 2003 are not necessarily indicative of the results to be expected for the year ending June 30, 2003.

2. GOING CONCERN

These consolidated financial statements have been prepared reflecting the on-going assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business rather than through a process of forced liquidation. However, certain conditions noted below currently exist which raise substantial doubt about the Company's ability to continue as a going concern. These consolidated financial statements do not include any adjustments to the amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

2. GOING CONCERN (cont'd)

The operations of the Company have primarily been funded by the issuance of capital stock. Continued operations of the Company are dependent on the Company's ability to complete additional equity financings or generate profitable operations in the future. Management's plan in this regard is to secure additional funds through future equity financings. Such financings may not be available or may not be available on reasonable terms.

	March 31, 2003
Accumulated deficit	$ (2,809,372)
Working capital (deficiency)	(1,166,500)

===

3. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned and partially-owned subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

Use of estimates

The preparation of financial statements in accordance with generally accepted accounting principles in the United States of America 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 amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Foreign currency translation

The Company has determined that the functional currency of certain of its wholly-owned and partially-owned subsidiaries is the local currency, the Canadian dollar. Assets and liabilities denominated in foreign currency are translated into U.S. dollars at the period end exchange rates. Revenue and expenses are translated at the rates of exchange prevailing on the dates such items are recognized in earnings. Related exchange gains and losses are included in a separate component of shareholders' equity under other comprehensive income. Exchange gains and losses resulting from foreign currency transactions are included in income for the period.

Marketable securities

Marketable securities are classified into available-for-sale or trading securities stated at fair market values. Any unrealized holding gains or losses are to be reported as a separate component of shareholders' equity until realized for available-for-sale securities, and included in earnings for trading securities.

==

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Inventory

Inventory is stated at the lower of cost or net realizable value. Cost is generally determined on the first in, first out basis.

Property and equipment

Property and equipment are recorded at cost less accumulated depreciation. Depreciation is recorded on a declining balance basis at the following annual rates:

Auction equipment	20%
Automotive equipment	30%
Computer equipment	30%
Computer software	50%
Leasehold improvements	Lease term
Office equipment	20%
Sign	20%
Tools and equipment	20%

Intangible asset

Intangible assets are recorded at cost and amortized using the straight-line method over their estimated useful lives. As at March 31, 2003, the intangible asset consists of a customer list with an estimated useful life of 3 years (Note 5).

The carrying value of intangible assets is re-evaluated for potential permanent impairment on an ongoing basis at the reporting unit level. In order to determine whether permanent impairment exists, management considers the Company's and its subsidiaries' financial condition as well as expected pre-tax earnings, undiscounted cash flows or market related values. If the carrying value of intangible assets of a reporting unit exceeds the fair value of the reporting unit, the carrying value of intangible assets must be written down to fair value in the year the impairment is recognized.

Revenue recognition

Revenues consist of two main activities, auction revenues and held for sale revenues. Auction revenues are comprised of buyers premiums, being premiums over and above the purchase prices of items sold, and commissions paid by consignors of items for auction. Held for sale revenues are comprised of revenues from items purchased and held for sale and or liquidation. Revenue is recognized once the auction or sales are completed and collection is reasonably assured. Other commissions are earned when the Company provides guarantees on the gross proceeds to be received from sale to the consignor.

The Company conducts these sales where it, or in joint venture with others, temporarily acquires title to the goods. Where these activities are conducted, the profits are divided between the Company and the joint venturers on a negotiated basis. If the actual proceeds are less than cost, or less than the guaranteed price, the Company may be required to fund the shortfall (Note 12).

Revenue is also earned from fees charged for appraisals and is recognized when

the work is completed and collection is reasonably assured.

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

==

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes are recognized for the future income tax consequences attributable to differences between the financial statement carrying values and their respective income tax bases (temporary differences). Future income tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period in which the change occurs. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

Loss per share

Basic loss per share is computed by dividing the net loss for the period attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted loss per share takes into consideration shares of common stock outstanding (computed under basic loss per share) and potentially dilutive shares of common stock. Diluted loss per share is not presented separately from loss per share as the conversion of outstanding stock options and warrants into common shares would be anti-dilutive.

Stock-based compensation

Statements of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to account for stock-based compensation using Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee is required to pay for the stock.

The Company accounts for stock-based compensation issued to non-employees in accordance with the provisions of SFAS 123 and the consensus in Emerging Issues Task Force No. 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring or in Conjunction with Selling, Goods or Services".

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Stock-based compensation (cont'd)

The following table illustrates the effect on loss and loss per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation.

	Three Month Period Ended March 31, 2003	Three Month Period Ended March 31, 2002	Nine Month Period Ended March 31, 2003	Nine Month Period Ended March 31, 2002
Net loss, as reported	$(511,094)	$(207,553)	$(978,025)	$(291,021)
Add: Total stock-based employee compensation expense included in loss, as reported determined under APB 25, net of related tax effects	-	-	-	-
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(4,973)	-	(7,680)	-
Pro-forma net loss	$(516,067)	$(207,553)	$(985,705)	$(291,021)
Basic and diluted net loss per share, as reported	$ (0.05)	$ (0.04)	$ (0.14)	$ (0.05)
Basic and diluted net loss per share, pro-forma	$ (0.05)	$ (0.04)	$ (0.14)	$ (0.05)

Recent accounting pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") approved the issuance of Statements of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 142 requires that goodwill no longer be amortized to earnings, but instead be reviewed for impairment. The statement is effective for fiscal years beginning after December 15, 2001, and is required to be applied at the beginning of an entity's fiscal year and to be applied to

all goodwill and other intangible assets recognized in its financial statements at that date. Impairment losses for goodwill and indefinite-lived intangible assets that arise due to the initial application of this statement (resulting from a transitional impairment test) are to be reported as resulting from a change in accounting principle. Under an exception to the date at which this statement becomes effective, goodwill and intangible assets acquired after June 30, 2001, will be subject immediately to the non-amortization and amortization provisions of this statement.

In June 2001, FASB issued Statements of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143") that records the fair value of the liability for closure and removal costs associated with the legal obligations upon retirement or removal of any tangible long-lived assets. The initial recognition of the liability will be capitalized as part of the asset cost and depreciated over its estimated useful life. SFAS 143 is required to be adopted effective January 1, 2003.

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

==

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Recent accounting pronouncements (cont'd)

In August 2001, FASB issued Statements of Financial Accounting Standards No. 144, "Accounting for the Impairment on Disposal of Long-lived Assets" ("SFAS 144"), which supersedes Statements of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed of". SFAS 144 requires that long-lived assets that are to be disposed of by sale be measured at the lower of book value or fair value less cost to sell. Additionally, SFAS 144 expands the scope of discontinued operations to include all components of an entity with operations that (1) can be distinguished from the rest of the entity and (2) will be eliminated from the ongoing operations of the entity in a disposal transaction. SFAS 144 is effective for fiscal years beginning after December 15, 2001, and, generally, its provisions are to be applied prospectively.

In April 2002, FASB issued Statements of Financial Accounting Standards No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145"). SFAS 145 eliminates the requirement that gains and losses from the extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect and eliminates an inconsistency between the accounting for sale-leaseback transactions and certain lease modifications that have economic effects that are similar to sale-leaseback transactions. Generally, SFAS 145 is effective for transactions occurring after May 15, 2002.

In June 2002, FASB issued Statements of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146") that nullifies Emerging Issues Task Force No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)" ("EITF 94-3"). SFAS 146

requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, whereby EITF 94-3 had recognized the liability at the commitment date to an exit plan. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002 with earlier application encouraged.

In October 2002, FASB issued Statements of Financial Accounting Standards No. 147, "Accounting of Certain Financial Institutions - an amendment of FASB Statements No. 72 and 44 and FASB Interpretation No. 9" ("SFAS 147"). SFAS 147 requires the application of the purchase method of accounting to all acquisitions of financial institutions, except transactions between two or more mutual enterprises. SFAS 147 is effective for acquisitions for which the date of acquisition is on or after October 1, 2002.

In December 2002, FASB issued Statements of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123" ("SFAS 148"). SFAS 148 amends FASB Statement No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of FASB Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS 148 is effective for fiscal years ending after December 31, 2002.

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

==

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Recent accounting pronouncements (cont'd)

In April 2003, FASB issued Statements of Financial Accounting Standards No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS 149"). SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under FASB Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities". SFAS 149 is generally effective for contracts entered into or modified after June 30, 2003.

The adoption of these new pronouncements is not expected to have a material effect on the Company's consolidated financial position or results of operations.

4. BUSINESS COMBINATION WITH ICOWORKS HOLDINGS

On November 20, 2002, the Company entered into an agreement to merge with Icoworks Holdings. On February 20, 2003, the Company acquired a 56% interest in Icoworks Holdings through the private acquisition of 3,593,199 shares of Icoworks Holdings from several non-U.S. stockholders and, accordingly, the Company is considered to be the legal acquirer. As consideration, the Company issued 7,186,398 common shares to the former non-U.S. stockholders of Icoworks

Holdings and control of the combined companies passed to the former non-U.S. stockholders of Icoworks Holdings and therefore, Icoworks Holdings is considered the accounting acquirer. Consequently, the consolidated statements of operations, stockholders' equity (deficiency) and cash flows include Icoworks Holdings' results of operations, deficit and cash flows from February 27, 1998 (date of inception) and the Company's results of operations and cash flows from February 20, 2003. The issued number of shares of common stock is that of the Company. The acquisition was accounted for as a business combination. The Company plans to complete the merger with Icoworks Holdings as contemplated by the merger agreement.

Under the terms of the merger agreement, the Company agreed to issue shares of its common stock to the shareholders of Icoworks Holdings on a two-for-one basis. The Company anticipates issuing an aggregate of 12,886,398 shares in order to complete the acquisition of all of the outstanding shares of Icoworks Holdings, inclusive of the 7,186,398 shares already issued by the Company. In addition, the Company will issue options and warrants to the current option holders and warrant holders of Icoworks Holdings on a two-for-one basis.

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

==

4. BUSINESS COMBINATION WITH ICOWORKS HOLDINGS (cont'd)

At the date of acquisition, the fair market value of the net assets of the Company was as follows:

Cash and cash equivalents	$49
Accounts receivable	2,592
Accounts payable and accrued liabilities	(17,066)
Due to related parties	(82,892)
Net liabilities assumed	$(97,317)

5. ACQUISITIONS

Acquisition of Icoworks Services Ltd. (formerly Wigley Auction Ltd.)

On December 1, 2001, Icoworks Holdings acquired all of the issued and

outstanding common stock of Icoworks Services Ltd. ("Icoworks Services") for consideration of $679,584, consisting of a cash payment of $572,082 and the

issuance of 600,000 shares of common stock. Icoworks Holdings funded $367,805 while $115,000 was advanced by related parties.

The acquisition of Icoworks Services has been accounted for using the purchase method and accordingly, these consolidated financial statements include the results of operations and cash flows of Icoworks from the date of acquisition.

The total purchase price of $679,584 was allocated as follows:

Cash	$270,958
Marketable securities	9,373
Accounts receivable	7,723
Inventory	48,275
Prepaid expenses	5,292
Due from related parties	177,677
Property and equipment	55,342
Trust assets	1,270
Accounts payable and accrued liabilities	(429,358)
Trust liabilities	(1,270)
Customer list	534,302
	$ 679,584

The customer list is being amortized using the straight-line method to the consolidated statements of operations over its estimated useful life of 3 years. As at March 31, 2003, the customer list, with a cost of $534,302, has been amortized by $237,467, leaving a net book value of $296,835.

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

5. ACQUISITIONS (cont'd)

Acquisition of DM International Appraisals & Consulting Ltd.

On April 1, 2002, Icoworks Holdings acquired all of the issued and outstanding common stock of DM International Appraisals & Consulting Ltd. ("DM") for consideration of $75,000, consisting of the issuance of 75,000 shares of common stock.

The acquisition of DM has been accounted for using the purchase method and accordingly, these consolidated financial statements include the results of operations and cash flows of DM from the date of acquisition.

The total purchase price of $75,000 was allocated as follows:

Cash	$5,729
Accounts receivable	1,806
Income taxes recoverable	111
Property and equipment	3,650
Accounts payable and accrued liabilities	(7,481)
Due to related parties	(4,396)
Deferred bonus	75,581
	$75,000

The deferred bonus relates solely to the value of the employment contract Icoworks Holdings entered into with the former shareholder and key executive of DM that was part of the terms of the acquisition. The deferred bonus was amortized to the consolidated statements of operations commencing April 1, 2002 over a period of one year, being the term of the employment contract with the former shareholder of DM.

6. INVENTORY

	March 31, 2003
Wood products and associated equipment	$1,532,925
Books	674,487
Miscellaneous and other goods held for resale	10,914
	$2,218,326

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

7. PROPERTY AND EQUIPMENT

	March 31,2003		
	Cost	Accumulated Depreciation	Net Book Value
Auction equipment	$ 17,015	$ 10,260	$ 6,755
Automotive equipment	60,576	40,368	20,208
Computer equipment	68,393	44,249	24,144
Computer software	16,718	5,161	11,557
Leasehold improvements	12,265	-	12,265
Office equipment	17,611	10,832	6,779
Sign	7,605	1,914	5,691
Tools and equipment	16,702	15,517	1,185
	$216,885	$128,301	$88,584

8. DEFERRED FINANCING COSTS

The Company issued 1,531,029 warrants to an investor group that has made available to the Company funds totaling $1,087,030 (CDN$1,600,000). These warrants are exercisable at $0.71 per warrant and expire on March 28, 2005. The Company has recorded $304,554 in the consolidated balance sheets, being the fair value calculated using the Black-Scholes option-pricing model of $306,000 net of amortization of $1,446.

The Company used the Black-Scholes option pricing model to compute estimated fair value, based on the following assumptions:

Risk free interest rate	4.0%
Dividend yield rate	0.0%
Volatility	45%
Weighted average expected life of options	2 years

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

9. DUE TO RELATED PARTIES

	March 31, 2003
Advances due to directors, unsecured, non-interest bearing, no fixed terms of repayment.	$ 69,099
Management fees due to a company related by common ownership and a common director, unsecured, non-interest bearing, no fixed terms of repayment.	311,086
Advances due to a company controlled by common management, unsecured, non-interest bearing, no fixed terms of repayment	144,398
Payment due to the former shareholders of Icoworks (Note 4), unsecured, non-interest bearing, no fixed terms of repayment.	85,190
Due to shareholders	37,690
Advances due to a company related by common ownership and a common director, unsecured, bearing interest at prime plus 1%, due on demand. These advances require the Company to pay a cash bonus and a stock bonus, each equivalent to 10% of the outstanding advances when demand for repayment is requested.	137,866
	$785,329

10. COMMON STOCK

During the year ended June 30, 2001, the Company issued 799,000 shares of common stock for gross proceeds of $399,500 and incurred share issuance costs of $35,202 paid in cash.

During the year ended June 30, 2002, the Company issued 1,521,000 units for gross proceeds of $1,521,000 and incurred share issuance costs of $226,475 paid in cash. Each unit consists of one share of common stock and one non-transferable share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share on the earlier of 36 months from the date of issuance or January 8, 2005 at an exercise price of $1.50 per share.

On December 1, 2001, the Company issued 600,000 shares of common stock as part of the consideration paid to acquire Icoworks (Note 5).

On January 1, 2002, the Company issued 4,200 shares of common stock at a fair value of $1.00 per share for consulting services. The Company also issued 42,200 shares of common stock at a fair value of $1.00 per share to a company related by common ownership and a common director as a financing fee for advances received.

On April 1, 2002, the Company issued 75,000 shares of common stock at a fair value of $1.00 per share to acquire DM (Note 5).

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

==

10. COMMON STOCK (cont'd)

During the nine month period ended March 31, 2003, the Company issued 88,600 units for proceeds of $88,600. Each unit consists of one share of common stock and one non-transferable share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share on the earlier of 36 months from the date of issuance or January 8, 2005 at an exercise price of $1.50 per share. The Company also issued 60,960 of the 150,850 shares of common stock to be issued to various brokers as compensation for arranging private placements during the year ended June 30, 2002.

On February 20, 2003, the Company issued 7,186,398 shares of common stock to acquire a 56% interest in Icoworks Holdings (Note 4).

The Company has received the consent of a majority of its stockholders to increase to the authorized number of shares of common stock to 100,000,000 shares and to create a class of 10,000,000 shares of preferred stock. Each of these changes will require an amendment to the Company's articles of incorporation.

Warrants

At March 31, 2003, Icoworks Holdings had warrants which were outstanding enabling holders to acquire the following shares of common stock:

	Number of Shares Subsidiary (Parent)	Exercise Price Subsidiary (Parent)	Expiry Date
Warrants	21,000 /(42,000)	$1.50 ($0.75)	December 27, 2004
Warrants	1,500,000/(3,000,000)	1.50 ($0.75)	January 8, 2005

Stock options

At March 31, 2003, Icoworks Holdings had options which were outstanding enabling holders to acquire the following shares of common stock:

	Number of Shares Subsidiary (Parent)	Exercise Price Subsidiary (Parent)	Expiry Date
Options	200,000/(400,000)	0.75 ($0.375)	November 12, 2007

The stock option plan serves as an equity incentive program for management, qualified employees, members of the board of directors and independent advisors or consultants. Generally, the stock options have a life of 5 years and vest equally on each anniversary date over a 3 year period.

On November 12, 2002, Icoworks Holdings granted 200,000 options to qualified employees. The stock options granted have a life of 5 years, an exercise price $0.75 ($0.375 based on a 2:1 transfer from the subsidiary to the parent plan if the proposed merger) and vest equally on each anniversary date over a 3 year period. As at March 31, 2003, no stock options had vested or expired and no stock options were exercised or forfeited.

10. COMMON STOCK (cont'd)

Stock options (cont'd)

The Company used the Black-Scholes option pricing model to compute estimated fair value, based on the following assumptions:

Risk free interest rate	3.17% to 3.65%
Dividend yield rate	0.0%
Volatility	45%
Weighted average expected life of options	3 years

11. RELATED PARTY TRANSACTIONS

During the nine month period ended March 31, 2003, the Company entered into the following transactions with related parties:

a) Paid or accrued consulting expenses of $56,729 (2002 - $27,868) to companies related by common ownership and directors.

b) Paid or accrued financing fees of $Nil (2002 - $42,200) to a company related by common ownership and a common director.

c) Paid or accrued management fees of $148,000 (2002 - $115,086) to a company related by common ownership and a common director.

d) Paid or accrued rent of $124,166 (2002 - $49,739) to a company controlled by employees who were previously directors of Icoworks Services.

These transactions were in the normal course of operations and were measured at the exchange value which represented the amount of consideration established and agreed to by the related parties.

12. SUPPLEMENTAL DISCLOSURES WITH RESPECT TO CASH FLOWS

The significant non-cash transaction during the nine month period ended March 31, 2003 consisted of the Company issuing 7,186,398 shares of common stock to acquire a 56% interest in Icoworks Holdings (Note 4).

The significant non-cash transaction during nine month period ended March 31, 2002 consisted of the Company issuing 600,000 shares of common stock as part of the consideration paid to acquire all of the issued and outstanding shares of Icoworks Services and 75,000 shares of common stock as consideration paid to acquire all of the issued and outstanding shares of DM (Note 5).

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

13. COMMITMENTS AND CONTINGENCIES

Icoworks Services was named as a defendant in a statement of claim relating to the purchase of certain equipment Icoworks Services considered to be in poor condition. Consequently, Icoworks Services accrued a liability of $63,530 relating to this claim in a prior year's financial statements. During the nine month period ended March 31, 2002, the claim was settled in favor of Icoworks Services, however, the plaintiff appealed the ruling. Management believes the appeal has no merit and, as a result, the $63,530 contingent liability previously recorded was reversed during the nine month period ended March 31, 2002.

The Company has entered into an arrangement in which it has guaranteed profits to investors who provide funds to the Company that are to be used to guarantee minimum return to clients who wish to sell assets or to acquire assets outright to be held for resale. These investors will share in the profits from these transactions on the basis of 65% of the profits to the Company and 35% to the investors. The Company has in turn guaranteed to those investors a minimum return of 15% per annum on the funds advanced. Further, the Company issued warrants to those investors to purchase shares of common stock the (Note 8) up to the value of their investment. Management is confident that the arrangement will yield the investor group sufficient return so that the guarantee will not result in any additional expense to the Company. As at March 31, 2003, the Company would be liable for $163,055 (CDN$240,000) in each of the 12 month periods ended March 31, 2004 and 2005 as $1,087,030 (CDN$1,600,000) has been made available by the investors.

The Company has the following commitments not disclosed elsewhere in these consolidated financial statements as at March 31, 2003:

a) Pay management fees of $17,000 per month plus all reasonable out-of-pocket disbursements to a company related by common ownership and a common director.

b) Pay consulting fees relating to assistance with investor relation services to a company related by common ownership. The agreement required a payment of $25,000 upon signing (paid) and a payment of $125,000 upon completion of all services. As at March 31, 2003, $100,000 of the $125,000 of services remained to be performed.

c) Issue 89,890 shares of common stock to various brokers as compensation for arranging private placements during the year ended June 30, 2002.

d) Pay $111,536 (CDN$175,000) annually plus bonuses under employment contracts to former shareholders of Icoworks. The employment contracts expire on December 31, 2004.

e) Pay $108,000 annually under an employment contract to the former shareholder of DM. The employment contract expires on April 1, 2003.

f) Pay minimum lease payments for premises of $127,000 per annum, plus common area costs, under an operating lease expiring November 30, 2003.

ICOWORKS, INC.
(formerly Paragon Polaris Strategies.com Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. Dollars)
MARCH 31, 2003
(Unaudited)

==

14. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash, marketable securities, accounts receivable, income taxes recoverable, accounts payable and accrued liabilities and due to related parties. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximates their carrying values unless otherwise noted.

15. SEGMENT INFORMATION

Notwithstanding that the Company may operate certain assets it acquires while it holds the goods for resale, the Company conducts operations in one reportable segment, being the conduct of customized auctions, in Canada.

16. SUBSEQUENT EVENT

Subsequent to March 31, 2003, the Company accepted the subscription for 30,000 Series A preferred shares as part of an offering of 300,000 shares. Each Series A preferred share will have a face value of $10.00 per share, and;

a) Will be convertible into shares of the Company's common stock on the basis of one share of common stock for each $0.75 of Series A preferred shares at the option of the holder. The minimum amount of Series A preferred shares that may be converted by a holder will be $10,000.

b) Will accrue interest at the rate of 10% per annum. Interest will be paid quarterly at the end of each calendar quarter, commencing June 30, 2003.

c) The Company will have the right to redeem the Series A preferred share at any time after eighteen months from the date of issuance in the event that the closing price of the Company's common stock is equal to or greater than $1.50 per share for at least twenty consecutive trading days during the three month period prior to the date of notice of redemption.

d) Each holder will have the right to redeem the Series A preferred share at any time after the date that is three years from the date of closing of the purchase of the Series A preferred shares.

e) Will not have voting rights, other than on matters affecting the Series A preferred shares, as prescribed by Nevada law.

f) Will not have dividend rights, other than to receive the annual 10% interest rate.

The subscriptions received will result in the quarterly obligation to pay $7,500 and if all of the Series A preferred shares which have been offered are sold, the payments will be $75,000 per quarter ($300,000 annually). If converted, the Series A preferred shares which have been subscribed would result in the issue of 400,000 shares of common stock.

The holders shall have the right to redeem the preferred shares anytime after the closing date.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

FORWARD LOOKING STATEMENTS

The information in this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties, including statements regarding our capital needs, business strategy and expectations. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "expect", "plan", "intend", "anticipate", "believe", "estimate", "predict", "potential" or "continue", the negative of such terms or other comparable terminology. Actual events or results may differ materially. In evaluating these statements, you should consider various factors, including the risks outlined below, and, from time to time, in other reports we file with the SEC. These factors may cause our actual results to differ materially from any forward-looking statement. We disclaim any obligation to publicly update these statements, or disclose any difference between our actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

OVERVIEW

Icoworks, Inc. (formerly Paragon Polaris Strategies.com Inc.) ("We", "Icoworks" or the "Company") was incorporated in the State of Nevada on May 27, 1999.

On July 1, 1999, we acquired limited rights to distribute and produce an oxygen enriched water product for fish farming, aquaculture, mariculture, poultry raising, and for treating animal waste from dairies, feedlots of all kinds, and for other similar uses. The rights to use this technology were subsequently withdrawn by agreement with the owner. We subsequently acquired a three year license to market and sell vitamins, minerals, nutritional supplements from Vitamineralherb.com Inc. We have abandoned this business.

We entered into an agreement on November 20, 2002 to merge with Icoworks Holdings Inc. (formerly Icoworks, Inc.) (www.icoworks.com), a Nevada corporation ("Icoworks Holdings") that specializes in offering a complete array of industrial, oilfield and commercial appraisal, liquidation and auction services. Under the terms of the merger agreement, we agreed to issue shares of our common stock to the shareholders of Icoworks Holdings on a two-for-one basis. This merger agreement has terminated in accordance with its terms as the merger was not consummated by May 1, 2003, however we anticipate that we will enter into a new merger agreement to complete the acquisition of the minority interest in Icoworks Holdings that we currently do not own. There is no assurance that this merger will be completed.

We completed the acquisition of a 56% interest in Icoworks Holdings on February 20, 2003 through the private acquisition of 3,593,199 shares of Icoworks Holdings from several non-U.S. shareholders. We issued 7,186,398 shares of our common stock to acquire this interest. We plan to complete the merger with Icoworks Holdings as originally contemplated by the merger agreement. We anticipate issuing an aggregate of 12,886,398 shares in order to complete the acquisition of all of the outstanding shares of Icoworks Holdings, inclusive of the 7,186,398 shares issued on February 20, 2003 to acquire the majority 56% interest in Icoworks Holdings. In addition, we anticipate we will issue options and warrants to the current optionholders and warrantholders of Icoworks Holdings on a two-for-one basis if a new merger agreement is signed. The completion of the merger will be subject to approval by the shareholders of both the Icoworks and Icoworks Holdings. We anticipate proceeding with the filing of a registration statement with the Securities and Exchange Commission in connection with obtaining shareholder approval of the merger.

Our shareholders approved the change of our corporate name to "Icoworks, Inc." to reflect our acquisition of the majority interest in Icoworks Holdings. In connection with this name change, the name of Icoworks Holdings has been changed from "Icoworks, Inc." to "Icoworks Holdings Inc." Our shareholders also approved the increase to the authorized number of shares of common stock to 100,000,000 shares and the creation of a class of 10,000,000 authorized shares of preferred stock. We have filed a certificate of amendment to our articles of incorporation with the Nevada Secretary of State in order to give effect to the changes to our name and our authorized capital.

3

We do not have any business or subsidiaries other than our 56% interest in Icoworks Holdings.

OVERVIEW OF ICOWORKS HOLDINGS

Icoworks Holdings is engaged in the asset realization business and is a provider of a full and comprehensive range of auction, liquidation and appraisal services to the industrial, oilfield, commercial and office markets. Icoworks Holdings' business operations have historically been based in Calgary, Alberta, Canada and have recently been expanded to include a subsidiary operation in Oakville, Ontario, Canada. Icoworks Holdings plans to expand its business, both through the expansion of its traditional auction, liquidation and appraisal services and through the acquisition of other businesses engaged in the asset realization business that complement Icoworks Holdings' growth strategy. Icoworks Holdings also plans to enhance its traditional services by the use of technology, including the use of live internet auctions, online internet auctions and technology-assisted auctions, in order to expand the scope of potential purchasers for its asset realization business and to facilitate auction transactions.

PRESENTATION OF FINANCIAL INFORMATION

We completed the acquisition of Icoworks Holdings effective February 20, 2003. Under United States generally accepted accounting principles, our financial statements have been prepared using reverse-acquisition accounting principles, which result in Icoworks Holdings acquiring Icoworks for accounting purposes. Accordingly, Icoworks Holdings is treated as the acquirer for accounting purposes, even though Icoworks is the legal acquirer. Under United States generally accepted accounting principles, comparative figures for prior periods are based on the operating results of Icoworks Holdings, but the type of share capital and number of issued and outstanding shares continue to reflect those of Icoworks. Therefore, our consolidated financial statements include the accounts of Icoworks Holdings and its legal subsidiaries and all significant intercompany accounts and transactions have been eliminated on consolidation. Our results of operations for the nine months ended March 31, 2003 include the financial results of Icoworks since February 20, 2003. Comparative figures shown in our financial statements for the nine month period ended March 31, 2002 are for Icoworks Holdings only. Further adjustments were also required as outlined in the notes to the financial statements. We have adopted the June 30 year end of Icoworks Holdings to reflect the accounting treatment of the acquisition, rather than proceeding with our previous December 31 year end. Due to the fact that we own less than 100% of Icoworks Holdings, our financial statements account for the minority interest in Icoworks Holdings that we do not own.

BUSINESS STRATEGY AND PLAN OF OPERATIONS

Our business strategy is to continue to expand the asset realization business of Icoworks Holdings with the objective of increasing revenues and profitability. Icoworks Holdings' strategies to achieve this business plan are as follows:

1. Icoworks Holdings intends to target and acquire regional auction businesses that are currently engaged in traditional industrial and commercial auction and liquidation services. The objective of this strategy is to expand the geographic scope of Icoworks Holdings' business, to expand its customer base and to expand the scope of the prospective bidders for items sold by Icoworks Holdings. By pursuing this strategy, Icoworks Holdings plans to be able to market to a broader base of customers on the basis that Icoworks Holdings' geographic influence and its database of prospective bidders will result in customers achieving higher prices for items to be sold.

2. Icoworks Holdings plans to continue to integrate technology into its traditional auction business. Icoworks Holdings will focus its efforts on using technology to supplement its existing traditional auction business services, rather than attempting to shift traditional auctions into an online format. Icoworks Holdings plans to continue the use of live internet auctions using the BidSpotter or competing technology. Icoworks Holdings also plans to pursue online auctions through its e-Bay store. Icoworks Holdings will also consider conducting live online auctions that are accessible to users through its corporate website.

3. Icoworks Holdings plans to pursue creative financing strategies for financing and selling bought deals. Bought deals involve purchase of a group of assets from the seller at a discount to the anticipated selling price. The advantage of this arrangement to a seller is that the seller would be able to achieve immediate proceeds from the sale at a guaranteed amount rather than waiting for the completion of the auction

process and being at risk to lower than anticipated sales price at the auction. The risk to Icoworks Holdings as a purchaser is that it would not be able to sell the assets at the price paid to the seller. In order to be able to participate in such ventures at a lower risk, Icoworks Holdings plans to evaluate the financing transactions, including limited partnerships whereby Icoworks Holdings and other venture partners would fund the purchase price for a block of assets and share the risk associated with the sale of the assets on the market. This business strategy would offer greater potential returns for Icoworks Holdings, but at potentially greater risks than in its traditional auction and liquidation business where assets are sold on a fixed commission basis.

Icoworks Holdings has incorporated a subsidiary, Icoworks Joint Ventures Inc. ("Icoworks Joint Ventures"), for the purpose of financing and selling bought deals. Icoworks Holdings and Icoworks Joint Ventures have entered into a joint venture agreement with several initial investors. The purpose of the joint venture formed pursuant to the joint venture agreement is to purchase and resell various types of assets being liquidated in receiverships and bankruptcy on a "bought deal" basis. Assets purchased will be resold using the services of Icoworks Holdings. The joint venture will plan to generate profit by selling these assets at a higher price than the original purchase cost plus costs of sale. Under the joint venture agreement, Icoworks Holdings will carry out the purchase and sale of assets for each bought deal. Icoworks Joint Ventures has agreed to pay to Icoworks Holdings 3.5% of the gross sale price of the assets to compensate Icoworks Holdings for sale costs relating to the marketing, promotion and resale of the purchased assets. The gross profit, being the sale price of each completed sale, less acquisition costs, sale costs and any additional

costs, will be distributed as follows:

(1) 65% to Icoworks Holdings, and
(2) 35% to be divided proportionately to each of the joint venture investors.

Icoworks Holdings has guaranteed a return to each joint venture investor of 15% per annum. The term of the joint venture agreement is for a minimum of one year and a maximum of three years. Icoworks Holdings will report quarterly to the joint venture investors and distributions will be made on a quarterly basis of cash available for distribution. The joint venture investors will have the option to convert their investments in Icoworks Joint Ventures into shares of our common stock at any time within one year of their initial investment at a price based on the market price of our common stock for the period immediately prior to the date of investment. To date, a total of $1,087,030 has been made available by investors. As at March 31, 2003, we would be liable for $163,055 in each of the twelve month periods ended March 31, 2004 and 2004 if we are required to pay the investors based on our guarantee obligation.

Our plan of operations includes the following components over the next twelve months:

1. We plan to complete the merger with Icoworks Holdings in order to acquire the remaining 44% interest in Icoworks Holdings that we do not currently own. We anticipate that the completion of this acquisition will take approximately six months and will cost approximately $100,000 due to the fact that we must file a registration statement with the United States Securities and Exchange Commission to register the shares to be issued to the remaining shareholders of Icoworks Holdings.

2. We plan to continue the existing business of Icoworks Holdings, as its major shareholder. We anticipate that we will be required to advance approximately $1,000,000 to Icoworks Holdings in order to fund its existing business operations over the next twelve months.

3. We plan to advance approximately $1,390,000 to Icoworks Holdings to fund the participation by Icoworks Holdings in bought deals, as described above.

4. We plan to advance approximately $1,000,000 to Icoworks Holdings to fund the acquisition strategy of Icoworks Holdings, as described above.

Based on these anticipated expenditures, we anticipate spending approximately $3,500,000 over the next twelve months in pursuing our plan of operations. Of this amount, we anticipate that approximately $1,750,000 will be advanced during the next six months. Our cash position as of March 31, 2003 was $132,645 and we had a working capital deficit of $1,166,500 as of March 31, 2003. Accordingly, we will require substantial additional financing in order to proceed with our plan of operations. We do not have any arrangements for financing currently in place.

There is no assurance that we will be able to obtain the financing necessary to pursue this plan of operations. If we are successful in achieving financing, we anticipate that any financing would be either through sales of our common stock or sales of preferred stock that will be convertible into shares of our common stock. Accordingly, any financing could result in dilution to our shareholders.

If we are not able to obtain the necessary financing, then we will scale back the plan of operations in order to reflect available funds. Our first

priorities will be to complete the merger with Icoworks Holdings and to continue the existing business of Icoworks Holdings. The funds available to fund the participation of Icoworks Holdings in bought deals and to fund the acquisition strategy of Icoworks Holdings will be scaled back according to the amounts of available funds. If we are not successful in raising the necessary financing, we will also pursue alternate financing arrangements, such as the joint venture financing arrangement involving Icoworks Joint Ventures, as described above.

RESULTS OF OPERATIONS

REVENUES

We earn revenues from two principal activities, namely auction revenues and held for sale revenues. Auction revenues are comprised of buyers premiums, being premiums over and above the purchase prices of items sold, and commissions paid by consigners of items for auctions. Held for sale revenues are comprised of revenues from items purchased and held for sale and/or liquidation. Revenue is recognized once the auction or sales are completed and collections reasonably assured. Other commissions are earned by us when we provide guarantees on the gross proceeds to be received from sale to a consigner. We conduct our sales where we temporarily acquire title to goods pending sale. We also enter into joint venture agreements through our subsidiary, Icoworks Joint Ventures, whereby goods are purchased for resale on a joint venture basis. When these activities are conducted on a joint venture basis, the profits are divided between us and the joint venture party on a negotiated basis. If the actual proceeds are less than cost, or less than the guaranteed price, then we may be required to fund any shortfall.

We also earn fees charged for appraisals. Revenues from appraisals is recognized when work is completed and collection is reasonably assured.

Our revenues increased to $1,397,887 for the nine month period ended March 31, 2003, compared to $629,143 for the nine month period ended March 31, 2002. The increase in revenues for the nine month period is primarily attributable to the fact that Icoworks Services Ltd. ("Icoworks Services"), was acquired as a wholly owned subsidiary of Icoworks Holdings Inc. on December 1, 2001. Accordingly, results for the nine month period ended March 31, 2002 only reflect the operations of Icoworks Services. for the four month period from December 1, 2001 to March 31, 2002.

Our revenues have increased to $722,754 for the three month period ended March 31, 2003, compared to $542,131 for the three month period ended March 31, 2002, representing an increase of $180,623 or 33%. The increase was primarily attributable to a large auction involving the liquidation of the assets of Synsorb, a Calgary, Alberta based company, in January 2003.

Our gross margin was $362,157 for the nine month period ended March 31, 2003, compared to $277,087 for the nine month period ended March 31, 2002. Gross margin as a percentage of sales decreased to 25.9% for the nine month period ended March 31, 2003, compared to 44.0% for the nine month period ended March 31, 2002.

Gross margins decreased to $56,248 for the three months ended March 31, 2003, compared to $252,826 for the three months ended March 31, 2002, representing a decrease of $196,578 or 77.8%. Gross margins as a percentage of sales decreased to 7.8% for the three months ended March 31, 2003, compared to 46.6% for the three months ended March 31, 2002.

Variations in our operating results on a quarter by quarter basis are explained in part due to the nature of the auction business. Our auction business involves large sales of items through auctions. The scheduling of these large auction sales will impact on the timing of revenues earned and will result in

quarter by quarter variations in revenues and consequent operating results.

EXPENSES

Our general and administrative expenses increased to $1,207,726 for the nine months ended March 31, 2003, compared to $563,909 for the nine months ended March 31, 2002. The large increase in general and administrative expenses is again explained by the fact that the acquisition of Icoworks Services was completed on December 1, 2001 and consequently expenses for the nine month period ended March 31, 2002 do not reflect the operating expenses of Icoworks Services for the full nine month period.

General and administrative expenses increased to $568,380 for the three months ended March 31, 2003, compared to $415,870 for the three months ended March 31, 2002, representing an increase of $152,510 or 36.7%. The increase in our general and administrative expenses reflects our acquisition of Icoworks Services in December 2001 and our acquisition of DM International Appraisals and Consulting ("DM International") in April 2002. Our general and administrative expenses also increased due to the expansion of our operations into Ontario, Canada and British Columbia, Canada, from our initial base in Calgary, Alberta. We recently formed a 75% owned subsidiary named Icoworks Eastern which operates in the Greater Toronto area in the Province of Ontario, Canada. Expenses in respect of these operations were incurred in the three months ended March 31, 2003; however, revenues from this business expansion are not expected to be realized until subsequent quarters. The acquisition of DM International was completed in order to enable us to offer a wider range of services to our clients and to provide additional synergies for our Calgary, Alberta office and additional expertise for our expanded operations. We expect that our additional locations will contribute to increase appraisal revenue in the future as the current appraisal revenue are currently limited to the Alberta office.

Our total expenses increased to $1,430,154 for the nine months ended March 31, 2003, compared to $623,276 for the nine months ended March 31, 2002. Our total expenses increased to $652,408 for the three months ended March 31, 2003, compared to $460,396 for the three months ended March 31, 2002, representing an increase of $192,112 or 41.7%. The increase in our total expenses is attributable to the increase in our general and administrative expenses, as discussed above, and to increased amortization and depreciation expenses which are largely attributable to our acquisition of Icoworks Services and DM International, as discussed in the Notes To Financial Statements.

NET LOSS

Our net loss increased to $978,025 for the nine months ended March 31, 2003, compared to $291,021 for the nine months ended March 31, 2002. Our net loss increased to $511,094 for the three months ended March 31, 2003, compared to $207,553 for the three months ended March 31, 2002, representing an increase of $297,333 or 143%. Our increased loss is primarily attributable to the increases to our costs of sales which have resulted in decreased gross margins and in increased expenses attributable to our expansion efforts.

LIQUIDITY AND FINANCIAL CONDITION

CASH AND WORKING CAPITAL

As at March 31, 2003, we had cash of $132,645 and a working capital deficiency of $1,166,500. Our working capital deficiency is the result of a number of

factors including the expansion of operations and continuing losses. We anticipate that we will require additional funding in order to achieve profitable operations and to implement our plan of operations.

CASH USED IN OPERATING ACTIVITIES

We used $394,285 of cash in operating activities during the nine months ended March 31, 2003, compared to $542,175 during the nine months ended March 31, 2002. We experienced an increase in inventory in the amount of $2,208,631 during this period and an increase in accounts payable and accrued liabilities in the amount of $2,509,308.

FINANCING ACTIVITIES

We financed our cash used in operating activities primarily from cash generated from financing activities. Cash from financing activities was $441,187 for the nine months ended March 31, 2003 compared to $613,753 for the nine months ended March 31, 2002. Increases in the amounts due to related parties was the principal component of the cash generated from financing activities. There is no assurance that we will be able to continue finance our continued operations using funds received from related parties.

Subsequent to March 31, 2003, we completed a financing with a non-US investor for proceeds of $300,000 pursuant to which we have agreed to issue 30,000 shares of our preferred stock which will be designated as Series A preferred shares. Each Series A preferred share will be issued for each $10 advanced and will be convertible into shares of our common stock at rate of one share for each $0.75 of preferred shares converted. We received the funds from this financing in early April and we have applied the proceeds to working capital. We anticipate designating the class of Series A Preferred Shares and issuing the preferred shares to the investor in the near future.

We have access to a fund of capital in the amount of $1,087,030 through the Icoworks Joint Ventures joint venture arrangement which we anticipate will be used to finance the acquisition of inventory and assets for resale on a project by project basis. These joint ventures arrangements and our obligations thereunder are described above under "Plan of Operations".

FINANCING REQUIREMENTS

Our strategy is to increase sales through acquisitions with the objective of increasing the sales and revenue of those acquired businesses by making capital available to the acquired businesses allowing bids on bought deals or the acquisition of assets for resale. In addition, we will seek to expand the geographic scope of our business operations through the establishment of new branch offices if no viable acquisition is available. Our ability to implement this strategy is dependant on our ability to raise the necessary capital to carry out our plans.

As discussed above under Plan of Operations, we will require additional financing if we are to continue as a going concern and to complete our plan of operations. In the event that we are unable to raise additional financing under acceptable terms, then we may not be able to proceed with our plan of operations or we may be required to scale back our plan of operations. We also anticipate that we will continue to incur losses until such time as we are able to generate profits from the business of Icoworks Holdings and its expansion strategy.

The implementation of our business plan will require additional financial resources that are in excess of our current financial resources. We plan to pursue equity financings involving sales of our common stock or convertible preferred stock in order to raise financing to fund the business plan of Icoworks Holdings and to funds our ongoing capital requirements. It is contemplated that funds would be advanced by us to Icoworks Holdings as a loan pending the completion of the merger with Icoworks Holdings. There is no assurance that we will be successful in raising the necessary financing to pursue our stated plan of operations.

In the event that we are successful in achieving financing, we anticipate advancing funds to Icoworks Holdings to fund bought deals and the acquisition strategy of Icoworks Holdings as a loan pending the completion of the merger of Icoworks Holdings. These loans may be advanced as secured or unsecured loans. In the event that we advance funds to Icoworks Holdings, there will be no assurance that these funds will be repaid by Icoworks Holdings. If the business of Icoworks Holdings is not successful in generating sufficient funds to repay these loans, then our financial condition will be adversely affected. In addition, there is a risk that we will advance substantial funds to Icoworks Holdings and the merger of Icoworks Holdings will not proceed.

ITEM 3. CONTROLS AND PROCEDURES.

As required by Rule 13a-15 under the Securities Exchange Act of 1934 (the "Exchange Act"), we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures within the 90 days prior to the filing date of this report. This evaluation was carried out under the supervision and with the participation of our Chief Executive Officer, Mr. Robert Foo, and our Chief Financial Officer, Mr. Samuel Lau. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting management to material information relating to us required to be included in our periodic SEC filings. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out our evaluation.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosure.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not a party to any material legal proceedings and to our knowledge, no such proceedings are threatened or contemplated.

ITEM 2. CHANGES IN SECURITIES

We completed a two to one forward split of our outstanding shares of common stock in December 2002. Upon completion of the forward split, there were two shares of our common stock outstanding for each previously issued and outstanding shares of common stock. All information set forth below is based on post-forward split numbers of shares with corresponding adjustments to share and warrant prices.

We completed the following unregistered sales of our common stock during our fiscal quarter ended March 31, 2003;

1. On February 20, 2003, we issued a total of 7,186,398 shares of our common stock to several of the shareholders of Icoworks Holdings on closing of the acquisition of a 56% majority interest in Icoworks Holdings as follows:

NAME OF BENEFICIAL OWNER	NUMBER OF SHARES OF COMMON STOCK	PERCENTAGE OF COMPANY COMMON STOCK CURRENTLY HELD (1)
Ian Brodie	3,584,398 (2)	27.8%
Bill Wigley	1,200,000 (3)	9.3%
Hollywood Holdings Ltd.	800,000	6.3%
Solara Ventures Inc.	2,084,398	16.9%
J. Graham Douglas	1,602,000 (4)	12.4%
TOTAL	7,186,398	55.8%

(1) Based on 12,886,398 shares of the Company's common stock issued and outstanding as of February 28, 2003.
(2) Mr. Brodie is a director and officer of Solara Ventures and a minority shareholder of Solara Ventures. Accordingly, Mr. Brodie is deemed to beneficially own shares held by Solara Ventures for the purposes of Rule 13d-3. Mr. Brodie was individually issued 1,500,000 shares of the Company's common stock. The balance of the shares deemed to be beneficially held by Mr. Brodie are held by Solara Ventures.
(3) Includes shares held by the spouse of Mr. Wigley.
(4) The shares held by Mr. Douglas are held by a private corporation controlled by Mr. Douglas.

The shares of our common stock that were issued to the former shareholders of Icoworks Holdings listed above were issued in consideration of the transfer to us of the shares of Icoworks Holdings held by the former shareholders. The shares were issued to the former Icoworks Holdings shareholders on the basis of two shares of our common stock in consideration for each one share of Icoworks Holdings' common stock. The number of shares issued was based on our assessment of the fair market value of Icoworks Holdings and the trading price of our common stock at the time of the execution of the share purchase agreement.

These shares were issued pursuant to Regulation S of the Securities Act of 1933 (the "Securities Act") on the basis that each former shareholder of Icoworks Holdings is not a U.S person, as defined in Regulation S, and received the offer to exchange their securities in an offshore transaction, as defined in Regulation S. The share certificates issued to the former shareholders of Icoworks Holdings were endorsed with a legend confirming that the shares are restricted shares under the Securities Act and can be sold only pursuant to Regulation S of the Securities Act,

10

pursuant to an exemption from the registration requirements of the Securities Act or pursuant to an effective registration statement under the Securities Act.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

During the quarter ended March 31, 2003, we filed a proxy statement with the Securities and Exchange Commission in connection with the solicitation of the consent of our shareholders to our name change and to certain changes to our authorized capital. Shareholders holding in excess of 55% of our common stock approved the change our corporate name to "Icoworks, Inc." to reflect our acquisition of the majority interest in Icoworks Holdings, the increase to the authorized number of shares of our common stock to 100,000,000 shares and the creation of a class of 10,000,000 authorized shares of preferred stock. We have filed a certificate of amendment to our articles of incorporation with the Nevada Secretary of State in order to give effect to the changes to our name and our authorized capital.

ITEM 5. OTHER INFORMATION

None.

11

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

EXHIBITS REQUIRED BY ITEM 601 OF FORM 8-K

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
3.3	Certificate of Amendment to Articles of Incorporation (1)
99.1	Certification of Chief Executive Officer pursuant to pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 90

99.2 Certification of Chief Financial Officer pursuant to pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 90

---

(1) Filed as an Exhibit to this Quarterly Report on Form 10-QSB

REPORTS ON FORM 8-K

We filed the following Current Reports on Form 8-K during the fiscal quarter ended March 31, 2003:

1. Form 8-K dated February 20, 2003 filed with the Securities and Exchange Commission on March 6, 2003.

We are required to file an amendment to the Form 8-K filed with the SEC on March 6, 2003 in order to include the audited financial statements of Icoworks Holdings and the pro forma financial statements required to be included on the Form 8-K in accordance with the SEC's disclosure requirements. We are currently endeavoring to complete these financial statements and to proceed with the filing on the required amendment to the original Form 8-K.

Subsequent to March 31, 2003, we filed a Current Report on Form 8-K dated June 10, 2003 respecting the change to our auditor from Janet Loss, CPA to Dohan and Company, Certified Public Accountants and the change of our fiscal year end.

12

SIGNATURES

In accordance with the Securities Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Robert Foo

Robert Foo, Chief Executive Officer and Director
(Principal Executive Officer)

Date: June 19, 2003

By: /s/ Samuel Lau

Samuel Lau, Chief Financial Officer and Director
(Principal Financial Officer and Principal Accounting Officer)

Date: June 19, 2003

CERTIFICATIONS

I, Robert Foo, Chief Executive Officer of Icoworks, Inc. (the "Registrant"), certify that;

(1) I have reviewed this quarterly report on Form 10-QSB of Icoworks, Inc.;

(2) Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

(3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this quarterly report;

(4) The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

(5) The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the Registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls; and

(6) The Registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other facts that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Robert Foo

Date: June 19, 2003 ________________________________

(Signature)

CHIEF EXECUTIVE OFFICER

(Title)

CERTIFICATIONS

I, Samuel Lau, Chief Financial Officer of Icoworks, Inc. (the "Registrant"), certify that;

(1) I have reviewed this quarterly report on Form 10-QSB of Icoworks, Inc.;

(2) Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

(3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this quarterly report;

(4) The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

(5) The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the Registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls; and

(6) The Registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other facts that could significantly affect internal

controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses

Date: June 19, 2003

/s/ Samuel Lau
____
(Signature)

CHIEF FINANCIAL OFFICER
____
(Title)

ervices provided by a customer's local and long-distance phone company. The customer keeps its existing telephone number and is not required to purchase any new telephone handsets. The process for getting the service is relatively simple. Once the customer signs up for service with a VoiceOne VSP, it will receive a small integrated access device (IAD) or our Multimedia Terminal Adapter (MTA) from the VSP or through our fulfillment center. The subscriber plugs the device into its broadband internet connection and existing telephone handset. Once the customer turns it on, the device automatically connects to the Internet, configures itself and is ready for use. We offer a full suite of features, including caller ID, call waiting, call forwarding, voicemail, speed dial, call detail records, music on hold, 3-way calling and others. This enhanced service has been packaged as a bundle that includes local service, long distance, enhanced voicemail, and most of the popular calling features. Other Products and Support Offerings We offer complementary services and products to support our customers. These VoiceOne Origination services support all protocols and connection types and are bundled with the termination product to supplement the VoiceOne Carrier Direct and VSP service offerings. DIDs As a CLEC, we can purchase local numbers for use by our VoiceOne Carrier Direct and VSP customers. VoiceOne Origination provides our customers with one of the largest selections of direct inward dial (DID) numbers available. Our Web based administration and automated XML provisioning saves our customers time when managing the inventory, access, reservation and allocation of DIDs. 800 Origination Our 800 Origination service is a flexible solution with IP or TDM delivery. Our 800 Origination product provides nationwide toll free numbers with full control over routing. Customers can easily re-route a number due to local area problems and can log into an easy-to-use, attractive web interface to manage their 800 numbers. Our 800 Origination service supports geographic routing and vanity numbers. v911(TM) Services Our VoiceOne v911 exceeds the FCC compliant solution for VoIP e911 calls. Our v911 services go beyond the requirements of the recent FCC order to help ensure reliability and quality of e911 calls. We utilize our private MPLS network along with our proprietary softswitch, selective routers, and media gateway controllers to provide the redundancy necessary for high quality of service for emergency calls over IP. v911 provides for XML and web interfaces so that providers can update customer location information automatically, and/or provide an interface for the customer to update it themselves. Customers' emergency calls route to the correct Public Service Answering Point (PSAP) via selective routing. v911 also provides a remedy for nomadic subscribers. When lines are classified as nomadic, calls will be handled by a call center. 22 ANI Recognition The ANI Recognition calling platform, known as EasyTalk, is a long distance service with "ease of use" features for consumers. We believe that EasyTalk is a generation beyond calling cards. Our network can be programmed to automatically recognize certain phone numbers and to provide callers from these numbers immediate access to long-distance services. No calling card or PIN number calling card number is required, and because the call is routed over the Internet, the customer avoids the long-distance rates charged by the traditional telephony carriers. VSP and Carrier Direct customers can private-label this platform, customizing its web pages. Consumer features include PIN-less dialing, fast *1 recharge of the service, speed dial, and quick query of current balance. Providers can specify many billing options and can opt for fraud screening services, customer support, and use of our payment processing service. Hosted IP Centrex Hosted IP Centrex provides the immediate ability to provide complete PBX functionality for phone service in small office/home office and small/medium enterprise business environments. Phone service is provided over IP connectivity from the customer to the Internet, a provider's private IP network, or

virtual private network. All standard features of PBX functionality, as well as more advanced calling features, are provided to the customer. Management of the features, phones and options are accomplished through a web management interface. Changes may be made by users, administrators and the service provider. Additional Services vFax Service - this service provides a personal fax number and web based management of faxes. vFax allows a consumer to send and receive faxes anywhere they can receive email. Voicemail / Unified Messaging - Our unified messaging solutions provide users an integrated step in bringing together many of the functions, features and necessities under a simple unified approach of communications. We allow users to control their communications needs and provide the flexibility to modify the way they operate. This product integrates with our voice services, but also can be an adjunct service to carriers in existing markets, allowing carriers, cable operators and other service providers to enhance their existing voice offerings. Pathfinder(TM) 2.0 Provisioning Server Software - Our Pathfinder application enables broadband service providers to easily adapt our MTA to their existing platform. Pathfinder fully automates the process of configuring and provisioning the MTA device. The automated process identifies the user and their personal profile information before carrying out any instructions that the Broadband Provider has scheduled. Fulfillment Services and Value-added Distribution - We operate a fulfillment center and supply chain solutions provider for our broadband service provider partners. We are an established and respected supplier of broadband components and VoIP hardware to the cable television industry. We were awarded the National Cable Television Cooperative's First Platinum Vendor status, giving us credibility and direct access to over 1,400 independent cable operators. Other - We recently acquired substantially all of the assets relating to WQN, Inc.'s VoIP business. This acquisition will enable us offer high quality international prepaid virtual calling cards, personal 800 numbers, and VoIP subscriber based services, such as RocketVoIP, our retail VoIP solution. Our prepaid calling cards are sold through our website and through a network of over 90 private distributors. Through this network we estimate that our services are sold through over 10,000 retail outlets, with more than half of these outlets in Southern California. Our Strategy Our objective is to provide reliable, scalable, and competitively-priced worldwide VoIP communication services with unmatched quality. We plan to achieve this objective by delivering innovative technologies and services and balancing the needs of our customers with the needs of our business. We intend to bring high quality voice products and services, at an affordable price, to residential consumers and businesses and enhance the ways in which these customers communicate with the rest of the world. 23 Specific strategies to accomplish this objective include: o building our CLEC customer base through aggressive marketing of our VoiceOne Carrier Direct program; o completing the expansion of our network currently in process; o capitalizing on our technological expertise to introduce new products and features; o offering the best possible service and support to our customers with a world class customer support organization; o developing additional distribution channels; o expanding our market share for our retail calling services; o increasing our customer base by introducing cost-effective solutions to interconnect with our network; and o controlling operating expenses and capital expenditures. Competition We compete primarily in the market for enhanced IP communications services. This market is highly competitive and has numerous service providers. The market for enhanced Internet and IP communications services is new and rapidly evolving. We believe that the primary competitive factors determining success in the Internet and IP communications market are: o quality of service; o the ability to meet and anticipate customer needs through multiple service offerings and feature sets; o responsive customer care services, and; o price. Future competition could come from a variety of companies both in the Internet and telecommunications industries. These industries include major companies who have greater resources and larger subscriber bases than we have, and have been in operation for many years. We also compete in the growing market of discount telecommunications services including "pure play" VoIP service providers, calling cards, prepaid cards, call-back services, dial-around or 10-10 calling and collect calling services. In addition, some Internet service providers have begun to aggressively enhance their real time interactive communications, including instant messaging, PC-to-PC and PC-to-Phone services, and Broadband phone services. Some competitors may be able to bundle services and products that are not offered by us together with enhanced Internet and IP communications services, which could place us at a significant competitive disadvantage. Many of our competitors enjoy economies of scale that can result in lower cost structure for transmission and related costs, which could cause significant pricing pressures within the industry. At the same time, we see these potential competitors as potential customers, and have organized our various reseller and service provider products and services to meet the emergent needs of these companies. Our primary competitors include: o carriers operating in the U.S. and abroad, which include the RBOCs, AT&T, British Telecom, France Telecom, Deutsche Telecom, NTT, MCI, Sprint, Level 3, Infonet, Qwest, Broadwing, Ibasis, and Teleglobe; o

subscriber based service provider competitors, which include Vonage, Packet8, DeltaThree, SunRocket, Time Warner, Comcast and Net2phone. 24 Industry Overview The advance of broadband delivery of the Internet into residential and small offices has opened up a large market for high-speed services to be delivered in a manner that is independent of the actual wires connected to each property. Nearly three out of four households with basic phone service have Internet access, and of that 75% of all households in the US, almost half have broadband access. (Source: Nielsen/NetRatings) The penetration of broadband is rising at around 2.5% per month. These growth figures are even higher in other nations, which have only recently been implementing systems after understanding and modeling their platforms on what has become the standard in the United States. An additional factor in the cost savings of VoIP is the relatively inexpensive nature of IP transit data at the core of the Internet. In the late 90's, a large amount of capital was invested in fiber connectivity between major metropolitan areas. Due to market forces, this fiber became available at incredibly inexpensive rates, and a "bandwidth glut" or "fiber glut" occurred at the core of the Internet, driving costs down. VoIP is a technology that enables voice communications over the Internet through the compression of voice into data packets that can be transmitted over data networks and then converted back into voice at the other side. Data networks, such as the Internet or local area networks (LANs), have always utilized packet-switched technology to transmit information between two communicating terminals (for example, a PC downloading a page from a web server, or one computer sending an e-mail message to another computer). The most common protocol used for communicating on these packet switched networks is internet protocol, (IP). VoIP allows for the transmission of voice along with other data over these same packet switched networks, and provides an alternative to traditional telephone networks, which uses a fixed electrical connection to carry voice signals through a series of switches to the final destination. VoIP has experienced significant growth in recent months. The telephone networks maintained by many local and long distance telephone companies were designed solely to carry low-fidelity audio signals with a high level of reliability. Although these traditional telephone networks are very reliable for voice communications, they are not well suited to service the explosive growth of digital communication applications for the following reasons: o Until recently, telephone companies have avoided the use of packet switched networks for transmitting voice calls due to the potential for poor sound quality attributable to latency issues (delays) and lost packets which can prevent real-time transmission. Recent improvements in packet switch technology, compression and broadband access technologies, as well as improved hardware and provisioning techniques, have significantly improved the quality and usability of packet-switched voice calls. o Packet-switched networks have been built mainly for carrying non real-time data, and the advantages of such networks are their efficiency, flexibility, reliability and scalability. Bandwidth is only consumed when needed, networks can be built in a variety of configurations to suit the number of users, client/server application requirements and desired availability of bandwidth and many terminals can share the same connection to the network. As a result, significantly more traffic can be transmitted over a packet switched network, such as a home network or the Internet, than a circuit-switched telephony network. Packet switching technology allows service providers to converge their traditionally separate voice and data networks and more efficiently utilize their networks by carrying voice, video, fax and data traffic over the same network. The improved efficiency of packet switching technology creates network cost savings that can be passed on to the consumer in the form of lower telephony rates. The exponential growth of the Internet in recent years has proven the scalability and reliability of these underlying packet switched IP based networks. As broadband connectivity has become more available and less expensive, it is now possible for service providers like us to offer voice services that run over these IP networks to consumers and business worldwide. The growth of the Internet in recent years has proven the scalability of these underlying packet switched networks. As broadband connectivity, including cable modem and digital subscriber line, or DSL, has become more available and less expensive, it is now possible for service providers like us to offer voice and video services that run over these IP networks to businesses and residential consumers. Providing such services has the potential to both substantially lower the cost of telephone service and equipment costs to these customers and to increase the breadth of features available to our subscribers. Services like full-motion, two-way video are now supported by the bandwidth spectrum commonly available to broadband customers, whether business or residential. As the wireless industry has shown, disruptive new technology with better product and service features has the effect of luring customers to regularly change carriers. To minimize this risk of churn, carriers must continually expand their service offering in order to retain their existing customers. With the growing acceptance of packet and VoIP telephony, the incumbent carriers are again faced with a disruptive technology with a lower cost of service. 25 Human Resource Team; VoIP Inc. Group VoIP, Inc. currently employs 72 persons in the following capacities: 8 officers, 27

general and administrative employees, and 37 technology personnel. We consider our relations with our employees to be good. We have never had a work stoppage, and none of our employees is represented by collective bargaining agreements. We believe that our future success will depend in part on our ability to attract, integrate, retain and motivate highly qualified personnel, and upon the continued service of our senior management and key technical personnel. None of our key personnel is bound by employment agreements that prohibit them from ending their employment at any time. Competition for qualified personnel in our industry and geographical location is intense. We cannot assure you that we will be successful in attracting, integrating, retaining and motivating a sufficient number of qualified employees to conduct our business in the future. Legal Proceedings On April 8, 2005, Volo Communications, Inc. ("Volo") (a wholly-owned subsidiary of Caerus, Inc.) filed suit against MCI WorldCom Network Services, Inc. d/b/a UUNET ("MCI"). Volo alleges that MCI engaged in a pattern and practice of over-billing Volo for the telecommunications services it provided pursuant to the parties' Services Agreement, and that MCI refused to negotiate such overcharges in good faith. Volo also seeks damages arising out of MCI's fraudulent practice of submitting false bills by, among other things, re-routing long distance calls over local trunks to avoid access charges, and then billing Volo for access charges that were never incurred. On April 4, 2005, MCI declared Volo in default of its obligations under the Services Agreement, claiming that Volo owes a past due amount of $8,365,980, and threatening to terminate all services to Volo within 5 days. By this action Volo alleges claims for (1) breach of contract; (2) fraud in the inducement; (3) primary estoppel; and (4) deceptive and unfair trade practices. Volo also seeks a declaratory judgment that (1) MCI is in breach of the Services Agreement; (2) $8,365,980 billed by MCI is not "due and payable" under that agreement; and (3) MCI's default letter to Volo is in violation of the Services Agreement. Volo seeks direct, indirect and punitive damages in an amount to be determined at trial. On May 26, 2005, MCI filed an Answer, Affirmative Defenses, Counterclaim and Third-Party Complaint naming Caerus, Inc. as a third-party defendant. MCI asserts a breach of contract claim against Volo, a breach of guarantee claim against Caerus, Inc., and a claim for unjust enrichment against both parties, seeking an amount to be determined at trial. On July 11, 2005, Volo and Caerus, Inc. answered the counterclaim and third-party complaint, and filed a third-party counterclaim against MCI for declaratory judgment, fraud in the inducement, and breach of implied duty of good faith and fair dealing. Volo and Caerus, Inc. seek direct, indirect, and punitive damages in an amount to be determined at trial. Discovery should commence shortly. The Company is currently unable to assess the likelihood of a favorable or unfavorable outcome. Properties Our headquarters are in Fort Lauderdale, Florida. We have offices and facilities in a number of other locations. Following is a list of our leased offices and facilities as of October 12, 2005. 26 Location Purpose App. sq. ft. Annual Rent ----------------------------- ----------------------------- ----------- ----------- 12330 SW 53rd Street, Suite 712 Principal executive offices 3,200 $ 39,648 Ft. Lauderdale, FL 33330 151 S. Wymore Rd, Suite 3000 Network facilities and offices 11,500 196,872 Altamonte Springs, FL 32714 13101 56th Court N., Suite 813 Fullfillment center 4,500 35,304 Clearwater, FL 33760 14911 Quorum Dr., Suite 140 Offices 6,250 54,000 Dallas, Texas 75254 17806 Pioneer Blvd, Suite 106 Offices 1,000 41,000 Artesia, California 90701 Manufacturing and Sources of Supply Our products are manufactured by iCable System Co. Ltd. a South Korean Company. iCableSystem provides offshore inventory and delivery services worldwide and large scale orders are shipped directly from Korea to providers at any destination. iCableSystem has in-house PC board pressing, case design and manufacturing, and board processing facilities, making them less susceptible to supply chain dropouts than other manufacturers. The primary chipset used in the CPE units is the Broadcom chipset, for which there is an available supply path and rapid delivery periods. It is not anticipated that there will be any significant shortfalls in the ability to produce equipment or deliver equipment, given past experience and current operating procedures, even under heavy volume sales. Equipment for VoIP Solutions, Inc. which involve a "solution" delivery for a customer, are primarily software driven, and do not involve significant hardware resources that are manufactured in-house. Inventories All the inventories are kept in our warehouse facility in Clearwater, Florida. Our local inventory and supply methods provide adequate capacity for most order volumes, but special orders or multi-thousand unit deliveries are typically drop-shipped from Korea. All softswitch and "back office" solution materials are also kept on-site for customer deployment, except in cases where local purchase of equipment is less difficult or less costly than in-country sourcing. The "cascading provisioning" server method that is used in the network allows for the "out-of-box" configuration and deployment of CPE hardware without ever being configured on the customer's network. This means that deployment time can be reduced drastically for field-shipping equipment, and no intermediate warehouse or customer care steps are required. Devices are delivered from overseas and can be directly put into use by any of our customers without

manual configuration. This is significantly different than most other hardware and softswitch providers, in that our solution removes the requirement for customer configuration of equipment (which is confusing and slow) or two-step shipping (which is costly and slow.) 27 Intellectual Property The Company has developed several important intellectual property features. VoiceOne has developed and the network provides a ubiquitous E911 solution to fully comply with the FCC's recent order imposing E911 requirements on VoIP Service Providers. VoiceOne's 911 service is known as i-911 and we believe it is the most accurate and advanced in the industry. A key feature of the i-911 service is that it can route emergency calls for the customer whose location is constant as well as the customer who often moves the location of his VoIP device. Customers can update their location information in real time, so that their i-911 call will be delivered to the appropriate Public Safety Answering Point (PSAP) in the new location. To further support the FCC 911 mandate, VoIP, Inc. has applied for a patent for its state-of-the-art 911 compliant VoIP Multimedia Terminal Adaptor. VoIP Inc. has developed Pathfinder as a "cascading provisioning server" feature for deployment of zero-touch hardware deployment and is a new development that is exclusive to VoIP, Inc.'s platform. The system allows each device to auto-provision without any customer interaction even in situations where there are multiple levels of VAR or resellers to distribute the product to their customers (to any number of resale levels.) This allows for installations without any customer service or technical support time spent in configuration issues. The Company has developed significant software resources in all areas of its business. Many of the core features of the Company's services and deliverables are constructed on software that has been custom-designed and completely owned by the Company. Hardware inventory control, accounting, least cost routing, customer records, telephony element management, network monitoring and administration, billing reconciliation, and internal sales resource tools are some of the integrated features of the Company's software development effort. Regulation The Company currently is a value added service provider. The hardware, integration and softswitch portions of our business are expected to remain unthreatened by regulation in major nations in which the Company expects to do business. The eGlobalphone service offering may potentially experience regulatory pressures as the United States makes changes in its telecommunications law to encompass VoIP services. The imposition of government regulation on our business could adversely affect our operations by requiring additional expense to meet compliance requirements. 1) Regulation is expected to be applied to the following areas of our service: E911, CALEA (law enforcement wiretap) and USF taxation. a. Our existing E911 service addresses this concern already and we are working with industry groups to also address E911 delivery via the network when that technology becomes mature and affordable. The combined delivery methods should adequately protect the Company against negative regulatory or economic pressure in the future. b. CALEA data delivery is almost complete in the system for the basics of call status and PIN tapping. The additional steps of call monitoring and call splitting are yet to be even defined, though it is not anticipated that their deployment would require anything other than minor expense for adequate compliance with these laws, given current technology. c. USF (Universal Service Fee) taxation has been explicitly not required for data services. The classification of VoIP as a value added data service has clearly indicated that it is outside of the USF charter. 2) Comments by the FCC staff have indicated that VoIP will be handled in a relatively "hands-off" manner until the industry is more mature and capable of competing directly with RBOC and ILEC carriers. This is anticipated to be at least another two years. 3) Even with additional regulations and if they were to be applied, the costs of compliance would be significantly lower than those of traditional telephony, as these regulatory structures are already being considered and compensated for in design aspects of the network. 4) Our primary focus on non-US customers should limit our exposure in the United States. 5) Federal Regulations 28 Federal Regulation The Federal Communications Commission (FCC) regulates interstate and international telecommunications services. The FCC imposes extensive regulations on common carriers such as incumbent local exchange carriers ("ILECs") that have some degree of market power. The FCC imposes less regulation on common carriers without market power, such as Volo. The FCC permits these nondominant carriers to provide domestic interstate services (including long-distance and access services) without prior authorization; but it requires carriers to receive an authorization to construct and operate telecommunications facilities and to provide or resell telecommunications services between the United States and international points.. Under the Telecommunications Act of 1996 (the "1996 Act"), any entity, including cable television companies and electric and gas utilities, may enter any telecommunications market, subject to reasonable state regulation of safety, quality and consumer protection. Because implementation of the 1996 Act is subject to numerous federal and state policy rulemaking proceedings and judicial review, there is still uncertainty as to what impact it will have on Volo. The 1996 Act is intended to increase competition. The 1996 Act opens the local services market by requiring ILECs to permit

interconnection to their networks and establishing ILEC obligations with respect to: o Reciprocal Compensation. Requires all ILECs and CLECs to complete calls originated by competing carriers under reciprocal arrangements at prices based on a reasonable approximation of incremental cost or through mutual exchange of traffic without explicit payment. o Resale. Requires all ILECs and CLECs to permit resale of their telecommunications services without unreasonable restrictions or conditions. In addition, ILECs are required to offer wholesale versions of all retail services to other telecommunications carriers for resale at discounted rates, based on the costs avoided by the ILEC in the wholesale offering. o Interconnection. Requires all ILECs and CLECs to permit their competitors to interconnect with their facilities. Requires all ILECs to permit interconnection at any technically feasible point within their networks, on nondiscriminatory terms and at prices based on cost (which may include a reasonable profit). At the option of the carrier seeking interconnection, colocation of the requesting carrier's equipment in an ILEC's premises must be offered, except where the ILEC can demonstrate space limitations or other technical impediments to colocation. o Unbundled Access. Requires all ILECs to provide nondiscriminatory access to specified unbundled network elements (including certain network facilities, equipment, features, functions and capabilities) at any technically feasible point within their networks, on nondiscriminatory terms and at prices based on cost (which may include a reasonable profit). o Number Portability. Requires all ILECs and CLECs to permit, to the extent technically feasible, users of telecommunications services to retain existing telephone numbers without impairment of quality, reliability or convenience when switching from one telecommunications carrier to another. o Dialing Parity. Requires all ILECs and CLECs to provide "1+" equal access to competing providers of telephone exchange service and toll service, and to provide nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listing, with no unreasonable dialing delays. o Access to Rights-of-Way. Requires all ILECs and CLECs to permit competing carriers access to poles, ducts, conduits and rights-of-way at regulated prices. The FCC has to date treated ISPs as "enhanced service providers," exempt from federal and state regulations governing common carriers, including the obligation to pay access charges and contribute to the universal service fund. Nevertheless, regulations governing disclosure of confidential communications, copyright, excise tax, and other requirements may apply to the provision of Internet access services. 29 The FCC, on March 10, 2004, adopted a Notice of Proposed Rulemaking, which will address a variety of issues concerning the regulatory treatment of VoIP telephony. At the same time, the FCC ruled on a petition which dealt with a VoIP service that never used the PSTN, was offered free to members of the service, and did not involve the transport of the calls. The FCC determined the service was not a telecommunications service under the Act. We cannot predict the outcome of these proceedings or other FCC or state proceedings that may affect our operations or impose additional requirements, regulations or charges upon our provision of Internet access and related Internet Protocol-based telephony services. The FCC and many state public utilities commissions have implemented rules to prevent unauthorized changes in a customer's pre-subscribed local and long distance carrier services (a practice commonly known as "slamming.") Pursuant to the FCC's slamming rules, a carrier found to have slammed a customer is subject to substantial fines. In addition, the FCC's slamming rules allow state public utilities commissions to elect to administer and enforce the FCC's slamming rules. These slamming liability rules substantially increase a carrier's possible liability for unauthorized carrier changes, and may substantially increase a carrier's administrative costs in connection with alleged unauthorized carrier changes. The Communications Assistance for Law Enforcement Act (CALEA) provides rules to ensure that law enforcement agencies would be able to properly conduct authorized electronic surveillance of digital and wireless telecommunication services. CALEA requires telecommunications carriers to modify their equipment, facilities, and services used to provide telecommunications services to ensure that they are able to comply with authorized surveillance requirements. Our switches are CALEA compliant. The FCC is currently looking at whether VoIP and other Internet enabled communications services should continue to be unregulated Internet services. We cannot predict the outcome of such proceedings or that any increased level of regulation resulting therefrom will not have a material adverse affect on our business or operations. State Regulation The 1996 Act is intended to increase competition in the telecommunications industry, especially in the local exchange market. With respect to local services, ILECs are required to allow interconnection to their networks and to provide unbundled access to network facilities, as well as a number of other pro-competitive measures. Because the implementation of the 1996 Act is subject to numerous state rulemaking proceedings on these issues, it is currently difficult to predict how quickly full competition for local se Local Regulation Our network is subject to numerous local regulations such as building codes and licensing. Such regulations vary on a city-by-city, county- by-county and state-by-state basis. 30 Increasing interest by U.S. states in the regulation of voice over IP services could result in laws

or regulatory actions that harm our business. Several states have recently shown an interest in regulating voice over IP, or VoIP, services, as they do for providers of traditional telephone service. If this trend continues, and if state regulation is not preempted by action by the U.S. federal government, we may become subject to a "patchwork quilt" of state regulations and taxes, which would increase our costs of doing business, and adversely affect our operating results and future prospects. Our company and industry are highly regulated, which restricts our ability to compete in our target markets and imposes substantial compliance costs on us that adversely impact our results. We are subject to varying degrees of regulation from federal, state and local authorities. This regulation imposes substantial compliance costs on us. It also restricts our ability to compete. For example, in each state in which we desire to offer our services, we are required to obtain authorization from the appropriate state commission. If any required authorization for any of our markets or services is revoked or otherwise terminated, our ability to operate in the affected markets would be adversely affected. Attempts to limit the basic competitive framework of the Telecom Act could interfere with the successful implementation of our business plan. Successful implementation of our business plan is predicated on the assumption that the basic framework for competition in the local exchange services market established by the Telecom Act will remain in place. We expect that there will be attempts to limit or eliminate this basic framework through a combination of federal legislation, new rulemakings by the FCC and ILEC challenges to existing and proposed regulations. It is not possible to predict the nature of any such action or its impact on our business and operations. 31 MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS AND PLAN OF OPERATION The information presented in this section should be read in conjunction with the information contained in the financial statements, including the notes thereto, and the other financial statements appearing elsewhere in this Prospectus. General The following discussion should be read in conjunction with the Consolidated Financial Statements and the notes thereto and the other financial information appearing elsewhere in this Prospectus. Certain statements contained in this Prospectus and other written material and oral statements made from time to time by us do not relate strictly to historical or current facts. As such, they are considered "forward-looking statements" that provide current expectations or forecasts of future events. Such statements are typically characterized by terminology such as "believe," "anticipate," "should," "intend," "plan," "will," "expect," "estimate," "project," "strategy" and similar expressions. Our forward-looking statements generally relate to the prospects for future sales of our products, the success of our marketing activities, and the success of our strategic corporate relationships. These statements are based upon assumptions and assessments made by our management in light of its experience and its perception of historical trends, current conditions, expected future developments and other factors our management believes to be appropriate. These forward-looking statements are subject to a number of risks and uncertainties, including the following: our ability to achieve profitable operations and to maintain sufficient cash to operate its business and meet its liquidity requirements; our ability to obtain financing, if required, on terms acceptable to it, if at all; the success of our research and development activities; competitive developments affecting our current products; our ability to successfully attract strategic partners and to market both new and existing products; exposure to lawsuits and regulatory proceedings; our ability to protect our intellectual property; governmental laws and regulations affecting operations; our ability to identify and complete diversification opportunities; and the impact of acquisitions, divestitures, restructurings, product withdrawals and other unusual items. A further list and description of these risks, uncertainties and other matters can be found elsewhere in this Prospectus. Except as required by applicable law, we undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. Balance Sheet Data: June 30, 2005 (unaudited) December 31, 2004 ------------- ----------------- Goodwill and other intangible assets $30,765,594 $6,923,854 Total assets 43,250,279 10,215,552 Notes payable, current 7,736,929 760,000 Total liabilities (all current) 20,542,992 2,108,114 Shareholders' equity 22,707,287 8,107,438 Six Months Ended Year Ended June 30, December 31, ----------------------- ----------------------- Statement of Operations Data: 2005 2004 2004 2003 ----------- --------- ----------- --------- (Unaudited) Revenue $ 3,916,920 $ 85,298 $ 2,619,393 $ 0 Operating (loss)(1) (5,033,437) (430,981) (4,160,050) 0 Net (loss) (1) (5,033,437) (430,981) (4,014,739) (352,968) Net (loss) per common share (0.19) (0.05) (0.27) (0.20) (1) The year ended December 31, 2004 includes $3,520,000 non-cash compensation expenses resulting from the issuance to executive officers of warrants to purchase 4,400,000 shares of common stock for $1.00 per share in August, 2004. See "Financial Statements" beginning on Page F-1. Results of Operations We commenced operations during the fourth quarter of 1998 and focused significant resources through December 2003 in procuring and importing inventory and developing sales and distribution channels for our tea business, which was

discontinued in 2004. Accordingly, we generated only minimal revenues and experienced cumulative losses of approximately $624,647, through December 31, 2003. Our net loss for the year ended December 31, 2003 was $352,968, or $0.20 per share. 32 In 2004 we changed our focus to the IP telephony business. Our 2004 fiscal year revenues were provided primarily by DTNet Technologies, Inc., and Voipamericas, companies we acquired in June and September, respectively, of the year ended December 31, 2004. Sales generated for us by DTNet and Voipamericas amounted to approximately $1.6 million and $0.6 million respectively, in 2004. The sales generated by DTNet and our hardware sales generated substantially all of our gross profit for the year ended December 31, 2004. Our operating expenses totaled $4,909,174 for the year ended December 31, 2004 and were comprised of $2,721,296 for compensation and related expenses and $2,187,878, for general and administrative expenses. Our net loss for the 2004 fiscal year was $4,014,739 or $0.27 per share. Net losses for the respective six months ended June 30, 2005 and 2004 were $5,033,437 and $430,981, respectively, reflecting levels of revenues and gross profit that were inadequate to support our operating cost structure. Our net loss per share was $0.19 and $0.05 for the six months ended June 30, 2005 and 2004, respectively. Revenues for the six months ended June 30, 2005 increased by approximately $3.8 million, to $3,916,920 from the comparable 2004 period. This revenue increase is attributable to the inclusion of the results of DTNet and Voipamericas in 2005. The increase in gross profit to $812,074 for the six months ended June 30, 2005 from $26,375 for the comparable 2004 period is attributable to our revenue increase. Our operating expenses increased from $457,356 for the six months ended June 30, 2004 to $5,845,511 for the six months ended June 30, 2005 due to the addition of the operating costs of the subsidiaries we acquired in the second and third quarters of 2004. Total assets at June 30, 2005 were $43,250,279, up $33,034,727 from December 31, 2004. This increase in assets and the corresponding increase in accounts payable and other current liabilities are almost entirely related to the acquisition of Caerus, Inc. on May 31, 2005. We have recorded significant amounts of goodwill and intangible assets in connection with the acquisition of Caerus and other acquisitions. Goodwill and intangible assets comprised 71% of our total assets at June 30, 2005. We expect to record additional amounts of goodwill and intangible assets in connection with our WQN, Inc. acquisition, which was completed on October 5, 2005. Under Statement of Financial Accounting Standards No. 142 we are required to periodically evaluate the carrying values of our goodwill and intangible assets. If in the future such carrying values exceed their fair values, we will be required to record an impairment charge in our consolidated statement of operations. Such an impairment charge could have a significant adverse impact on our operating results and financial condition. Liquidity and Capital Resources and Plan of Operation As of June 30, 2005, we had cash and cash equivalents of $1,068,514, as compared to $1,141,205 at December 31, 2004. Cash and cash equivalents decreased by $72,691 for the six months ended June 30, 2005. We used $4,583,648 in cash for our operating activities. We funded our operating activities through private placements of notes payable and common stock. These financing activities provided us with net cash of $4,548,736 for the six months ended June 30, 2005. Liquidity for the period from inception through June 30, 2005 has been provided by sales of common stock through private placements and borrowing from affiliates. We anticipate that we will continue to experience negative cash flows from operations. We have incurred losses since the inception of our business and as of June 30, 2005 our accumulated deficit was $9,672,823. We have not achieved profitability in any quarter or year. We may incur additional net losses in future quarters or years. We have $7,736,929 due under outstanding notes payable as of June 30, 2005 consisting of a note payable to a shareholder ($1,053,196), convertible notes ($1,552,925) and a loan payable to a lending institution ($5,130,818). The note payable to the shareholder bears interest at 3.75% and matures on December 31, 2005. Of the $1,552,995 convertible notes payable, $125,000 was converted into 166,667 shares of common stock in July 2005. The remaining balance of $1,427,995 represents 8% notes issued pursuant to a subscription agreement, convertible into 1,784,895 shares of common stock. In connection with these notes the holders received warrants to purchase 829,447 shares of common stock at $1.60 per share and 892,448 shares of common stock at $1.43 per share. The subscription agreement for these notes requires the issuance of an additional $1,427,916 of these 8% notes, convertible into 1,784,895 shares of common stock, within five business days following the effective date of a Company registration statement on Form SB-2. In connection with these notes the Company will issue warrants for the purchase of 892,447 shares of common stock at $1.60 per share and 892,448 shares of common stock at a per share price equal to 110% of the volume weighted average price for the five business days immediately preceding the effective date of the Form SB-2. Borrowings under the loan payable to the lending institution are repayable over a three-year period and bear interest at 12.5% per annum. Additional borrowings under this facility are contingent upon, among other things, our success in raising certain levels of additional equity

financing. The loan agreement contains customary covenants and restrictions and provides the lender the right to a perfected first-priority, secured interest in all of Caerus, Inc.'s assets, as well as rights to preferred stock warrants. We are currently in violation of certain requirements of the debt facility. Accordingly, the full amount of the note at June 30, 2005 has been classified as current. No default on this loan has been declared. We will need to significantly increase our revenues, and earn adequate margins on these revenues, to become profitable. We believe we will be able to add new customers and increase our revenues with the completion of the nationwide expansion of our network. Our revenues will also increase, as compared to prior periods, as a result of our recent acquisition of Caerus and the VoIP assets of WQN. We estimate that the expansion of our network will require approximately $4.0 million. We will continue to be dependent upon the sale of debt and equity securities not only to complete our network expansion, but to fund our existing operations. We are presently pursuing this additional financing. However, we may not be successful in obtaining further debt or equity financing for our business. Critical Accounting Policies and Estimates We have identified the policies and significant estimation processes below as critical to our business operations and the understanding of our results of operations. This listing is not intended to be a comprehensive list. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States, with no need for management's judgment in their application. In other cases, management is required to exercise judgment in the application of accounting principles with respect to particular transactions. The impact and any associated risks related to these policies on our business operations is discussed throughout "Management's Discussion and Analysis of Financial Condition and Results of Operations" where such policies affect reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note B in the Notes to Consolidated Financial Statements for the year ended December 31, 2004, included in this Form SB-2. Our preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from those estimates and such differences could be significant. 33 Revenue recognition - Our revenue is derived from fees charged to terminate voice services over our network, from monthly recurring charges associated with Internet services, and from sales of hardware product. Variable revenue is earned based on the number of minutes during a call and is recognized upon completion of a call. Revenue for each customer is calculated from information received through our network switches. We track the information from the switch and analyze the call detail records against stored detail information about revenue rates. Fixed revenue is earned from monthly recurring services provided to customers that are fixed and recurring in nature, and are contracted for over a specified period of time. Revenue recognition commences after the provisioning, testing, and acceptance of the service by the customer. The monthly charges continue until the expiration of the contract, or until cancellation of the service by the customer. Revenue from product sales is recognized when persuasive evidence of an arrangement exists, delivery to customer has occurred, the sales price is fixed and determinable, and collectibility of the related receivable is probable. Accounts receivable - Accounts receivable are stated at the amount we expect to collect from outstanding balances. We provide for probable uncollectible amounts based on our assessment of the current status of the individual receivables. Business combinations - We account for business combinations in accordance with Statement of Financial Accounting Standards No. 141 "Business Combinations" (SFAS No. 141). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations. SFAS No. 141 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually by comparing carrying value to the respective fair value in accordance with the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). This pronouncement also requires that the intangible assets with estimated useful lives be amortized over their respective estimated useful lives. Impairment of long-lived assets - We review the recoverability of our long-lived assets, such as property and equipment, when events or changes in circumstances occur that indicate that the carrying value of the asset group may not be recoverable. The assessment of possible impairment is based on our ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires us to estimate future cash flows and the fair value of

long-lived assets. Stock based compensation - We apply the fair value method of Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation" (SFAS No. 123) in accounting for its stock options. This standard states that compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. The fair value for each option granted is estimated on the date of the grant using the Black-Scholes option pricing model. The fair value of all vested options granted has been charged to salaries, wages, and benefits in accordance with SFAS No. 123. Recent accounting pronouncements - In November 2004, FASB issued Statement No. 151, "Inventory Costs - an amendment of ARB No. 43, Chapter 4." Statement No. 151 requires that abnormal amounts of costs, including idle facility expense, freight, handling costs and spoilage, should be recognized as current period charges. The provisions of this Statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not expect the adoption of this Statement to have a material impact on our financial statements. In December 2004, FASB issued Statement No. 153, "Exchange of Nonmonetary Assets - an amendment of Accounting Principles Board ("APB") Opinion No. 29." Statement No. 153 amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have a commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this Statement are effective for nonmonetary exchange occurring in fiscal periods beginning after June 15, 2005. We do not expect the adoption of this Statement to have material impact on our financial statements. 34 In December 2004, FASB issued Statement No. 123R, "Share -Based Payment." Statement No. 123R revises Statement No. 123, supersedes APB Opinion No. 25 and amends Statement No. 95. Statement No. 123R requires the cost of employee services received in exchange for an award of equity instruments be recognized over the period during which an employee is required to provide service in exchange for the award. The provisions of this Statement are effective for public entities that do not file as small business issuers as of the beginning of the first interim period or annual reporting period that begins after June 15, 2005. We do not expect the adoption of this Statement to have a material impact on our financial statements. Payments Due by Period The following table illustrates our outstanding debts and the terms of that debt as of June 30, 2005: 2006- Contractual Obligations Total Remainder of 2005 2008 ---------------------- ---------- ----------------- -------- Long-term debt $0 $0 $0 Notes payable $7,736,929 $7,736,929 $0 Operating leases $594,905 $ 149,905 $445,000 Purchase obligations $0 $0 $0 ---------- ---------------- -------- Total $8,331,834 $7,886,834 $445,000 ========== ================ ======== Recent Developments We have recently made a number of announcements regarding key developments in our business. We launched the industry's private network 911 service (v911) for broadband and packet communications in September 2005. We began adding an additional 48 CLEC customers and cities to our Voice One direct network footprint. This expansion is anticipated to be completed in November 2005. We closed our acquisition of the assets of WQN, Inc.'s VoIP business on October 5, 2005. During October 2005 we interconnected our Voice One network with Stealth Communications' Voice Peering FabricTM (VPF), the world's largest peering network. VPF allows members to exchange VoIP traffic without relying on the traditional Public Switched Telephone Network. VPF members now have the ability to exchange traffic directly with our network and access the services we offer, including our v911 services. MANAGEMENT Directors, Executive Officers and Control Persons The following table contains information concerning the Company's executive officers and directors. Start Date Name Age Position with Company with Company --------------- --- ------------------------------------ ------------- Steven Ivester 41 Chairman, Chief Executive Officer March 2004 Osvaldo Pitters 47 Chief Financial Officer May 2004 Bill Burbank 47 Chief Operating Officer December 2004 Shawn Lewis 38 Chief Technology Officer May 2005 Clive Raines 46 Chief Marketing Officer March 2004 B. Michael Adler 58 Prospective Director October 2005 Stuart Kosh 49 Prospective Director December 2005 George Firestone 73 Director October 2005 Thomas Reeves* 57 Prospective Director October 2005 -------------- * Anticipated. 35 Steven Ivester - Chairman & Chief Executive Officer Mr. Ivester has been a successful technology inventor and entrepreneur since 1982. In 1985 he established a chain of automotive service centers, All State Auto Centers (Founder & President) and sold the business in 1991. He subsequently established, expanded and sold a chain of computer stores known as 21st Century Computers. In 1997, Mr. Ivester became President and CEO of Navigator, PC, which invented a series of rugged waterproof military grade navigational computer and display systems. From 2001 to 2004, he consulted for Voice over IP companies and was responsible for the specification and development of IP desktop telephone devices, Multimedia Terminal Adaptors, and portable WiFi phones in addition to sourcing, negotiation and quality assurance.

In early 2004, Mr. Ivester founded VoIP, Inc. Osvaldo Pitters - Chief Financial Officer Osvaldo has a successful track record and progressive working experience managing finance, administration, accounting and auditing functions in the US, England, UK and Latin America. Osvaldo worked 10 years with PriceWaterhouseCoopers in the Audit Department in Latin America and in England, UK. Osvaldo also worked 7 years with Pepsi Cola International in the Finance Area in several countries within the Latin American region. He also worked for two years as Deputy General Manager of Banco Republica in Lima, Peru. Before joining us, from January 2003 to April 2004, Osvaldo was the Controller of the Cima Telecom Group in Miami, Florida. Osvaldo is a 1983 graduate of the Santiago University, Chile and a 1985 post graduate of the Cambridge University, UK. Bill Burbank - Chief Operating Officer Bill Burbank brings over 25 years of success in Business Development and Operations to our company. Bill has extensive experience in working with both private and public emerging technology development companies. He was co-founder of Incite Global Services, a consulting firm specializing in Business Development, Operations and Crisis Management for emerging companies in the high tech communications sector. Prior to IGS, he was the Senior Vice President of Sales and Chief Marketing Officer for Intraco Systems, Inc., a provider of virtual office solutions and applied speech recognition applications. Bill was co-founder and President of Foresight Technology. At Foresight, he played an instrumental role in fostering Foresight's leadership in computer telephone integration (CTI) and customer premise-based speech recognition products. Prior to Foresight, Burbank served as Vice President of Worldwide Sales and Marketing for Registry Magic Inc., where he led the sales of the company's speech recognition call routing system. As Vice President of Sales for The Automatic Answer Inc., a voice and unified messaging software company. Shawn M. Lewis - Chief Technology Officer Shawn M. Lewis oversees all of our Technological and Engineering activities. Prior to accepting our CTO position, Mr. Lewis was President and CEO of Caerus, Inc. and its three subsidiaries, Volo Communications, Caerus Networks, Inc., and Caerus Billing & Mediation, Inc. Shawn Lewis wrote the patent for the first Softswitch and SS7 Media Gateway for XCOM Technologies, Inc., a CLEC he co-founded at the time of the Telecommunications Act in 1996 and directed before its acquisition by Level 3 in 1998. Level 3 proceeded to make these patents public, which created the packet communications industry. His next venture, set-top box vendor, River Delta, sold to Motorola. His third successful venture, Caerus, Inc. empowers carriers and service providers to begin selling advanced services and realizing revenues and profits immediately. Clive Raines - Chief Marketing Officer Clive is a VoIP industry pioneer holding senior management positions with several United States based VoIP start ups prior to co-founding VoIP Inc. Born in England and a resident of New Zealand, his professional qualifications are complemented by extensive international marketing and business development experience in the Telco, computer and wireless industries. His experience has assisted the Company in the development of unique market driven products, solutions and services. Clive's industry experience commenced when he established the first private telephone, PBX and Interconnect businesses to compete with the incumbent PTT when New Zealand deregulated in 1987. After selling these businesses in 1993, Clive progressed to the Computer Telephony Integration and Call Center industries as they emerged and later became involved with Internet related businesses as the first VoIP calls were being made. In 1997 he relocated to Sydney, Australia to help found the first Internet start up to be listed on the Australian stock exchange. He was later recruited by a VoIP equipment vendor based in California to develop business and marketing plans for a new VoIP Telco. During this period he traveled to Sarajevo to establish satellite based payphones for multinational troops to be able to call home and developed other value added services for global markets. During the period 1998 - 2002 Clive developed marketing plans and an international business model for USA Talks, the first company to offer VoIP based unlimited calling with the United States for a flat monthly charge. He relocated to London and served from 1998 to 2002 as European CEO and opened a UK office offering the same services to UK consumers. He has also traveled extensively establishing wholesale carrier services with direct routes to developing countries in Africa, the Middle East and Asia utilizing VoIP. In 2003, Clive was instrumental in launching Voiceglo, a VoIP Telco service providing home line replacement services based on the newly available SIP technology. 36 B. Michael Adler - Prospective Director B. Michael Adler is the founder of WQN, Inc. and has been its Chairman of the Board since its inception in 1996. Mr. Adler is the Chief Executive Officer of Eagle Venture Capital, LLC, a Delaware limited liability company, formerly known as WorldQuest Networks, LLC, and a Director of Intellicall, Inc., a publicly traded manufacturer of pay phones and call processing equipment (American Stock Exchange symbol "ICL"). Mr. Adler founded Intellical in 1984 and served as Chairman or Vice Chairman of the Board from its inception until November 1993. From 1994 to July 1999, Mr. Adler was the Chairman of the Board of The Payphone Company Limited, a company that owns a wireless pay telephone network in Sri

Lanka. Stuart Kosh - Prospective Director Mr. Kosh moved to Florida in 1978 to join his father and brother at Kosh Ophthalmic, Inc., a wholesale optical laboratory with annual sales of $15 million, where he managed 100 employees. In 1998, the company was sold to Essilor of America and Mr. Kosh maintains his position as General Manager. His leadership roles have included involvement with the Big Brothers Big Sisters Program of Broward County as a mentor to needy youth. For the past 15 years, Mr. Kosh has been involved with the National Multiple Sclerosis Society. He has served on their board and chairs their annual golf tournament which raises over $50,000. Presently he is serving on the Temple Dor Dorim Board of Directors. George Firestone - Director Senator Firestone was elected Florida's 20th Secretary of State of Florida in 1978, and was re-elected for two additional terms. Previously, he served as a member of the House of Representatives and as a member of the Florida Senate. During his legislative tenure, he was responsible for the passage of laws permitting international banking and foreign trade zones. This provided the groundwork for Florida becoming a major center for international business and finance. He has led trade missions and traveled extensively throughout Europe, Asia, Africa and South America and has visited 41 countries. Senator Firestone currently serves as the state of Florida's "Special Envoy" to the Foreign Consular Corp of Florida. He has a long history of valued legislative service, including serving as a member of the Florida Cabinet, the state's Chief Elections Officer, and Chief Cultural Officer. A distinguished military career, Senator Firestone served in the U.S. Army as Sergeant First Class and graduated in the top 25 percent of his class at the Non-commissioned Officer Academy in Munich, Germany. In the private sector, Senator Firestone is Chairman and CEO of Tecton, Inc., a financial and operations Management Company. He is a licensed real estate broker and developer, and insurance broker specializing in the field of estate planning and business insurance for individuals and corporations. Senator Firestone is a vice president, general manager, and stockholder of Gray Security Service, which provides security investigations of commercial and industrial matters. He serves on the board of Eastern National Bank of Miami. His long public service support includes serving as chairman of the city of Miami Economic Advisory Board; member of the Dade County Personnel Advisory Board; and receiver and trustee of the U.S. Bankruptcy Court. Accolades and awards abound throughout Senator Firestone's career, including the Florida Democratic Party Award for Outstanding Service and Leadership, and the Florida Times Union Award for Most Outstanding First Term Senator. A lecturer and published author, Senator Firestone works with the National Conference of State Legislators and the Citizens Conference on State Legislators, and he writes articles on various issues of interest to senior citizens and condominium owners. Thomas Reeves - Prospective Director Mr. Reeves graduated from Cal State University with a BS in Business Administration and also holds an AA degree from Chabot College. Mr. Reeves has a broad professional career that began with Shaklee Corporation as Contract Manufacturing Manager and was later promoted to Director of Purchasing. In 1980 he accepted a Vice President position with Nutrition Pak Corporation. From 1984 to 1992 Mr. Reeves was President of Torick Inc. an electrical wire harness manufacturer. In 1992 he started Transportation Safety Technologies where he was President and CEO. From 2000 to present he has been President of TRJB Inc. a holding company for various companies in the hospitality industry. In addition, Mr. Reeves has been actively involved in supporting the American Cancer Society and is a committee member of the Cystic Fibrosis Foundation. Organization of the Board of Directors and Management From February 2004 until September 2005, Mr. Ivester served as the sole member of the Board of Directors. In September 2005, the Company was proud to announce the addition of Senator George Firestone to a seat on the Board. The Company intends to effect a reorganization of management during the coming weeks, as follows: On October 17, 2005, B. Michael Adler will replace Steven Ivester as CEO. Ten days after filing an Information Statement pursuant to SEC Rule 14f, Mr. Ivester will resign as a director and Mr. Adler will be appointed to fill his vacancy. At the same time, an additional seat on the Board will be created, and Thomas Reeves will be appointed to fill the seat. At the Company's next annual shareholders meeting, anticipated to occur in November or December 2005, the entire Board will be reelected, along with Stuart Kosh and possibly one other director. Mr. Ivester will remain associated with the Company as a Consultant and observer on the Board. At the meeting of the Board of Directors following the shareholders meeting, the Board will be organized to create an Audit Committee and Compensation Committee, and will adopt a Code of Conduct and charters for the Audit and Compensation Committees. 37 Executive Compensation Summary Compensation Table. The following table sets forth the compensation earned by the Company's Chief Executive Officer for the year ended December 31, 2004 in salary and bonus for services rendered in all capacities to the Company for the fiscal years ended December 31, 2004, 2003 and 2002: Annual Compensation Long-Term Compensation ----------------------------- ------------------------ Securities Underlying Other Annual Options or All Other Name/Principal Position Year Salary Bonus Compensation

Warrants Compensation ---------------------- ---- -------- ----- ----------- ---------- ------------ Steven Ivester, CEO 2004 $125,000 $ 0 $ 0 0 0 2003 0 0 0 0 0 2002 0 0 0 0 0 Number of Securities Value of Unexercised Underlying Unexercised In-the-Money Options Options at Fiscal at Fiscal Year End Year End -------------------------- -------------------------- Number of Shares Name Acquired or Exercised Realized Value Exercisable Unexercisable Exercisable Unexercisable ---- -------------------- ------------- ----------- ------------ ---------- ------------- None Estimated Future Payments under Non-Stock Price-Based Plans ------------------------------ Number of Performance or Other Shares, Under or Period Until Threshold Target Maximum Name Other Rights # Maturation or Payout ($ or #) ($ or #) ($ or #) ---- --------------- ------------------- --------- -------- -------- None Stock Option Plan The Company's Stock Option Plan (the "2004 Option Plan") provides for the grant to eligible employees and directors of options for the purchase of Common Stock. The Option Plan covers, in the aggregate, a maximum of 4,000,000 shares of Common Stock and provides for the granting of both incentive stock options (as defined in Section 422 of the Internal Revenue Code of 1986) and nonqualified stock options (options which do not meet the requirements of Section 422). Under the Option Plan, the exercise price may not be less than the fair market value of the Common Stock on the date of the grant of the option. The Board of Directors administers and interprets the Option Plan and is authorized to grant options there under to all eligible employees of the Company, including officers. The Board of Directors designates the optionees, the number of shares subject to the options and the terms and conditions of each option. Each option granted under the Option Plan must be exercised, if at all, during a period established in the grant which may not exceed 10 years from the later of the date of grant or the date first exercisable. An optionee may not transfer or assign any option granted and may not exercise any options after a specified period subsequent to the termination of the optionee's employment with the Company. Certain Relationships and Related Transactions The Company was organized by Kevin Halter and members of his family in 1998, when they purchased 1,000,000 shares at its par value. Then in March 2004, the Company sold 12,500,000 shares of stock to Steven Ivester for par value ($12,500), plus his agreement to contribute two operating companies. Such companies were contributed in May 2004, effective April 15, 2004. As of December 31, 2003, the Company had amounts due to affiliated entities and/or shareholders and/or officers of approximately $151,000. These advances were unsecured, due upon demand and are non-interest bearing. Subsequently, in April 2004, the Company issued 339,242 shares of common stock to satisfy the balance due at December 31, 2003. 38 Promoters On February 27, 2004, the Company issued and sold 12,500,000 shares of common stock to Steven Ivester in exchange for cash of $12,500 and his agreement to contribute the intellectual property rights and related assets of two start-up companies formed to engage in the telecommunications industry. The shares issued represented approximately 88% of the shares outstanding after the exchange, as a result of which Mr. Ivester became the controlling shareholder of the Company. On May 25, 2004 (but effective for all purposes as of April 15, 2004), the Company completed the acquisition of two Florida-based subsidiaries, eGlobalphone, Inc. and VoIP Solutions, Inc., both Florida Corporations. On August 4, 2004, the Company issued warrants to purchase 2,200,000 shares of common stock for an exercise price of $1.00 per share to each of John Todd and Clive Raines. Mr. Todd's warrants were exchanged for 750,000 shares in a net cashless exercise in February 2005. Messrs. Ivester, Todd and Raines may be considered to be "promoters" of the Company. DESCRIPTION OF SECURITIES General The following summary is qualified in its entirety by reference to the Company's Articles of Incorporation and its By-Laws. The Company's authorized capital stock consists of 100,000,000 shares of common stock, $.001 par value per share. Common Stock As of September 30, 2005, 56,588,004 common shares of the Company's common stock are held of record by approximately 326 persons. Each share of common stock entitles the holder of record thereof to cast one vote on all matters acted upon at the Company's shareholder meetings. Directors are elected by a plurality vote. Because holders of common stock do not have the cumulative voting rights, holders or a single holder of more than 50% of the outstanding shares of common stock present and voting at an annual meeting at which a quorum is present can elect all of the Company's directors. Holders of common stock have no preemptive rights and have no right to convert their common stock into any other securities. All of the outstanding shares of common stock are fully paid and non-assessable. Holders of common stock are entitled to receive ratably such dividends, if any as may be declared from time to time by the Board of Directors in its sole discretion from funds legally available therefore. In the event the Company is liquidated, dissolved or wound up, holders of common stock are entitled to share ratably in the assets remaining after liabilities and all accrued and unpaid cash dividends are paid. Transfer Agent The Company's transfer agent is Securities Transfer Corporation, Frisco, Texas. PRINCIPAL SHAREHOLDERS The following table sets forth certain information with respect to the beneficial ownership of our Common Stock as of October 9, 2005, before

this offering and as adjusted to reflect the sale of 15,372,245 shares in this offering, by all officers and directors and by all those known by us to be beneficial owners of more than 5% of our Common Stock. Unless otherwise specified, the business address of the shareholder is our address as set forth in this memorandum. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally means sole or shared power to vote or direct the voting or to dispose or direct the disposition of any Common Stock. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table below have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them. 39 Beneficial Beneficial Ownership Ownership(1) After Before Offering Offering ---------------------- ---------- Beneficial Owner Shares Percentage Shares --- ---------- ---------- ---------- Steven Ivester .... 8,250,000 14.6% 8,250,000 Shawn Lewis .... 5,346,231 9.4% 5,346,231 Clive Raines .... 1,000,000 1.8% 1,000,000 Bill Burbank .... 1,000,000 1.8% 1,000,000 Osvaldo Pitters .... 500,000 0.8% 500,000 Thomas Reeves .... 318,961 0.5% 318,961 Stuart Kosh .... 778,227 1.3% 778,227 Michael Adler .... 0 0% 0 George Firestone .... 0 0% 0 LEGAL MATTERS Legal matters in connection with the common stock being offered hereby will be passed upon for the Company and selling shareholders or by Andrews Kurth LLP, Dallas, Texas. EXPERTS Our financial statements as of December 31, 2004, in this Prospectus, have been audited by the firm of Berkovits, Lago & Company, LLP , independent registered certified public accountants, as set forth in their report herein included, and have been so included in reliance upon such report being given upon their authority as experts in accounting and auditing. Our financial statements and the financial statements for our subsidiary, Caerus, Inc. as of December 31, 2003, in this Prospectus have been audited by the firm of Tschopp, Whitcomb & Orr, P.A. and Moore Stephens Lovace, P.A., respectively, independent registered certified public accountants, as set forth in their report herein included, and have been so included in reliance upon such report being given upon their authority as experts in accounting and auditing. AVAILABLE INFORMATION We have filed with the Securities and Exchange Commission (the "Commission") a Registration Statement on Form SB-2, together with all amendments, schedules and exhibits thereto, pursuant to the Securities Act with respect to the securities offered by this prospectus. This prospectus does not contain all information set forth in the registration statement and the exhibits. The statements contained in this prospectus as to the contents of any contract or other document identified as exhibits in this prospectus are materially complete, but in each instance, reference is made to a copy of such contract or document filed as an exhibit to the Registration Statement. For further information with respect to the Company and the securities offered hereby, reference is made to the Registration Statement and exhibits which may be inspected without charge at the Commission's principal office 100 F Street, NW, Washington, D. C. 20549. We are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith will file reports, proxy statements and other information with the Commission Such reports, proxy statements and other information can be inspected and copied at the public reference facilities of the Commission at 100 First Street, NE, Washington, D. C. 20549. Copies of such material may also be obtained from the Public Reference Section of the Commission at prescribed rates. Our Registration Statement on Form SB-2, as well as any reports to be filed under the Exchange Act can also be obtained electronically after we have filed such documents with the Commission through a variety of databases, including among others, the Commission's Electronic Data Gathering, Analysis and Retrieval ("EDGAR") program, Knight-Ridder Information, Inc., Federal Filings/Dow Jones and Lexis/Nexis. Additionally, the Commission maintains a Website (http://www sec.gov) that contains such information regarding the Company. We intend to furnish our shareholders with annual reports containing audited financial statements and such other reports as we deem appropriate or as may be required by law. Requests for information may be directed to Steven Ivester, CEO, c/o the Company at 12330 S.W. 53rd Street, Suite 712, Fort Lauderdale, Florida 33330, telephone (954) 434-2000. 40 INDEX TO FINANCIAL STATEMENTS VoIP, Inc. Financial Statements Page

-- ----- Reports of Independent Certified Public Accountants F-1-2 Consolidated Balance Sheets December 31, 2004 and 2003 F-3 Consolidated Statements of Operations for Years Ended December 31, 2004 and 2003 F-4 Consolidated Statement of Changes in Shareholders Equity for years Ended December 31, 2004 and 2003 F-5 Consolidated Statements of Cash Flow for Years Ended December 31, 2004 and 2003 F-6 Notes to Consolidated Financial Statements for Year Ended December 31, 2004 F-7 Report of Independent Certified Public Accountants F-16 Consolidated Balance Sheets for June 30, 2005 and

December 31, 2004 F-17 Consolidated Statements of Operations for Six Months Ended June 30, 2005 and 2004 And Three Months Ended June 30, 2005 and 2004 F-18 Consolidated Statements of Cash Flows for Six Months Ended June 30, 2005 and 2004 F-19 Notes to Financial Statements for Six Months Ended June 30, 2005 and 2004 F-20 Proformas Page --- ----- Proforma Condensed Combined Statement of Operations for Three Months Ended June 30, 2005 - Unaudited F-27 Proforma Condensed Combined Statement of Operations for Six Months Ended June 30, 2005 - Unaudited F-28 Proforma Condensed Combined Statement of Operations for Year Ended December 31, 2004 - Unaudited F-29 Proforma Condensed Combined Statement of Operations for Three Months Ended June 30, 2004 - Unaudited F-30 Proforma Condensed Combined Statement of Operations for Six Months Ended June 30, 2004 - Unaudited F-31 Notes to Unaudited Pro Forma Condensed Combined Financial Statements F-32 Caerus, Inc. Financial Statements Page --- ----- Report of Independent Certified Public Accountants F-33 Consolidated Balance Sheets December 31, 2004 and 2003 F-34 Consolidated Statements of Operations for Years Ended December 31, 2004 and The Period May 15, 2002 through December 31, 2003 F-35 Consolidated Statement of Changes in Shareholders Equity for years Ended December 31, 2004 and the Period May 15, 2002 through December 31, 2003 F-36 Consolidated Statements of Cash Flow for Years Ended December 31, 2004 and The Period May 15, 2002 through December 31, 2003 F-37 Notes to Consolidated Financial Statements for Year Ended December 31, 2004 and The Period May 15, 2002 through December 31, 2003 F-38 41 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM --- Board of Directors VoIP, Inc. and Subsidiaries Fort Lauderdale, Florida We have audited the accompanying consolidated balance sheet of VoIP, Inc. and Subsidiaries ("the Company") as of December 31, 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for the year ended December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company has determined that it is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express such an opinion. 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 that our audit provides a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above presents fairly, in all material respects, the consolidated financial position of VoIP, Inc. and its subsidiaries, as of December 31, 2004, and the results of operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. /s/ Berkovits, Lago & Company, LLP Fort Lauderdale, Florida March 16, 2005 F-1 TSCHOPP, WHITCOMB & ORR, P.A. 2600 Maitland Center Parkway, Suite 330 Maitland, Florida 32751 Report of Independent Certified Public Accountants Board of Directors and Stockholder Millennia Tea Masters, Inc. We have audited the accompanying balance sheet of Millenia Tea Masters, Inc. as of December 31, 2003 and the related statements of operations, changes in shareholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 that our audit provides a reasonable basis for our opinion. In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of Millennia Tea Masters, Inc. as of December 31, 2003, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has experienced limited sales and incurred cumulative operating losses since its inception through December 31, 2003. The Company has been dependent upon the proceeds from the sales of common stock and advances from related parties to provide working capital. This situation raises a substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. /s/ Tschopp, Whitcomb & Orr, P.A. -------------------------------- January 30, 2004 Maitland, Florida F-2 VoIP Inc. Consolidated Balance Sheets December 31, 2004 and 2003 Dec. 31, 2004 Dec. 31, 2003 ------------- ------------- ASSETS Current Assets: Cash and cash equivalents $ 1,141,205 $ -- Accounts receivable, net of allowance of $136,795 818,071 -- Due from related parties 245,402 -- Inventory 187,451 -- Assets from discontinued operations 412,419 259,459 Other current assets 43,702 -- ------------- ------------- Total Current Assets 2,848,250 259,459 ------------- ------------- Property and equipment, net 419,868 -- Intangibles 6,923,854 -- Other assets 23,580 -- ------------- ------------- TOTAL ASSETS $ 10,215,552 $ 259,459 ============= ============ LIABILITIES AND SHAREHOLDERS' EQUITY Current liabilities: Accounts payable and accrued expenses $ 1,224,974 $ -- Bank loans and note payable 760,000 -- Liabilities from discontinued operations -- 151,167 Other current liabilities 123,140 -- ------------- ------------ Total Liabilities 2,108,114 151,167 ------------- ------------- Shareholders' equity: Common stock - $0.001 par value 100,000,000 shares authorized 24,258,982 and 1,730,939 issued and outstanding, respectively 24,259 1,731 Additional paid-in capital 12,722,565 731,208 Accumulated deficit (4,639,386) (624,647) ------------- ------------ Total shareholders' equity 8,107,438 108,292 ------------- ------------- TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY $ 10,215,552 $ 259,459 ============= ============= The accompanying notes are an integral part of these financial statements. F-3 VoIP Inc. Consolidated Statements of Operations For the Years Ended December 31, 2004 and 2003 Year ended Year ended December 31, 2004 December 31, 2003 ---------------- ----------------- Revenues $ 2,619,393 $ -- Cost of Sales 1,870,269 -- ----------------- ----------------- Gross Profit 749,124 -- Operating expenses Compensation and related expenses 2,721,296 -- General and administrative expenses 2,187,878 -- ----------------- ----------------- Loss from operations (4,160,050) -- Provision for income taxes -- -- ----------------- ----------------- Net loss before discontinued operations (4,160,050) -- Income (Loss) from discontinued operations 145,311 (352,968) ----------------- ----------------- Net Loss (4,014,739) (352,968) ================= ================= Basic and diluted loss per share: Loss before discontinued operations $ (0.28) $ -- Income from discontinued operations net of income taxes $ 0.01 $ (0.20) ----------------- ----------------- Total $ (0.27) $ (0.20) ================= ================= Weighted average number of shares outstanding 14,597,312 1,730,939 ================= ================= The accompanying notes are an integral part of these financial statements. F-4 VoIP, Inc. Consolidated Statements of Changes in Shareholders' Equity Years Ended December 31, 2004 and 2003 Common Stock Common Stock Additional Accumulated Shares Amount Paid-in Capital Deficit Total ------------ ------------ -------------- ----------- ----------- Balance as of December 31, 2002 1,730,939 $ 1,731 $ 731,208 $ (271,679) $ 461,260 Loss for the for the year -- -- -- (352,968) (352,968) ------------ ------------ -------------- ----------- ----------- Balance as of December 31, 2003 1,730,939 1,731 731,208 (624,647) 108,292 ------------ ------------ -------------- ----------- ----------- Common stock issued 12,500,000 12,500 -- -- 12,500 Common Stock issued for services received 568,235 568 342,432 -- 343,000 Common stock issued to investors for cash received 5,520,566 5,521 3,610,598 -- 3,616,119 Common stock issued for services 339,242 339 150,827 -- 151,166 Common Stock issued for acquisition of DTNet Tech 2,500,000 2,500 4,747,500 -- 4,750,000 Common Stock issued for acquisition of VoipAmericas 1,000,000 1,000 1,099,000 -- 1,100,000 Warrants issued to two company officers -- -- 1,936,000 -- 1,936,000 Warrants issued for intellectual property 100,000 100 105,000 -- 105,100 Loss for the year -- -- -- (4,014,739) (4,014,739) ------------ ------------ -------------- ----------- ----------- Balance December 31, 2004 24,258,982 $ 24,259 $ 12,722,565 $(4,639,386) $ 8,107,438 ============ ============ ============== =========== =========== The accompanying notes are an integral part of these financial statements. F-5 VoIP Inc. Consolidated Statements of Cash Flows Years ended December 31, 2004 and 2003 Year ended Year ended December 31, 2004 December 31, 2003 ----------------- ----------------- Cash flows from operating activities: Continuing operations: Net loss $ (4,160,050) $ -- Adjustments to reconcile net loss to net cash used in operating activities -- -- Depreciation 82,832 -- Provision for bad debt 136,795 -- Common shares issued for services 494,166 -- Warrants issued to employees 1,936,000 -- Shares issued for intellectual property 105,000 -- Changes in operating assets and liabilities net of assets and liabilities acquired: Accounts receivable (555,007) -- Due from related parties (245,402) -- Inventory 144,913 -- Other current assets 8,531

-- Accounts payable (296,305) -- Other current liabilities (315,587) -- ---------------- ---------------- Net cash used in continuing operating activities (2,664,114) -- ---------------- ---------------- Discontinued operations: Income (loss) from discontinued operations 145,311 (352,968) Changes in assets, liabilities, and net results (408,000) 274,262 ---------------- ---------------- Net cash used in discontinued operating activities (262,689) (78,706) ---------------- ---------------- Net used in operating activities (2,926,803) (78,706) ---------------- ---------------- Cash flows from investing activities Continuing operations: Cash from acquisitions 104,872 -- Purchase of property and equipment (157,881) -- Cash for intellectual property (50,000) -- Purchase of other assets (21,100) -- ---------------- ---------------- Net cash used in continuing investing activities (124,109) -- ---------------- ---------------- Discontinued operations: Cash from affiliates -- 82,196 ---------------- ---------------- Net cash provided by discontinued investing activities -- 82,196 ---------------- ---------------- Net cash provided by (used in) investing activities (124,109) 82,196 ---------------- ---------------- Cash flows from financing activities: Proceeds from issuance of notes payable 560,000 -- Proceeds from sales of common stock 3,628,618 -- ---------------- ---------------- Net cash provided by investing activities 4,188,618 -- Net increase in cash 1,137,706 3,490 Cash at beginning of year 3,499 9 ---------------- ---------------- Cash at end of year $ 1,141,205 $ 3,499 ================ ================ Non-cash investing and financing activities: Common stock issued for services $ 494,166 $ -- ================ ================ Warrants issued to employees $ 1,936,000 $ -- ================ ================ Shares issued for intellectual property $ 105,000 $ -- ================ ================ The accompanying notes are an integral part of these financial statements. F-6 VoIP, Inc. Notes to Financial Statements NOTE A - ORGANIZATION AND DESCRIPTION OF BUSINESS The Company was incorporated on August 3, 1998 under its original name of Millennia Tea Masters, Inc. under the laws of the State of Texas. The Company began operations in October 1998 with its initial order of imported teas from Sri Lanka. On February 27, 2004 the Company entered into a stock purchase agreement that provided for the sale of 12,500,000 shares of its common stock in exchange for $12,500 and a commitment by the purchaser to contribute the assets of two start-up companies in the telecommunications business, eGlobalphone, Inc. and VOIP Solutions, Inc. into the Company. On April 13, 2004 the Company changed its name to VoIP, Inc. and began to develop and manufacture innovative IP telephony customer premise equipment, provide premium voice over the internet subscriber based telephony services and state of the art long range WiFi technology solutions, for residential and enterprise customers, including multimedia applications. During December 2004 the Company decided to exit the tea import business in order to focus its efforts and resources in the "Voice over Internet Protocol" (VoIP) telecommunications industry. In connection with the decision the Company sold its imported tea inventory and began to wind down its tea import operations. The assets, liabilities, and results of operations of the imported tea business have been classified as discontinued operations on the accompanying consolidated financial statements. The Company offers quality Voice over IP (VoIP) based solutions offering residential and business customers more user friendly and affordable ways to communicate. VoIP, Inc. also manufactures products and provides services to Internet Service Providers, Telecommunication Service Providers and Cable Operators in strategic countries around the world. VoIP, Inc., through its subsidiaries, provides a comprehensive portfolio of IP multimedia-based solutions ranging from subscriber based voice services, to SIP based infrastructure design and deployment, to broadband customer premise equipment design and implementation services, as well as engineering design, manufacturing and distribution of wireless broadband technology. The Company's operations consist of one segment. NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Principles of Consolidation The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, eGlobalphone, Inc., VoIP Solutions, Inc., DTNet Technologies, Inc., and VoIP Americas, Inc. from their respective dates of acquisition. All significant inter-company balances and transactions have been eliminated in consolidation. 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; disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenses. Actual results could differ from those estimates. Cash and cash equivalents For purposes of reporting cash flows, the Company considers all cash on hand, in banks, including amounts in book overdraft positions, certificates of deposit and other highly liquid debt instruments with a maturity of three months or less at the date of purchase to be cash and cash equivalents. Cash overdraft positions may occur from time to time due to the timing of making bank deposits and releasing checks, in accordance with the Company's cash management policies. Accounts Receivable Accounts receivable are stated at the

amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts using the reserve method based on its assessment of the current status of the individual receivables and after using reasonable collection efforts. As of December 31, 2004 the balance of the allowance for uncollectible accounts amounted to $136,795. There was no allowance as of December 31, 2003. F-7 Inventory Inventory consists of finished goods and is valued at the lower of cost or market using the first-in, first-out method. Advertising expenses Advertising and marketing expenses are charged to operations as incurred. Income Taxes The Company and its subsidiaries file consolidated federal and state income tax returns. The Company has adopted Statement of Financial Accounting Standards No. 109 in the accompanying consolidated financial statements. The only temporary differences included therein are attributable to differing methods of reflecting depreciation for financial statement and income tax purposes. Earnings (loss) per share Basic earnings (loss) per share is computed by dividing the net income (loss) for the year by the weighted-average number of shares of common stock outstanding. The calculation of fully diluted earnings (loss) per share assumes the dilutive effect of the exercise of outstanding options and warrants at either the beginning of the respective period presented or the date of issuance, whichever is later. Common stock equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options and warrants, using the treasury stock method. Fair Value of Financial Instruments The carrying amount of cash, accounts receivable, accounts payable and notes payable, as applicable, approximates fair value due to the short term nature of these items and/or the current interest rates payable in relation to current market conditions. Revenue Recognition Revenue from product sales is recognized when persuasive evidence of an arrangement exists, delivery to customer has occurred, the sales price is fixed and determinable, and collectibility of the related receivable is probable. The recognition of revenues from Internet telephony services are deferred for new subscribers of eGlobalphone and Voipsolutions until it deems that the customer has accepted the service. Subsequent revenues are recognized at the beginning of each customer's month. Property, plant, and equipment Property, plant, and equipment are stated at cost. Depreciation is provided over the estimated useful lives of the related assets using the straight line method. The useful life of assets ranges from three to five years. The leasehold improvements are amortized over the life of the related lease. Business combinations The Company accounts for business combinations in accordance with Statement of Financial Accounting Standard No. 141 Business Combinations ("SFAS No. 141"). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations. SFAS No. 141 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually by comparing carrying value to the respective fair value in accordance with the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("SFAS No. 142"). This pronouncement also requires that the intangible assets with estimated useful lives be amortized over their respective estimated useful lives. F-8 Impairment of long-lived assets VoIP, Inc. reviews the recoverability of its long-lived assets, such as plant, equipment and intangibles when events or changes in circumstances occur that indicate that the carrying value of the asset group may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets. Recent accounting pronouncements In November 2004, FASB issued Statement No. 151, "Inventory Costs - an amendment of ARB No. 43, Chapter 4." Statement No. 151 requires that abnormal amounts of costs, including idle facility expense, freight, handling costs and spoilage, should be recognized as current period charges. The provisions of this Statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect the adoption of this Statement to have a material impact on its financial statements. In December 2004, FASB issued Statement No. 153, "Exchanges of Nonmonetary Assets - an amendment of Accounting Principles Board ("APB") Opinion No. 29." Statement No. 153 amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have a commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this Statement are effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not expect the adoption of this Statement to have a material impact on its financial statements. In December 2004, FASB issued Statement No. 123R, "Share-Based Payment." Statement No. 123R revises Statement

No. 123, supersedes APB Opinion No. 25 and amends Statement No. 95. Statement No. 123R requires the cost of employee services received in exchange for an award of equity instruments be recognized over the period during which an employee is required to provide service in exchange for the award. The provisions of this Statement are effective for public entities that do not file as small business issuers as of the beginning of the first interim period or annual reporting period that begins after June 15, 2005. The Company does not expect the adoption of this Statement to have a material impact on its financial statements. Stock Based Compensation The Company applies the fair value method of Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation" ("SFAS No. 123") in accounting for its stock options. This standard states that compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. The fair value for each option granted is estimated on the date of the grant using the Black-Scholes option pricing model. The fair value of all vested options granted has been charged to salaries, wages, and benefits in accordance with SFAS No. 123. NOTE C - PROPERTY AND EQUIPMENT, NET As of December 31, 2004 property and equipment consists of the following: Office Equipment $ 519,810 Furniture & Fixtures 56,748 Vehicles 4,769 Leasehold Improvements 4,562 --------- Total 585,889 Less accumulated depreciation (166,021) --------- Total $ 419,868 ========= Depreciation expense for 2004 amounted to $82,832. There was no depreciation expense for 2003. F-9 NOTE D - INTANGIBLES As of December 31, 2004 intangibles consist of the following: Goodwill-acquisition of DTNet Technologies, Inc. $5,210,553 Goodwill-acquisition of Voipamericas, Inc. 1,408,301 Intellectual property 305,000 ---------- Total $6,923,854 ========== The goodwill on the acquisition of DTNet Technologies, Inc. (DTNet) represents the fair market value of DTNet liabilities as of the date of the acquisition plus $4,750,000 which represents the market value of 2,500,000 shares of Company stock issued pursuant to its acquisition. The goodwill on the acquisition of Voipamericas represents the fair market value of Voipamericas liabilities as of the date of the acquisition plus $1,100,000 which represents the market value of 1,000,000 shares of the Company's stock pursuant to this acquisition. Intellectual property is carried at cost which is comprised of $50,000 paid in cash in 2004, $150,000 due in the first quarter of 2005, and the value assigned to 100,000 Company common shares and 400,000 warrants issued pursuant to this transaction. The valuation of the shares was $1.05 while the value was $105,000. The value of the warrants was determined using the Black-Scholes model calculated as of October 14, 2004. As these warrants were not "in the money", these warrants have been assigned a value of zero. This model uses the annualized deviation calculation and utilizes industry averages as a comparison for adequate statistical results in the valuation. This is a standard financial model that considers the statistical annual volatility of the market changes in a stock price. (See Note H) Intellectual property consists of the following: a) all rights of the Company of Record in the telephone numbers 1(800)TALKTIME, 1(888)TALKTIME, AND 1(877)TALKTIME.COM b) all rights to the URL's (domain names) 800TALKTIME.COM, 1800TALKTIME.COM, and 1-800-TALKTIME.COM c) all rights to U.S. Trademark Registration No. 2,209,316 directed to the mark 1-800-TALKTIME and the goodwill associated therewith. NOTE E - ACCOUNTS PAYABLES AND ACCRUED EXPENSES As of December 31, 2004 Accounts Payables and accrued expenses consist of the following: Account Payables Trade $ 988,815 Accrued Expenses 233,711 Other 2,448 ---------- Total $1,224,974 ========== NOTE F - BANK LOANS AND NOTE PAYABLE As of December 31, 2004 bank loans and note payable consists of the following: Bank Loan: Revolving Line of Credit $187,000 Promissory Note 13,000 -------- Sub-total 200,000 Note Payable 560,000 -------- Total $760,000 ======== a) The revolving line of credit with the Bank of Tampa is interest only payable at prime plus 1.0% monthly. The promissory note is payable in monthly installments of approximately $6,200 including interest at a rate of 7.5%. The loans are collateralized by receivables, inventory and equipment. Both balances were fully paid in January 2005. b) In December 2004 the Company issued a note payable to a shareholder in the amount of $560,000 at an interest rate of 3.75% with a maturity date of December 2005. As mentioned in Note K on January 6, 2005, the Company issued another note payable amounting to $1,040,000 to the same shareholder under the same terms and conditions as the previous one. F-10 NOTE G - ACQUISITIONS On May 25, 2004 (but effective for all purposes as of April 15, 2004), the Company completed the acquisition of two Florida-based entities, (eGlobalphone, Inc. and VoIP Solutions, Inc.). Contribution of these start-up companies was the basis for the original decision to issue a controlling block of shares of common stock to Mr. Ivester. eGlobalphone, Inc. and VoIP Solutions Inc. are both Florida corporations. In June 2004, the Company acquired DTNet Technologies, Inc. a Florida Corporation. The acquisition was financed through the issuance of 2,500,000 shares of the Company's common stock with a value of $4,750,000 in exchange for all issued and outstanding shares of DTNet common stock. In September 2004, VoIP Inc. closed the acquisition of VoIP

Americas, a Florida corporation. The acquisition was financed through the issuance of 1,000,000 shares of the Company's restricted common stock with the value of $1,100,000 in exchange for all issues and outstanding shares of VoIP Americas. NOTE H - WARRANTS On August 4th, 2004, the Company issued 4,400,000 warrants to two executives to acquire 2,200,000 Company common shares at $1.00 each. The compensation expenses of $1,936,000, is in the accompanying Consolidated Statement of Operations. A summary of the Company's warrants as of December, 31 2004 is presented below: 2004 --------------------------- Weighted average Warrants exercise price --------- ---------------- Warrants outstanding at beginning or year -- Granted to two company officers 4,400,000 $ 1.00 Granted to a third party 400,000 $ 1.75 Expired -- Exercised -- --------- ---------------- Warrants outstanding at end of year 4,800,000 $ 1.06 ========= ================ The value of warrants issued to the Company officers and the value of the 400,000 warrants granted to the third party was estimated using the Black-Scholes option pricing model with the following assumptions; risk free rate 3.35%, no dividend yield, expected life of five years and volatility of 175% and 152%, respectively. F-11 NOTE I - COMMITMENTS The Company is obligated under non-cancelable operating leases for its office facilities and two apartments used by its employees. Future minimum lease payments under the Company's non-cancelable operating leases as of December 31, 2004 are as follows: Year ending Dec 31 ----------------- 2005 $52,772 2006 15,155 ------- $67,927 ======= NOTE J - RELATED PARTY TRANSACTIONS As of December 31, 2004 the due from related party consists in the following: DTNet, Inc. (*) $ 134,317 DTNet International (*) 119,974 Mozart Communication 21,794 Com Laser 5,850 Due to related parties (36,533) --------- $ 245,402 ========= * The above entities are related to a shareholder of the Company. These advances are unsecured, due upon demand and are non-interest bearing. NOTE K - INCOME TAXES The components of the Company's consolidated income tax provision are as follows: Year ended December 31, 2004 2003 ----------- --------- Current Benefits $(1,365,000) (119,000) Valuation allowance 1,365,000 119,000 ----------- --------- Total -- -- =========== ========= 2004 2003 ----------- --------- Long-term deferred tax assets arising from net operating loss carry forward $(1,485,000) $(119,000) Valuation allowance 1,485,000 119,000 ----------- --------- Total -- -- =========== ========= The reconciliation of income tax provision at statutory rate to the reported income tax expense is as follows: F-12 Year ended December 31, 2004 2003 ---- ---- Computed at statutory rate 34% 34% State tax net of federal benefits -- -- Valuation allowance (34%) (34%) ---- ---- Total -- -- ==== ==== At December 31, 2004 and December 31, 2003 deferred tax assets are related solely to the Company's net operating loss carry forward of approximately $4,014,739 and $303,000, respectively, which have been reduced by a valuation allowance. If these carry forwards are not utilized, they will begin to expire in 2018. NOTE L - STOCKHOLDERS' EQUITY On February 27, 2004, the Company issued and sold 12,500,000 shares of common stock to Steven Ivester in exchange for cash of $12,500 and his agreement to contribute the intellectual property rights and related assets of two start-up companies formed to engage in the telecommunications industry. The shares issued represented approximately 88% of the shares outstanding after the exchange, as a result of which Mr. Ivester became the controlling shareholder of the Company. On April 1, 2004, the Company issued 142,902 shares to two accredited investors in satisfaction of accounts payable totaling $71,421. In May 2004, the Company issued 1,143,250 shares to twenty-two individual accredited investors. In May 2004, the Company issued 168,235 shares to one individual accredited investor in exchange for services. On May 10, 2004, the Company issued 67,300 shares to fourteen individual accredited investors at a price of $3.00 per share. On May 19, 2004, the Company issued 196,340 shares to two accredited investors in satisfaction of accounts payable totaling $79,745. On June 25, 2004, the Company closed the acquisition of DTNet Technologies, Inc. ("DTNet") a Florida corporation. The acquisition was effective through the issuance of 2,500,000 shares of VoIP, Inc. restricted common stock in exchange for all issued and outstanding shares of DTNet common stock. In July 2004, the Company issued 668,688 shares to six individual existing accredited investors. Also effective July 2004, registrant issued 41,688 shares to four accredited individual investors. On August 4, 2004, the Company issued 4,400,000 warrants to two executives to acquire 4,400,000 shares at $1.00 per share. As explained in Note N, subsequent events, in February 2005, 2,200,000 warrants were exchanged for restricted shares. In August 2004, the Company issued 50,000 shares to one individual accredited investor in satisfaction of accounts payable totaling $50,000. In August 2004, the Company issued 653,319 shares to forty-six individual accredited investors. In September 2004, the Company issued 38,461 shares to one accredited investor. On September 1st, 2004, VoIP Inc. closed the acquisition of VoIP Americas, a Florida corporation. The acquisition took the form of an exchange of 1,000,000 shares of VoIP restricted common stock in exchange for all the issued and outstanding shares of VoIP Americas common stock. In October 2004, the Company issued 251,831 shares to twelve accredited investors. F-13 In

October 2004, the Company issued 100,000 shares to one individual accredited investor. In November 2004, the Company issued 2,249,500 shares to five accredited investors. In November 2004, the Company issued 318,500 shares to twelve accredited investors. In December 2004, the Company issued 79,659 shares to five accredited investors. In December 2004, the Company issued 400,000 shares to sixteen accredited investors. NOTE M - DISCONTINUED OPERATIONS In December 2004, the Company decided to exit the tea business and sold all its tea inventory, therefore, those transactions have been presented as discontinued operations for the year ended December 31, 2004, and 2003. Assets, liabilities, and results of the discontinued tea operations of the Millennia Tea Master division are as follows: Assets from the discontinued operation: 2004 2003 -------- -------- Cash $ 4,419 $ 3,499 Notes receivable from purchaser of tea (non-interest bearing due in four equal installments through December 31, 2005) 408,000 -- Tea inventory at net realizable value -- 251,534 Other assets -- 4,426 -------- -------- Total $412,419 $259,459 ======== ======== 2004 2003 -------- -------- Liabilities from discontinued operations: Due to related parties -- 151,167 -------- -------- Total $ -- $151,167 ======== ======== F-14 Results from discontinued operations: 2004 2003 -------- --------- Revenues $408,613 $ 8,678 Cost of sales 263,302 11,213 -------- --------- Gross profit 145,311 (2,535) Other expenses -- 350,433 -------- --------- Income (loss) from discontinued operations $145,311 $(352,968) ======== ========= NOTE N - SUBSEQUENT EVENTS On January 6, 2005, the Company issued a Note Payable to its controlling shareholder in the amount of $1,040,000 at an interest rate of 3.75%, maturing in December 2005. On January 26, 2005, the Company filed a Form S-8 registration statement in connection with the Company's Stock Option Plan. The plan provides for the grant to eligible employees and directors of options for the purchase of Common Stock. The Option Plan covers, in the aggregate, a maximum of 4,000,000 shares of Common Stock and provides for the granting of both incentive stock options (as defined in Section 422 of the Internal Revenue Code of 1986) and nonqualified stock options (options which do not meet the requirements of Section 422). Under the Option Plan, the exercise price may not be less than the fair market value of the Common Stock on the date of the grant of the option. On February 14, 2005, an officer exercised a Stock Purchase Warrant to purchase 2,200,000 shares of VoIP, Inc. common stock by surrendering such Warrant, and, based upon an agreement with the Company, receiving in return 750,000 shares of restricted common stock in a net exercise. On February 23, 2005, VoIP, Inc. and its subsidiary eGlobalPhone, Inc. executed an Asset Purchase Agreement for the purchase of certain intellectual property rights associated with the trade names TALKTIME and TALKTIME.COM. In exchange for the rights, the Registrant issued 100,000 shares of restricted common stock, warrants to purchase 400,000 shares at $1.70 per share, and agreed to pay $200,000 cash. Negotiations started during the last quarter of 2004, therefore all the cash disbursements, liabilities, shares issued, and commitments were recorded in that period. F-15 Report of Independent Registered Public Accounting Firm To The Board of Directors and Shareholders VoIP, Inc. We have reviewed the accompanying consolidated balance sheet of VoIP, Inc. and Subsidiaries (the "Company") as of June 30, 2005 and the consolidated statements of operations and cash flows for the six and three month periods ended June 30, 2005 and 2004. These interim financial statements are the responsibility of the Company's management. We conducted our review in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion. Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with accounting principles generally accepted in the United States. We have previously audited, in accordance with auditing standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2004, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated March 16, 2005, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2004 is fairly presented in all material respects, in relation to the balance sheet from which it has been derived. /s/ Berkovits, Lago & Company, LLP --------------------------------- Ft. Lauderdale, Florida August 15, 2005 except for Notes A, D, E, and J as to which the date is October 7, 2005 F-16 VoIP, Inc. Consolidated Balance Sheets June 30, 2005 and December 31, 2004 (Unaudited) June 30, 2005 Dec. 31, 2004 ------------- ------------- ASSETS Current assets: Cash and cash equivalents $

1,068,514 $ 1,141,205 Accounts receivable, net of allowance of $99,047 and $136,795 respectively 1,023,226 818,071 Due from related parties 169,537 245,402 Inventory 889,373 187,451 Assets from discontinued operations less valuation allowance of $200,000 in 2005 192,000 412,419 Other current assets 209,884 43,702 ------------- ------------- Total current assets 3,552,534 2,848,250 Property and equipment, net 8,637,267 419,868 Goodwill and other intangible assets 30,765,594 6,923,854 Other assets 294,884 23,580 ------------- ------------- TOTAL ASSETS $ 43,250,279 $ 10,215,552 ============= ============= LIABILITIES AND SHAREHOLDERS' EQUITY Current liabilities: Accounts payable and accrued expenses $ 10,472,720 $ 1,224,974 Notes payable 7,736,929 760,000 Other current liabilities 2,333,343 123,140 ------------- ------------- Total current liabilities 20,542,992 2,108,114 ------------- ------------- Shareholders' equity: Common stock - $0.001 par value 100,000,000 shares authorized 47,166,380 and 24,258,982 shares issued and outstanding respectively 47,167 24,259 Additional paid-in capital 32,332,943 12,722,565 Accumulated deficit (9,672,823) (4,639,386) ------------- ------------- Total shareholders' equity 22,707,287 8,107,438 ------------- ------------- TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY $ 43,250,279 $ 10,215,552 ============= ============= The accompanying notes are an integral part of these consolidated financial statements. F-17 VoIP, Inc. Consolidated Statements of Operations Six Months Ended June 30, 2005 and 2004 And Three Months Ended June 30, 2005 and 2004 (Unaudited) Six Months Ended Six Months Ended Three Months Ended Three Months Ended June 30, 2005 June 30, 2004 June 30, 2005 June 30, 2004 ---------------- ---------------- ----------------- ------------------ Revenues $ 3,916,920 $ 85,298 $ 1,909,773 $ 85,298 Cost of sales 3,104,846 58,923 1,303,911 58,923 ---------------- ---------------- ----------------- ------------------ Gross profit 812,074 26,375 605,862 26,375 Operating expenses 5,845,511 457,356 4,132,002 435,033 ---------------- ---------------- ----------------- ------------------ Loss from operations (5,033,437) (430,981) (3,526,140) (408,658) Provision for income taxes -- -- -- -- ---------------- ---------------- ----------------- ------------------ Net loss $ (5,033,437) $ (430,981) $ (3,526,140) $ (408,658) ================ ================ ================== ================== Basic and diluted loss per share: $ (0.19) $ (0.05) $ (0.12) $ (0.03) ================= ================ ================== ================== Weighted average number of shares outstanding 26,940,458 8,255,570 30,012,632 16,233,813 ================ ================ ================== ================== The accompanying notes are an integral part of these consolidated financial statements. F-18 VoIP, Inc. Consolidated Statements of Cash Flows Six Months ended June 30, 2005 and 2004 (Unaudited) Six Months Ended Six Months Ended June 30, 2005 June 30, 2004 ---------------- ---------------- Cash flows from operating activities Net loss $ (5,033,437) $ (430,981) Adjustments to reconcile net loss to net cash (used in) operating activities Depreciation and amortization 540,400 293 Provision for bad debt 99,047 -- Provision on assets from discontinued operations 200,000 -- Common shares issued for services 748,325 143,000 Stock option plan 127,238 -- Common shares exchanged for warrants 239,500 -- Changes in operating assets and liabilities net of assets and liabilities acquired: Accounts receivable (174,591) -- Inventory (701,922) (2,460) Other current assets 342,534 (33,719) Accounts payable (134,456) 83,455 Other current liabilities (836,286) -- ---------------- ---------------- Net cash (used in) operating activities (4,583,648) (240,412) ---------------- ---------------- Cash flows from investing activities Cash from acquisitions -- (173,182) Purchase of property and equipment (37,779) (20,231) ---------------- ---------------- Net cash used in investing activities (37,779) (193,413) ---------------- ---------------- Cash flows from financing activities Proceeds from issuance of notes payable 2,615,339 -- Payments on notes payables (769,228) -- Proceeds from sales of common stock 2,702,625 591,400 ---------------- ---------------- Net cash provided by financing activities 4,548,736 591,400 Change in cash and cash equivalents (72,691) 157,575 Cash and cash equivalents at beginning of period 1,141,205 3,499 ---------------- ---------------- Cash and cash equivalents at end of period $ 1,068,514 $ 161,074 ================ ================ Non-cash investing and financing activities: Goodwill on acquisition $ (24,101,000) $ -- Issuance of common stock and warrants on acquisitions $ 13,819,119 $ -- Issuance of stock for debt conversion $ 1,996,478 $ -- Net liabilities assumed net of cash $ 8,285,403 $ -- ================ ================ The accompanying notes are an integral part of these consolidated financial statements. F-19 VoIP, Inc. Notes to Financial Statements NOTE A - ORGANIZATION AND DESCRIPTION OF BUSINESS The Company was incorporated on August 3, 1998 under its original name of Millennia Tea Masters, Inc. under the laws of the State of Texas. On February 27, 2004 the Company entered into a stock purchase agreement that provided for the sale of 12,500,000 shares of its common stock in exchange for $12,500 and a commitment by the purchaser to contribute the assets of two start-up companies in the telecommunications business, eGlobalphone, Inc. and VOIP Solutions, Inc. On April 13, 2004 the Company changed its name to VoIP, Inc. and began to develop and manufacture

internet protocol telephony customer premise equipment, provide voice over the internet subscriber based telephony services and long range WiFi technology solutions for residential and enterprise customers including multimedia applications. During December 2004 the Company decided to exit the tea import business in order to focus its efforts and resources in the voice over internet protocol (VoIP) telecommunications industry. In connection with the decision the Company sold its imported tea inventory and began to wind down its tea import operations. The assets, liabilities, and results of operations of the imported tea business have been classified as discontinued operations in the accompanying consolidated financial statements. On May 31, 2005 the Company acquired 100 percent of Caerus, Inc. and its wholly owned subsidiaries Volo Communications, Inc., Caerus Networks, Inc., and Caerus Billing, Inc. in exchange for 16.9 million of the Company's common shares. Volo Communications, Inc. is a licensed facilities-based Competitive Local Exchange Carrier and Inter Exchange Carrier. Volo Communications, Inc. markets its network products and services under the VoiceOne brand name. It has Network Access Points operating in Orlando, Atlanta, New York, Dallas and Los Angeles. Caerus Networks, Inc. is a technology research and development subsidiary, and Caerus Billing, Inc. is a billing and mediation subsidiary. The Company offers quality (VoIP) based solutions, providing residential and business customers more user friendly and affordable ways to communicate. The Company also manufactures products and provides services to Internet Service Providers, Telecommunication Service Providers and Cable Operators in strategic countries around the world. The Company, through its subsidiaries, provides a comprehensive portfolio of IP multimedia-based solutions ranging from subscriber based voice services, to SIP based infrastructure design and deployment, to broadband customer premise equipment design and implementation services, as well as engineering design, manufacturing and distribution of wireless broadband technology. The Company's operations consist of one segment. NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Principles of Consolidation The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Caerus, Inc. (after its May 31, 2005 acquisition), eGlobalphone, Inc., VoIP Solutions, Inc., DTNet Technologies, Inc., and VoIP Americas, Inc. from their respective dates of acquisition. All significant inter-company balances and transactions have been eliminated in consolidation. Unaudited Consolidated Interim Financial Statements The accompanying consolidated financial statements for the three and six months periods ended June 30, 2005 and 2004 are unaudited but, in the opinion of management, include all necessary adjustments (consisting of normal, recurring in nature) for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. Interim results are not necessarily indicative of results for a full year. Therefore, the results of operations for the three and six month periods ended June 30, 2005 are not necessarily indicative of operating results to be expected for 2005. 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, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses. Actual results could differ from those estimates. F-20 Cash and Cash Equivalents For purposes of reporting cash flows, the Company considers all cash on hand, in banks, including amounts in book overdraft positions, certificates of deposit and other highly liquid debt instruments with a maturity of three months or less at the date of purchase to be cash and cash equivalents. Cash overdraft positions may occur from time to time due to the timing of making bank deposits and releasing checks, in accordance with the Company's cash management policies. Our subsidiary, Caerus, Inc. has cash restrictions to support letters of credit which in turn support operating license bonds required by several states' regulatory agencies. The amount of restricted cash as of June 30, 2005 was $60,000. Accounts Receivable Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts based on its assessment of the current status of the individual receivables and after using reasonable collection efforts. As of June 30, 2005 and December 31, 2004 the balance of the allowance for uncollectible accounts amounted to $99,047 and $136,795, respectively. Inventory Inventory consists of finished goods and is valued at the lower of cost or market using the first-in, first-out method. Advertising Expenses Advertising and marketing expenses are charged to operations as incurred. Income Taxes The Company and its subsidiaries file consolidated federal and state income tax returns. The Company has adopted Statement of Financial Accounting Standards No. 109 in the accompanying consolidated financial statements. The only temporary differences included therein are attributable to differing methods of reflecting depreciation for financial statement and income tax purposes. Earnings (loss) per Share Basic earnings (loss) per share is computed by dividing the net income (loss) for the period by the weighted-average number of shares of common stock outstanding. The calculation of fully diluted earnings (loss) per share assumes the dilutive

effect of the exercise of outstanding options and warrants at either the beginning of the respective period presented or the date of issuance, whichever is later. Common stock equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options and warrants, using the treasury stock method. Fair Value of Financial Instruments The carrying amounts of cash, accounts receivable, accounts payable and notes payable, as applicable, approximate fair value due to the short term nature of these items and/or the current interest rates payable in relation to current market conditions. Revenue Recognition Revenue from product sales is recognized when persuasive evidence of an arrangement exists, delivery to customer has occurred, the sales price is fixed and determinable, and collectibility of the related receivable is probable. The recognition of revenues from Internet telephony services are deferred for new subscribers of eGlobalphone and VoIP Solutions until it deems that the customer has accepted the service. Subsequent revenues are recognized at the beginning of each customer's month. The recognition of revenue from Internet telephony services are recorded as rendered. Revenues related to long distance, carrier access service and certain other usage-driven charges are billed monthly in arrears and the associated revenues are recognized during the month of service. Property, Plant, and Equipment Property, plant, and equipment are stated at cost. Depreciation is provided over the estimated useful lives of the related assets using the straight line method. The useful life of assets ranges from three to five years. The leasehold improvements are amortized over the life of the related lease. Under the Statement of Position ("SOP") 98-1, "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use," the Company expenses computer software costs related to internal-use software that is incurred in the preliminary project stage. When the capitalization criteria of SOP 98-1 have been met, costs of developing or obtaining internal-use computer software are capitalized. Amortization of internal-use software over a 5-year estimated useful life commenced upon the software being placed in service beginning January 1, 2004. Amortization of internal-use software for the period ended June 30, 2005 was approximately $77,000. F-21 Business Combinations The Company accounts for business combinations in accordance with Statement of Financial Accounting Standard No. 141 Business Combinations ("SFAS No. 141"). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations. SFAS No. 141 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually by comparing carrying value to the respective fair value in accordance with the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). This pronouncement also requires that the intangible assets with estimated useful lives be amortized over their respective estimated useful lives. Impairment of Long-Lived Assets The Company reviews the recoverability of its long-lived assets, such as plant, equipment and intangibles when events or changes in circumstances occur that indicate that the carrying value of the asset group may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets. Concentration of Credit Risk Financial instruments that may subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company has investment policies and procedures that are reviewed periodically to minimize credit risk. One customer represented approximately 98% of our subsidiary Caerus, Inc.'s accounts receivable as of June 30, 2005 and approximately 91% of Caerus, Inc.'s revenues for the six months ended June 30, 2005. NOTE C - ACQUISITION OF CAERUS, INC. On May 31, 2005 the Company acquired 100 percent of Caerus, Inc. and its wholly owned subsidiaries Volo Communications, Inc., Caerus Networks, Inc., and Caerus Billing, Inc. in exchange for 16.9 million of the Company's common shares. The acquisition was accounted for as a business combination in accordance with Statement of Financial Accounting Standard No. 141 "Business Combinations" ("SFAS No. 141"). The purchase price was allocated to the identifiable net assets acquired including the identifiable intangible assets based on their estimated fair market values at the date of acquisition. The goodwill, intangible assets and property recorded for the acquisition of Caerus, Inc. (Caerus) represent the fair market value of liabilities as of the date of acquisition, plus $13,819,118 which represents the value of the Company's common stock and options issued pursuant to the acquisition, plus acquisition-related costs. The common stock issued to acquire Caerus was valued at the closing market price of the stock on the date of the acquisition, less a 25% discount due to restrictions on the shares. The amortizable lives of the intangible assets recorded for Caerus range from one to nine years. F-22 The fair market value of the assets acquired on May 31, 2005 is as follows: Fair Value of Assets Acquired

-------------- Cash $ 66,485 Accounts receivable 285,578 Deposits 108,500 Other current assets 156,659 Property and equipment, net 8,451,763 Other assets 271,609 Accounts payable (9,382,323) Note payable (6,960,818) Customer deposits (1,026,750) Other current liabilities (2,252,703) -------------- Sub total (10,282,000) Intangible assets 13,800,000 Goodwill 10,301,000 -------------- Sub total 24,101,000 -------------- Purchase price $ 13,819,000 ============== NOTE D - GOODWILL AND OTHER INTANGIBLE ASSETS a) As of June 30, 2005 goodwill consisted of the following: Amount ----------- Acquisition of Caerus, Inc. $ 10,301,000 Acquisition of DTNet Technologies, Inc. 5,210,553 Acquisition of Voipamericas, Inc. 1,408,301 ----------- Sub total 16,919,854 ----------- b) As of June 30, 2005 intangible assets consisted of the following: Ingangibles with finite lives: Useful Life Years Amount ---------------- ----------- Technology - Caerus, Inc. 4.0 $ 6,000,000 Customer relationships - Caerus, Inc. 6.0 5,800,000 Trade names - Caerus, Inc. 9.0 1,300,000 Non-compete agreements - Caerus, Inc. 1.0 500,000 Carrier licenses - Caerus, Inc. Unamortized 200,000 ----------- Sub total 13,800,000 Less accumulated amortization (259,260) ----------- Sub total 13,540,740 Ingangibles with indefinite lives: Intellectual property 305,000 ----------- Sub total 13,845,740 ----------- Total $ 30,765,594 =========== F-23 The goodwill on the acquisition of DTNet Technologies, Inc. (DTNet) represents the fair market value of DTNet liabilities as of the date of the acquisition plus $4,750,000 which represents the market value of 2,500,000 shares of Company stock issued pursuant to its acquisition. The goodwill on the acquisition of Voipamericas represents the fair market value of Voipamericas liabilities as of the date of the acquisition plus $1,100,000 which represents the market value of 1,000,000 shares of the Company's stock pursuant to this acquisition. Intellectual property is carried at cost which is comprised of $200,000 paid in cash and the value assigned to 100,000 Company common shares and 400,000 warrants issued pursuant to this transaction. The valuation of the shares was $1.05 while the value was $105,000. The value of the warrants was determined using the Black-Scholes model calculated as of October 14, 2004. This model uses the annualized deviation calculation and utilized industry averages as a comparison for adequate statistical results in the valuation. This is a standard financial model that considers the statistical annual volatility of the market changes in a stock price. Intellectual property consists of the following: a) all rights of the Company of Record in the telephone numbers 1(800)TALKTIME, 1(888)TALKTIME, AND 1(877)TALKTIME.COM b) all rights to the URL's (domain names) 800TALKTIME.COM, 1800TALKTIME.COM, and 1-800-TALKTIME.COM c) all rights to U.S. Trademark Registration No. 2,209,316 directed to 1-800-TALKTIME and the goodwill associated therewith. NOTE E - EXCHANGE OF WARRANTS FOR SHARES In February, 2005 an executive of the Company and the Company agreed to exchange his 2,200,000 warrants for 750,000 restricted shares of the Company. This created additional compensation of $239,500, shown in the compensation and related expenses in the consolidated statement of operations, which is the difference between the market price on the date of exchange and the value on the date of the issuance of the warrants. NOTE F - STOCK OPTION PLAN On January 26, 2005, the Company filed a Form S-8 registration statement in connection with the Company's Stock Option Plan. The plan provides for the grant to eligible employees, consultants, and directors of options for the purchase of Common Stock. The Option Plan covers, in the aggregate, a maximum of 4,000,000 shares of Common Stock and provides for the granting of both incentive stock options (as defined in Section 422 of the Internal Revenue Code of 1986) and nonqualified stock options (options which do not meet the requirements of Section 422). Under the Option Plan, the exercise price may not be less than the fair market value of the Common Stock on the date of the grant of the option. The Company uses the fair value method of Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation" ("SFAS No. 123") in accounting for its stock options. This standard states that compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. The fair value for each option granted is estimated on the date of the grant using the minimum value method. The vested options as of June 30, 2005 amounting to $127,238 are shown under the compensation and related expenses on the Consolidated Statement of Operation. F-24 NOTE G - NOTES PAYABLE As of June 30, 2005 Notes Payable consist of the following: a. Note Payable to Shareholder $1,053,196 b. Note Payable - Convertible 1,427,925 c. Note Payable - Convertible 125,000 d. Note Payable to lending institution 5,130,818 ---------- Notes Payable Total $7,736,939 ---------- a. Represents the balance due a shareholder at an interest rate of 3.75% with a maturity date of December 31, 2005. b. Represents 8% notes issued pursuant to a subscription agreement, convertible into 1,784,895 shares of common stock. In connection with these notes the holders received warrants to purchase 829,447 shares of common stock at $1.60 per share and 892,448 shares of common stock at $1.43 per share. The subscription agreement for these notes requires the issuance of an additional $1,427,916 of these 8% notes, convertible into 1,784,895 shares

of common stock, within five business days following the effective date of a Company registration statement on Form SB-2. In connection with these notes the Company will issue warrants for the purchase of 892,447 shares of common stock at $1.60 per share and 892,448 shares of common stock at a per share price equal to 110% of the volume weighted average price for the five business days immediately preceding the effective date of the Form SB-2. c. This note bears interest at 12% and in July, 2005 was converted into 166,667 shares of common stock. d. Represents the balance of a loan payable by Caerus, Inc. These borrowings are repayable over a three-year period and bear interest at 12.5% per annum. Additional borrowings under this facility are contingent upon, among other things, the Company raising certain levels of additional equity financing. The loan agreement contains customary covenants and restrictions and provides the lender the right to a perfected first-priority, secured interest in all of the Caerus, Inc.'s assets, as well as rights to preferred stock warrants. Caerus, Inc. is currently in violation of certain requirements of the debt facility. Accordingly, the full amount of the note at June 30, 2005 has been classified as current. No default on this loan has been declared. NOTE H - LITIGATION On April 8, 2005, Volo Communications, Inc. ("Volo") (a wholly-owned subsidiary of Caerus, Inc.) filed suit against MCI Worldcom Network Services, Inc. d/b/a UUNET ("MCI"). Volo alleges that MCI engaged in a pattern and practice of over-billing Volo for the telecommunications services it provided pursuant to the parties' Services Agreement, and that MCI refused to negotiate such overcharges in good faith. Volo also seeks damages arising out of MCI's fraudulent practice of submitting false bills by, among other things, re-routing long distance calls over local trunks to avoid access charges, and then billing Volo for access charges that were never incurred. On April 4, 2005, MCI declared Volo in default of its obligations under the Services Agreement, claiming that Volo owes a past due amount of $8,365,980, and threatening to terminate all services to Volo within 5 days. By this action Volo alleges claims for (1) breach of contract; (2) fraud in the inducement; (3) primary estoppel; and (4) deceptive and unfair trade practices. Volo also seeks a declaratory judgment that (1) MCI is in breach of the Services Agreement; (2) $8,365,980 billed by MCI is not "due and payable" under that agreement; and (3) MCI's default letter to Volo is in violation of the Services Agreement. Volo seeks direct, indirect and punitive damages in an amount to be determined at trial. On May 26, 2005, MCI filed an Answer, Affirmative Defenses, Counterclaim and Third-Party Complaint naming Caerus, Inc. as a third-party defendant. MCI asserts a breach of contract claim against Volo, a breach of guarantee claim against Caerus, Inc., and a claim for unjust enrichment against both parties, seeking an amount to be determined at trial. On July 11, 2005, Volo and Caerus, Inc. answered the counterclaim and third-party complaint, and filed a third-party counterclaim against MCI for declaratory judgment, fraud in the inducement, and breach of implied duty of good faith and fair dealing. Volo and Caerus, Inc. seek direct, indirect, and punitive damages in an amount to be determined at trial. Discovery should commence shortly. The Company is currently unable to assess the likelihood of a favorable or unfavorable outcome. NOTE I - SUBSEQUENT EVENTS On October 5, 2005, the Company through a wholly owned subsidiary purchased substantially all of the assets of WQN, Inc. relating to WQN's "Voice over Internet Protocol" business. Pursuant to the Asset Purchase Agreement, Acquisition Sub purchased the Assets for a purchase price consisting of (1) a Convertible Promissory Note, in the principal amount of $3,700,000 and convertible into 3,557,692 shares of the Company's common stock (the "Purchase Note"), (2) 1,250,000 restricted shares of the Company's common stock, par value $0.001 per share (the "Common Stock") and (3) a warrant (the "Purchase Warrant") to purchase 5,000,000 shares of Common Stock for $0.001 per share. In addition, the Asset Purchase Agreement provides that, in the event that the accounts payable of WQN transferred to the Company in the Asset Purchase exceed the accounts receivable transferred to the Company in the Asset Purchase, WQN will pay the Company the difference. If WQN is required to pay such difference, the Company will issue additional shares of Common Stock at the rate of one share per dollar of such excess, up to 500,000 shares. F-25 VOIP, INC. AND SUBSIDIARIES UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS The Following unaudited pro forma condensed combined financial statements are derived from and should be read in conjunction with the historical consolidated financial statements and related notes of VOIP, INC. ("VOIP" or the "Company"), and CAERUS, INC. ("CAERUS"). On June 1, 2005, the Company, and Caerus announced the closing of the merger of Volo Acquisition Corp., a wholly-owned subsidiary of the Company with and into Caerus, with Caerus as the surviving corporation (the "Merger"). The Merger was completed pursuant to an Agreement and Plan of Merger (the "Merger Agreement'), executed on May 31, 2005. The unaudited pro forma condensed combined statements of operation for the six month periods ended June 30, 2005 and 2004, and the year ended December 31, 2004 give effect to the merger of Caerus and the Company with the conversion of all Caerus capital stock into 16,434,470 shares of common stock, par value $0.001, of the Company.

The unaudited pro forma condensed combined statements of operations assume that the merger was consummated at the beginning of the respective period. The unaudited pro forma condensed combined balance sheet presents the combined financial position of the Company and Caerus as if the Merger was consummated on January 01, 2005. The unaudited pro forma condensed combined financial statements have been prepared based on currently available information and assumptions that are deemed appropriate by the Company's management. The pro forma information is for informational purposes only and is not intended to be indicative of the actual consolidated results that would have been reported had the transactions occurred on the dates indicated, nor does the information represent a forecast of the consolidated financial position at any future date or the combined financial results of the Company and Caerus for any future period. F-26 VoIP Inc. Proforma Consolidated Statement of Operations (Unaudited) Three Months Ended June 30, 2005 VoIP, Inc. Caerus, Inc. Adjustments Consol ----------- ------------ ----------- ------------ Revenues $ 1,260,274 $ 2,289,399 $ -- $ 3,549,673 Cost of Sales 638,369 2,785,740 -- 3,424,109 ----------- ------------ ----------- ------------ Gross Profit (Loss) 621,905 (496,341) -- 125,564 Operating expenses 3,133,639 2,246,261 518,518 5,898,418 ----------- ------------ ----------- ------------ Loss from operations (2,511,734) (2,742,602) (518,518) (5,772,854) Provision for income taxes -- -- -- -- ----------- ------------ ----------- ------------ Net Loss $(2,511,734) $ (2,742,602) $ (518,518) $ (5,772,854) =========== ============ =========== ============ Basic and diluted loss per share: $ (0.19) ============ Weighted average number of shares outstanding 30,012,632 ============ The accompanying notes are an integral part of this pro forma consolidated statement of operations. F-27 VoIP Inc. Proforma Consolidated Statement of Operations (Unaudited) Six Months Ended June 30, 2005 VoIP, Inc. Caerus, Inc. Adjustments Consol ----------- ------------ ----------- ------------ Revenues $ 3,267,421 $ 7,284,244 $ -- $ 10,551,665 Cost of Sales 2,439,304 9,143,457 -- 11,582,761 ----------- ------------ ----------- ------------ Gross Profit (Loss) 828,117 (1,859,213) -- (1,031,096) Operating expenses 4,847,148 4,098,918 1,296,295 10,242,361 ----------- ------------ ----------- ------------ Loss from operations (4,019,031) (5,958,131) (1,296,295) (11,273,457) Provision for income taxes -- -- -- -- ----------- ------------ ----------- ------------ Net Loss $(4,019,031) $ (5,958,131) $(1,296,295) $(11,273,457) =========== ============ =========== ============ Basic and diluted loss per share: $ (0.42) ============ Weighted average number of shares outstanding 26,940,458 ============ The accompanying notes are an integral part of this proforma consolidated statement of operations. F-28 VoIP Inc. Proforma Consolidated Statement of Operations Year Ended December 31, 2004 VoIP, Inc. Caerus, Inc. Adjustments Consolidated ----------- ------------ ----------- ------------ Revenues $ 2,619,393 $ 14,379,365 $ -- $ 16,998,758 Cost of Sales Network and termination costs 1,870,269 15,765,201 -- 17,635,470 ----------- ------------ ----------- ------------ Gross Profit (Loss) 749,124 (1,385,836) -- (636,712) Operating expenses 4,763,863 7,225,759 3,111,108 15,100,730 ----------- ------------ ----------- ------------ Loss from operations (4,014,739) (8,611,595) (3,111,108) (15,737,442) Provision for income taxes -- -- -- -- ----------- ------------ ----------- ------------ Net Loss $(4,014,739) $ (8,611,595) $(3,111,108) $(15,737,442) =========== ============ =========== ============ Basic and diluted loss per share: $ (0.51) ============ Weighted average number of shares outstanding 31,031,782 ============ The accompanying notes are an integral part of these pro forma consolidated statement of operations. F-29 VoIP Inc. Proforma Consolidated Statement of Operations (Unaudited) Three Months Ended June 30, 2004 VoIP, Inc. Caerus, Inc. Adjustments Consol --------- ------------ ----------- ----------- Revenues $ 85,298 $ 2,332,453 $ -- $ 2,417,751 Cost of Sales 58,923 2,700,914 -- 2,759,837 --------- ------------ ----------- ----------- Gross Profit (Loss) 26,375 (368,461) -- (342,086) Operating expenses 435,033 1,793,909 777,777 3,006,719 --------- ------------ ----------- ----------- Loss from operations (408,658) (2,162,370) (777,777) (3,348,805) Provision for income taxes -- -- -- -- --------- ------------ ----------- ----------- Net Loss $(408,658) $ (2,162,370) $ (777,777) $(3,348,805) ========= ============ =========== =========== Basic and diluted loss per share: $ (0.10) =========== Weighted average number of shares outstanding 32,668,283 =========== The accompanying notes are an integral part of this pro forma consolidated statement of operations. F-30 VoIP Inc. Proforma Consolidated Statement of Operations (Unaudited) Six Months Ended June 30, 2004 VoIP, Inc. Caerus, Inc. Adjustments Consol --------- ------------ ----------- ----------- Revenues $ 85,298 $ 5,369,624 $ -- $ 5,454,922 Cost of Sales 58,923 5,348,592 -- 5,407,515 --------- ------------ ----------- ----------- Gross Profit (Loss) 26,375 21,032 -- 47,407 Operating expenses 457,356 2,746,438 1,555,554 4,759,348 --------- ------------ ----------- ----------- Loss from operations (430,981) (2,725,406) (1,555,554) (4,711,941) Provision for income taxes -- -- -- -- --------- ------------ ----------- ----------- Net Loss $(430,981) $ (2,725,406) $(1,555,554) $(4,711,941) ========= ============ =========== =========== Basic and diluted loss per share: $ (0.19) =========== Weighted average number of shares outstanding 24,690,040 =========== The

accompanying notes are an integral part of this proforma consolidated statement of operations. F-31 VOIP, INC. AND SUBSIDIARIES NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS (1) VOIP, INC. Basis of Presentation Historical financial information for VOIP, INC. as of June 30, 2005 and for the three and six months ended June 30, 2005 and 2004 and the year ended December 31, 2004 has been derived from VOIP, INC.'s historical statements. (2) CAERUS, INC. Basis of Presentation Historical financial information for CAERUS, INC. as of June 30, 2005 and for the three and six months ended June 30, 2005 and 2004 and the year ended December 31, 2004 has been derived from CAERUS, INC.'s historical statements. (3) VOIP, INC. and CAERUS, INC. Merger On June 1, 2005, the Company, and Caerus, Inc. announced the closing of the merger of Volo Acquisition Corp., a wholly-owned subsidiary of the Company with and into Caerus, Inc. with Caerus, Inc. as the surviving corporation (the "Merger"). The Merger was completed pursuant to an Agreement and Plan of Merger (the "Merger Agreement'), executed on May 31, 2005 by the conversion of all Caerus, Inc. capital stock into 16,434,470 shares of common stock, par value $0.001, of the Company. (4) Pro Forma Statements of Operations Adjustments Adjustments to the pro forma Statements of Operations represent amortization of certain intangible assets recorded in connection with the acquisition. F-32 REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS Board of Directors Caerus, Inc. Altamonte Springs, Florida We have audited the accompanying consolidated balance sheets of Caerus, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity (deficit), and cash flows for the year ended December 31, 2004 and for period May 15, 2002 (date of inception) through December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 that 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 Caerus, Inc. as of December 31, 2004 and 2003, and the results of its operations and cash flows for the year ended December 31, 2004 and for the period May 15, 2002 (date of inception) through December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has incurred significant losses and negative cash flows from operations, has a working capital deficit, and has significant unresolved litigation as discussed in Note 8 to the financial statements. These matters, among other things, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans related to these matters are also discussed in Note 1. These financial statements do not include any adjustments that might result from the outcome of this uncertainty. /s/ Moore Stephens Lovelace, P.A. -------------------------------- Certified Public Accountants Orlando, Florida July 25, 2005 F-33 CAERUS, INC. CONSOLIDATED BALANCE SHEETS December 31, 2004 and 2003 2004 2003 ------------ ----------- ASSETS CURRENT ASSETS Cash and cash equivalents $ 19,414 $ 25,078 Restricted cash 60,224 196 Accounts receivable 2,098,598 358,522 Note receivable - related party -- 179,974 Supplies, deposits and prepaid expenses 70,999 350,199 ------------ ----------- TOTAL CURRENT ASSETS 2,249,235 913,969 ------------ ----------- PROPERTY AND EQUIPMENT Telecommunications equipment and computers 6,390,973 732,205 Furniture and fixtures 61,960 21,624 Leasehold improvements 163,808 146,358 Purchased and developed software 473,228 598,243 ------------ ----------- 7,089,969 1,498,430 Less accumulated depreciation and amortization (824,580) (183,408) ------------ ----------- NET PROPERTY AND EQUIPMENT 6,265,389 1,315,022 ------------ ----------- OTHER ASSETS Deferred loan origination costs, net 285,075 -- Lease deposit and other 28,959 65,000 ------------ ----------- TOTAL ASSETS $ 8,828,658 $ 2,293,991 ============ =========== LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) CURRENT LIABILITIES Accounts payable and accrued expenses $ 7,137,293 $ 452,094 Note payable 6,006,899 -- Convertible notes payable - related party 1,830,000 1,050,000 Deferred revenue and customer deposits 38,750 60,576 ------------ ----------- TOTAL CURRENT LIABILITIES 15,012,942 1,562,670 ------------ ----------- STOCKHOLDERS' EQUITY (DEFICIT) Common stock - $.01 par value; 50,000,000 shares authorized; 14,940,508 and 11,948,367 shares issued and outstanding, respectively 149,405 119,484 Preferred stock - $.01 par

value; 25,000,000 shares authorized; -0- shares issued and outstanding -- -- Additional paid-in capital 4,618,253 2,952,184 Accumulated deficit (10,951,942) (2,340,347) ------------ ----------- TOTAL SHAREHOLDERS' EQUITY (DEFICIT) (6,184,284) 731,321 ------------ ----------- TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT) $ 8,828,658 $ 2,293,991 ============ =========== F-34 CAERUS, INC. CONSOLIDATED STATEMENTS OF OPERATIONS For The Year Ended December 31, 2004, and The Period May 15, 2002 (Date of Inception) Through December 31, 2003 2004 2002-2003 ------------ ------------ (Development Stage) SALES $ 14,379,365 $ 1,191,287 COST OF SALES Network and termination costs 15,103,149 900,681 Testing and sales concessions 662,052 -- ------------ ------------ TOTAL COST OF SALES 15,765,201 900,681 ------------ ------------ GROSS PROFIT (LOSS) (1,385,836) 290,606 ------------ ------------ OPERATING EXPENSES Equipment and computer expenses 603,189 97,068 Office expenses 228,108 206,215 Labor-related expenses 2,973,070 1,214,240 Professional fees 814,243 400,872 Marketing 217,835 16,689 Litigation settlement 326,205 -- Rent, utilities and security 246,545 355,481 Taxes and licenses 55,527 25,390 Travel, lodging and entertainment 163,555 90,928 Depreciation and amortization 641,172 183,409 Asset impairment charge 299,122 -- ------------ ------------ TOTAL EXPENSES 6,568,571 2,590,292 ------------ ------------ LOSS FROM OPERATIONS (7,954,407) (2,299,686) OTHER EXPENSES Interest expense, net (657,238) (19,654) Other expense, net 50 (21,007) ------------ ------------ NET LOSS $ (8,611,595) $ (2,340,347) ============ ============ F-35 CAERUS, INC. CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT) For The Year Ended December 31, 2004, and The Period May 15, 2002 (Date of Inception) Through December 31, 2003 Common Stock $.01 Par Value Additional Total --------------------- Paid-In Accumulated Stockholders' Shares Amount Capital Deficit Equity (Deficit) ---------- -------- ---------- ----------- ---------------- BALANCE - MAY 15, 2002 -- $ -- $ -- $ -- $ -- ISSUANCE OF FOUNDER STOCK 5,400,000 54,000 -- -- 54,000 SALE OF COMMON STOCK 6,186,592 61,866 2,721,909 -- 2,783,775 ISSUANCE OF COMMON STOCK FOR SERVICES 150,000 1,500 81,750 -- 83,250 ISSUANCE OF COMMON STOCK FOR PROPERTY AND EQUIPMENT 211,775 2,118 148,525 -- 150,643 NET LOSS -- -- -- (2,340,347) (2,340,347) ---------- -------- ---------- ----------- ---------------- BALANCE - DECEMBER 31, 2003 11,948,367 119,484 2,952,184 (2,340,347) 731,321 ISSUANCE OF COMMON STOCK 712,071 7,121 273,139 -- 280,260 ISSUANCE OF COMMON STOCK FOR DEBT 2,280,070 22,800 1,097,200 -- 1,120,000 ISSUANCE OF STOCK WARRANTS IN CONNECTION WITH SECURED NOTE PAYABLE -- -- 218,813 -- 218,813 EMPLOYEE STOCK OPTIONS - COMPENSATION EXPENSE RECOGNIZED -- -- 76,917 -- 76,917 NET LOSS -- -- -- (8,611,595) (8,611,595) ---------- -------- ---------- ----------- ---------------- BALANCE - DECEMBER 31, 2004 14,940,508 $149,405 $4,618,253 $(10,951,942) $ (6,184,284) ========== ======== ========== ============ ================ F-36 CAERUS, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS For The Year Ended December 31, 2004, and The Period May 15, 2002 (Date of Inception) Through December 31, 2003 2004 2002-2003 ----------- ------------ (Development Stage) CASH FLOWS FROM OPERATING ACTIVITIES Net loss $(8,611,595) $ (2,340,347) Adjustments to reconcile net loss to net cash used in operating activities: Litigation settlement 326,205 -- Depreciation and amortization 641,172 183,408 Asset impairment charge 299,122 -- Amortization of deferred loan fees 56,613 -- Stock issued to Founder -- 54,000 Stock issued for services -- 83,250 Expense related to employee stock options 76,917 -- Forgiveness of related-party loan 415,323 -- Changes in: Restricted cash (60,028) (196) Accounts receivable (2,066,281) (358,522) Supplies, deposits and prepaid expenses 279,200 (415,199) Other assets 36,041 -- Accounts payable and accrued expenses 6,685,199 452,094 Deferred revenue (21,826) 60,576 ----------- ------------ NET CASH USED IN OPERATING ACTIVITIES (1,943,938) (2,280,936) ----------- ------------ CASH FLOWS FROM INVESTING ACTIVITIES Additions to property and equipment (5,890,661) (1,347,787) Additions to related-party loan (235,349) (179,974) ----------- ------------ NET CASH USED IN INVESTING ACTIVITIES (6,126,010) (1,527,761) ----------- ------------ CASH FLOWS FROM FINANCING ACTIVITIES Proceeds from borrowings 8,900,000 1,050,000 Repayment of note payable (993,101) -- Proceeds from issuance of common stock 280,260 2,783,775 Payments for loan origination costs (122,875) -- ----------- ------------ NET CASH PROVIDED BY FINANCING ACTIVITIES 8,064,284 3,833,775 ----------- ------------ NET CHANGE IN CASH (5,664) 25,078 CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD 25,078 -- ----------- ----------- CASH AND CASH EQUIVALENTS - END OF PERIOD $ 19,414 $ 25,078 ========== =========== F-37 Caerus, Inc. NOTES TO consolidated FINANCIAL STATEMENTS For The Year Ended December 31, 2004 and For The Period May 15, 2002 (Date of Inception) Through December 31, 2003 NOTE 1 - DESCRIPTION OF BUSINESS Caerus, Inc. and subsidiaries (collectively referred to as the "Company")

were incorporated on May 15, 2002 and are wholesale providers of advanced telecommunications technologies and services to carriers and service providers, including Inter Exchange Carriers ("IXCs"), Competitive Local Exchange Carriers ("CLECs"), Internet Service Providers, Cable Operators and Enhanced Voice and Data Service Providers. Through its wholesale-only model, the Company has positioned itself as a "carrier's carrier" and offers protocol-agnostic packet switched technologies to address the gap between traditional communications and "next generation" platforms. During the period May 15, 2002 (date of inception) to December 31, 2003, the Company was in the process of developing its resources, enhancing its proprietary technology, building a nationwide network with five physical interconnection points (cities), working with potential customers on testing its network, and attracting key engineering professionals; accordingly, the Company was considered to be a development stage enterprise. In January 2004, the Company became fully operational and management determined that the Company was no longer in a development stage. The Company offers a comprehensive suite of Internet Protocol ("IP")-based broadband packet voice services, IP and Time Division Multiplexing ("TDM") origination/termination services, IP PBX-hosted services, and unified messaging services that include enhanced voice and data solutions. The suite of services is complemented by a Service Creation Environment that enables the Company to develop custom applications and features "on the fly" for its customers. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The Company has incurred significant losses and negative cash flows from operations since its inception. Additionally, the Company has a working capital deficit of $12,763,707 and an accumulated deficit of $10,951,942 at December 31, 2004. Management continues to undertake steps as part of a plan to attempt to improve liquidity and operating results with the goal of sustaining Company operations. These steps include seeking (a) to increase high-margin sales; and (b) to control overhead costs and operating expenses. Management plans, in this regard, to continue the implementation of a stabilized and fully operational network, adding recurring-revenue customers, attracting an experienced management team capable of building a profitable company, and securing funding to meet current obligations. There can be no assurance that the Company can successfully accomplish these steps. Accordingly, the Company's ability to continue as a going concern is uncertain and dependent upon continuing to achieve improved operating results and cash flows or obtaining additional financing. These consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue in business. NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Cash and Cash Equivalents For financial presentation purposes, the Company considers short-term, highly liquid investments with original maturities of three months or less to be cash equivalents. F-38 Restricted Cash and Letters of Credit Certain cash is restricted to support standby letters of credit which, in turn, support operating license bonds required by several states' regulatory agencies. These standby letters of credit are generally in force for one year with automatic one-year extensions. Maximum draws available to the beneficiary as of December 31, 2004 were $60,000. If the Company was required to obtain replacement standby letters of credit as of December 31, 2004 for those currently outstanding, it is the Company's opinion that the replacement costs would not significantly vary from the present fee structure. Accounts Receivable Accounts receivable result from the sale of the Company's services, net of estimated allowances. The Company estimates an allowance for doubtful accounts based on a specific-identification basis. The Company had no allowance for doubtful accounts as of December 31, 2004 and 2003. Property and Equipment Property and equipment are recorded at cost. Depreciation and amortization are calculated on a straight-line basis over the assets' useful lives, which range from three to ten years. Leasehold improvements are amortized over the estimated useful lives of the improvements, or the term of the lease, if shorter. Maintenance and repairs are expensed as incurred, while renewals and betterments are capitalized. Upon the sale or other disposition of property, the cost and related accumulated depreciation are removed from the accounts, and any gain or loss is recognized in operations. Under the Statement of Position ("SOP") 98-1, "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use," the Company expenses computer software costs related to internal-use software that is incurred in the preliminary project stage. When the capitalization criteria of SOP 98-1 have been met, costs of developing or obtaining internal-use computer software are capitalized. The Company capitalized approximately $772,350 of costs incurred for internally developed software during the period from inception through December 31, 2004. Amortization of internal-use software over a 5-year estimated useful life commenced upon the software being placed in service beginning January 1, 2004. Amortization of internal-use software for the periods ended December 31, 2004 and 2003 was approximately $77,000 and $-0-, respectively. During 2004, the Company suspended a number of software development projects

and, accordingly, recognized a related asset impairment charge of $299,122 in 2004. Deposits Deposits consist primarily of an equipment deposit, a refundable office lease deposit and various other deposits outstanding with service providers. Deferred Revenue Deferred revenue represents fees for services that have not yet met the criteria to be recognized as revenue. Revenue Recognition Revenue is recognized when earned. Revenue related to long distance, carrier access service and certain other usage-driven charges are billed monthly in arrears, and the associated revenues are recognized during the month of service. Income Taxes The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recorded to reflect the tax consequences in future years of differences between the tax basis of assets and liabilities and their financially reported amounts at each year-end, based on enacted laws and statutory rates applicable to the periods in which differences are expected to affect taxable income. As of December 31, 2004, the Company had a deferred tax asset of approximately $3,000,000, the components of which consisted primarily of the Company's net losses, fixed asset depreciation and stock-based compensation. Also at December 31, 2004, the Company had a net operating loss carryforward of approximately $11,000,000 for federal income tax purposes that will begin to expire in 2022, and that is subject to significant limitations based upon the occurrence of certain changes in ownership of the Company. F-39 A valuation allowance is provided against the future benefits of deferred tax assets if it is determined that it is more likely than not that the future tax benefits associated with the deferred tax asset will not be realized. Due to recurring losses since inception and the resultant uncertainty of the realization of the tax loss carryforward, the Company has established a 100% valuation allowance against the carryforward benefit. Accordingly, no provision/benefit for income taxes has been included in these consolidated financial statements. Concentration of Credit Risk Financial instruments that may subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company has investment policies and procedures that are reviewed periodically to minimize credit risk. One customer represented approximately 98% and 90% of the Company's accounts receivable as of December 31, 2004 and 2003, respectively, and approximately 91% and 95% of the Company's revenues for the year ended December 31, 2004 and for the period May 15, 2002 (date of inception) through December 31, 2003, respectively. The loss of this customer would have a significant adverse affect on the Company's operations. Concentration of Supplier Risk One supplier represented approximately 86% of the Company's accounts payable as of December 31, 2004, and approximately 94% of the Company's cost of sales for the year ended December 31, 2004 (see Note 8). Stock-based Compensation The Company uses the fair value method of Statement of Financial Accounting Standards No. 123R, "Accounting for Stock Based Compensation" in accounting for its stock options. This standard states that compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. The fair value for each option granted is estimated on the date of the grant using the minimum value method. Estimates The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant management estimates affect the carrying value of, among other things, internal-use software, cost of goods sold (see Note 7), the estimating of the fair value of the Company's common stock (see Note 3), and the evaluation of existing disputes and claims (see Notes 7 and 8). Reclassifications Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation. NOTE 3 - CONVERTIBLE NOTES PAYABLE - RELATED PARTY During 2003, the Company issued two one-year convertible notes to a stockholder of the Company, $1,050,000 and $70,000 of which were funded in the periods ended December 31, 2003 and 2004, respectively. These notes accrued interest at 12% per annum, with all interest and principal due in September and December 2004. These notes, which had certain anti-dilution provisions and which were collateralized by substantially all of the assets of the Company, were converted into common stock in May 2004 (see Note 6) and the convertible notes were cancelled and the principal amount was satisfied in full. The Company determined the conversion rates based upon its evaluation of the Company's common stock on the issuance dates. The Company's evaluations were based upon, among other things, peer company valuations, industry and market conditions, the Company's current financial position, terms and conditions of funding available to the Company at the time of issuance, etc. F-40 During 2004, the Company issued two one-year convertible notes to a stockholder of the Company, totaling $1,830,000. These notes accrue interest at 12% per annum, with monthly principal and interest payments originally scheduled through August and November

2004. Restrictive covenants pertaining to the note payable discussed in Note 4 to these financial statements precluded payment of scheduled principal and interest on these notes, therefore, these notes are currently due. However, the same covenants preclude payment until the note described in Note 4 to these financial statements is paid in full. These one-year notes are collateralized by substantially all of the assets of the Company (see Note 8). Interest expense incurred with respect to these notes during the year ended December 31, 2004 and the period May 15, 2002 (date of inception) through December 31, 2003, was $122,223 and $19,653, respectively. Interest payments made with respect to these notes during the year ended December 31, 2004 and the period May 15, 2002 (date of inception) through December 31, 2003, were $42,560 and $-0-, respectively. NOTE 4 - NOTE PAYABLE In June 2004, the Company secured a $15,000,000 debt facility and drew down the first $7,000,000 traunch primarily for the purpose of funding network equipment purchases. These borrowings are repayable over a three-year period and bear interest at 12.5% per annum. Additional borrowings under this facility are contingent upon, among other things, the Company raising certain levels of additional equity financing. The loan agreement contains customary covenants and restrictions and provides the lender the right to a perfected first-priority, secured interest in all of the Company's assets, as well as rights to preferred stock warrants (see Notes 6 and 8). Interest paid under this debt facility during the year ended December 31, 2004, was $484,867. The Company is currently in violation of several of the restrictive covenants in this debt facility. Under its provisions, the lender has the right to call the related note payable due. Accordingly, the full amount of the note at December 31, 2004 has been classified as current. NOTE 5 - NOTE RECEIVABLE - RELATED PARTY During the period May 15, 2002 (date of inception) through December 31, 2004, the Company advanced $415,323 to an officer of the Company. In 2005, these advances were characterized as compensation and were forgiven; accordingly, their carrying value was reduced to zero at December 31, 2004. In addition, the Company agreed to pay the related federal income tax withholding of approximately $104,000 on behalf of the related party, which was accrued at December 31, 2004. NOTE 6 - STOCKHOLDERS' EQUITY In June 2002, the Company increased its authorized shares to 100,000 shares of $0.01 par value common stock. In July 2002, the Company increased its authorized shares to 3,000,000 shares of $0.01 par value common stock and approved a 2-for-1 common stock split. In October 2002, the Company increased its authorized shares to 6,000,000 shares of $0.01 par value common stock. In July 2003, the Company approved an additional 3-for-1 common stock split and an increase in the authorized shares of common stock to 18,000,000. The Articles of Amendment for this amendment were not filed with the state of Delaware until 2004. The accompanying consolidated financial statements and related notes present all of these amendments as if they were effected for all periods presented. In 2002, 5,400,000 shares of common stock were issued to the founder of the Company. These shares were recorded at their par value. In 2002, the Company issued 150,000 shares of its common stock for legal services provided to the Company, which were recorded at their estimated fair value of $83,250. During the period May 15, 2002 (date of inception) through December 31, 2003, the Company issued 5,965,957 shares of its common stock and received net proceeds of $2,783,775. Offering costs related to these sales consisted of the issuance of an additional 220,635 shares of the Company's common stock. F-41 During the period May 15, 2002 (date of inception) through December 31, 2003, the Company issued 211,775 shares of its common stock in consideration for leasehold improvements and equipment, of which 190,211 of the shares were issued to the founder of the Company. These shares were recorded at their estimated fair value of $150,643. In May 2004, $1,120,000 of convertible notes payable to a shareholder were converted into 2,280,070 shares of common stock. In May and August 2004, the Company issued 500,000 and 212,071 shares of its common stock for cash of $100,000 and $180,260, respectively. In May 2004, the Company authorized the issuance of up to 25,000,000 shares of $.01 par value preferred stock, the terms of which will be decided upon by the Company's Board of Directors. In August 2004, the Company approved increasing the authorized common stock to 50,000,000 shares. However, the related state filing has yet to be effected. Rights to Convert to Preferred Stock At December 31, 2004, related parties held 12,989,445 shares of common stock that had the right to be converted into preferred shares; however, as of December 31, 2004, no shares of preferred stock had been issued by the Company (see Note 8). Stock Options During October 2004, the Board approved the Company's 2004 Stock Option Plan (the "Plan"), whereby 4,000,000 shares of the Company's common stock were reserved for issuance under the Plan to selected directors, officers, employees and consultants of the Company. As of December 31, 2004, options to purchase 2,164,969 shares of common stock for $0.85 per share were issued and outstanding under the Plan. These options expire ten years from the date of issuance. They vest from 36 to 48 months of employment following the date of option issuance. These options had an estimated fair value of $330,599 at the date of grant, using the minimum-value method with the following assumptions:

Expected life (in years) 10.0 Risk-free interest rate 2.0% Dividend yield 0.0% Related 2004 compensation expense was $76,917, determined by amortizing the options' estimated fair value at grant date over their vesting period. The weighted average remaining contractual life of the options outstanding at December 31, 2004 was 9.8 years (see Note 8). The Company had no stock options outstanding at December 31, 2003. Stock Warrants In 2004, the Company granted a series of warrants to purchase shares of preferred stock, the specific terms of which had yet to be determined, at an exercise price of $0.85 per share, in conjunction with the long-term note payable issuance (see Note 4). These warrants expire at the earlier of ten years from their issuance date, or five years after a potential initial public securities offering. At the warrant holder's election, these warrants may be exercised on a non-cash basis whereby the warrant holder uses the surplus of the preferred stock's then-fair market value per share over the $0.85 exercise price as payment for the preferred stock purchased under these warrants. F-42 These warrants had estimated fair values totaling $218,813 at their grant dates, recognized as additional paid-in capital and deferred loan origination costs. Additional information pertaining to these warrants issued and outstanding at December 31, 2004 is as follows: Date Granted Shares -- --------- June, 2004 1,235,294 August, 2004 766,020 October, 2004 383,010 --------- Total Issued and Outstanding 2,384,324 ========= Also in conjunction with the long-term note payable issuance (see Note 4), the Company granted warrants to purchase up to $1.0 million of common or preferred stock that may be issued in conjunction with any future securities offering of at least $5.0 million, upon the same price and conditions as afforded to third-party investors in said potential securities offering. In August 2004, the Company issued warrants to purchase 150,000 shares of common stock to a former employee whose employment was terminated in June 2004. Such warrants are exercisable at $0.85 per share, and expire on June 26, 2006. The Company had no stock warrants outstanding at December 31, 2003. NOTE 7 - OTHER COMMITMENTS AND CONTINGENCIES Operating Leases In August 2002, the Company entered into an operating lease for office space, which expires in February 2008. Approximate minimum future lease payments due under this operating lease, are as follows: Year Ending December 31, Amount ----------- -------- 2005 $196,000 2006 $202,000 2007 $208,000 2008 $ 35,000 During the year ended December 31, 2004 and the period May 15, 2002 (date of inception) through December 31, 2003, $172,700 and $234,000, respectively, were charged to operations for rent expense related to this operating lease. Legal and Regulatory Proceedings The Company's 100%-owned subsidiary, Volo Communications, Inc., settled its breach of contract dispute related to a 2003 "take or pay" sales contract with the Company. In connection with this settlement, the Company wrote off its previously recorded account receivable of $326,205 in 2004. Vendor Dispute Certain transport and termination costs incurred by the Company are recorded at vendor invoice amount less any amounts that have been formally disputed, for which the Company expects to receive a credit. Disputed amounts are based upon management's detailed review of vendor call records and contract provisions; accordingly, the recorded transport and termination costs represent management's estimates of what is ultimately due and payable. During the year ended December 31, 2004, and the period May 15, 2002 (date of inception) through December 31, 2003, $4,500,000 and $2,500,000, respectively, of one vendor's charges were formally disputed. As of December 31, 2004, approximately $4,759,000 remained in dispute and are, therefore, not included in the accompanying financial statements (see Note 8). Differences between the disputed amounts and final settlements, if any, are reported in operations in the year of settlement. Other Telecommunications industry revenues are subject to statutory and regulatory changes, interpretations of contracts, etc., all of which could materially affect our revenues. Generally, our customers have sixty days from the invoice date to dispute any billed charges. Management reviews all billings for compliance with applicable rules, regulations and contract terms and believes that it is in compliance therewith; accordingly, no allowance has been recorded in the accompanying financial statements for potential disputed charges. F-43 NOTE 8 - SUBSEQUENT EVENTS Capital Stock Transactions In February 2005, the Company issued 511,750 shares of Series B preferred stock for $818,800 cash. In May 2005, 7,289,445 shares of common stock were converted into 5,944,669 shares of Series A preferred stock. Both Series A and Series B preferred stock are convertible into common stock, and they carry voting rights equal to the equivalent number of common shares into which they are convertible. Also, both Series A and Series B preferred stock contain equal and ratable dividend and liquidation preferences over common stock. Litigation On April 8, 2005, Volo Communications, Inc. ("Volo") (a wholly-owned subsidiary of Caerus, Inc.) filed suit against MCI Worldcom Network Services, Inc. d/b/a UUNET ("MCI"). Volo alleges that MCI engaged in a pattern and practice of over-billing Volo for the telecommunications services it provided pursuant to the parties' Services Agreement, and that MCI refused to negotiate such overcharges in good faith. Volo also seeks damages arising out of MCI's alleged fraudulent practice of

submitting false bills by, among other things, re-routing long distance calls over local trunks to avoid access charges, and then billing Volo for access charges that were never incurred. On April 4, 2005, MCI declared Volo in default of its obligations under the Services Agreement, claiming that Volo owes a past due amount of $8,365,980 through March, 2005, and threatening to terminate all services to Volo within 5 days. On April 12, 2005, MCI terminated all services to Volo. By these actions, Volo alleges claims for (1) breach of contract; (2) fraud in the inducement; (3) primary estoppel; and (4) deceptive and unfair trade practices. Volo also seeks a declaratory judgment that (1) MCI is in breach of the Services Agreement; (2) $8,365,980 billed by MCI is not "due and payable" under that agreement; and (3) MCI's default letter to Volo is in violation of the Services Agreement. Volo seeks direct, indirect and punitive damages in an amount to be determined at trial. On May 26, 2005, MCI filed an Answer, Affirmative Defenses, Counterclaim and Third-Party Complaint naming Caerus, Inc. as a third-party defendant. MCI asserts a breach of contract claim against Volo, a breach of guarantee claim against Caerus, Inc., and a claim for unjust enrichment against both parties, seeking an amount to be determined at trial. On July 11, 2005, Volo and Caerus, Inc. answered the counterclaim and third-party complaint, and filed a third-party counterclaim against MCI for declaratory judgment, fraud in the inducement, and breach of implied duty of good faith and fair dealing. Volo and Caerus, Inc. seek damages in an amount to be determined at trial. MCI has filed a motion to strike certain of Caerus' affirmative defenses and a motion to dismiss Caerus' counterclaims. Discovery should commence shortly. While management is optimistic about the outcome of this litigation, it is currently unable to assess the ultimate likelihood of a favorable or unfavorable outcome; accordingly, no related provision or liability has been made in the accompanying financial statements. Merger On May 31, 2005, the Company consummated an Agreement and Plan of Merger ("Merger Agreement") with VoIP, Inc. ("VoIP") (OTCBB:VOII.OB), whereby 100% of Caerus, Inc.'s common and preferred stock, stock options and warrants were exchanged for the common stock of a wholly-owned subsidiary of VoIP. The VoIP subsidiary's name was then changed to Caerus, Inc. Also in conjunction with this merger, the holder of the $1,830,000 notes payable at December 31, 2004 referred to in Note 3 agreed to exchange those notes plus accrued interest for an equivalent number of shares of VoIP common stock valued at $1.23 per share. F-44 You may rely on the information contained in this prospectus. We have not authorized anyone to provide information different from that contained in this prospectus. Neither the delivery of this prospectus nor the sale of common shares means that information contained in this prospectus is correct after the date of this prospectus. This prospectus is not an offer to sell or solicitation of an offer to buy our common shares in any circumstances under which the offer or solicitation is unlawful. --------------------- TABLE OF CONTENTS Heading Page ----------------------------------- ---- Prospectus Summary 2 Risk Factors 6 Use of Proceeds 15 Dividend Policy and Market Data 15 Business and Properties 16 Management's Discussion and Analysis of Financial Condition and Results of Operations 25 Management 36 Principal Shareholders 43 Description of Securities 44 Plan of Distribution 48 Investor Suitability Requirement 49 Legal Matters 51 Experts 51 Available Information 51 Index to Financial Statements F-1 Until __________, 2005 (90 days from the date of this Prospectus), all dealers effecting transactions in the registered securities, whether or not participating in this distribution, may be required to deliver a Prospectus. This is in addition to the obligation of dealers to deliver a Prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions. UP TO 15,372,245 SHARES COMMON STOCK VoIP, Inc. ------------------ P R O S P E C T U S ------------------ _____________, 2004 PART II INFORMATION NOT REQUIRED TO BE IN PROSPECTUS Item 24. Indemnification of Directors and Officers The Registrant's Articles of Incorporation provide that no director of the Registrant will be personally liable to the Registrant or any of its shareholders for monetary damages arising from the director's breach of fiduciary duty as a director, with certain limited exceptions. Pursuant to the Texas Business Corporation Act (the "Act"), every Texas corporation has the power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding (other than an action by or in the right of the corporation) by reason of the fact that such person is or was a director, officer, employee or agent of the corporation or is or was serving in such a capacity at the request of the corporation for another corporation, partnership, joint venture, trust or other enterprise, against any and all expenses, judgments, fines and amounts paid in settlement and reasonably incurred in connection with such action, suit or proceeding. The power to indemnify applies only if such person acted in good faith and in a manner such person reasonably believed to be in the best interests, or not opposed to the best interests, of the corporation and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. The power to indemnify applies to actions brought by or in the right of the corporation as well, but only to the extent of defense and settlement expenses

and not to any satisfaction of a judgment or settlement of the claim itself, and with the further limitation that in such actions no indemnification shall be made in the event of any adjudication of negligence or misconduct unless the court, in its discretion, believes that in light of all the circumstances indemnification should apply. The Registrant's Articles of Incorporation contain provisions authorizing it to indemnify its officers and directors to the fullest extent permitted by the Act. Item 25. Other Expenses of Issuance and Distribution The estimated expenses of the registration, all of which will be paid by the Company, are as follows: SEC Filing Fee $ 2,005 Accounting Fees and Expenses 25,000 Legal Fees and Expenses 15,000 -------- TOTAL $ 42,005 Item 26. Recent Sales of Unregistered Securities Common stock - Registrant has sold and issued the shares of common stock described below within the past three years that were not registered under the Act. Effective July 2004, registrant issued 668,688 shares to six individual existing accredited investors. Also effective July 2004, registrant issued 41,688 shares to four accredited individual investors. Effective August 2004, registrant issued 50,000 shares to one individual accredited investor in satisfaction of accounts payable totaling $50,000. Effective August 2004, registrant issued 653,319 shares to 46 individual accredited investors. Effective September 10th, 2004, registrant issued 1,000,000 shares to acquire all issues and outstanding shares of Voipamericas Inc., common stock. Effective September 2004, registrant issued 38,461 shares to one accredited investor. On November 11, 2004, Registrant issued and sold 1,937,500 shares of common stock, for a purchase price of $0.80 per share, to four accredited investors in a private placement pursuant to Rule 506 of SEC Regulation D, for aggregate proceeds of $1,550,000 (net proceeds of approximately $1,400,000 to Registrant). The investors also received five-year warrants to purchase a total of 589,250 shares for an exercise price of $1.75 per share, and thirty-day warrants to purchase 968,750 shares for an exercise price of $1.20 per share. On November 17, 2004, Registrant issued and sold 312,500 shares of common stock, for a purchase price of $0.80 per share, to one additional accredited investor in a private placement pursuant to Rule 506 of SEC Regulation D, for aggregate proceeds of $250,000 (net proceeds of approximately $225,000 to Registrant). The investor also received five-year warrants to purchase a total of 75,000 shares for an exercise price of $1.75 per share, and thirty-day warrants to purchase 125,000 shares for an exercise price of $1.20 per share. Effective January 2005, registrant issued 187,500 shares of common stock for cash of $328,125. Effective January 2005, registrant issued 312,500 shares of common stock for cash of $375,000. Effective February 2005, registrant issued 812,500 shares of common stock for cash of $975,000. Effective February 2005, registrant issued 750,000 shares of common stock for exchanging warrants issued in August 2004. Effective March 2005, registrant issued 56,650 shares of common stock for services provided to the company. Effective April 2005, registrant issued 166,250 shares of common stock for cash of $125,000. Effective May 2005, registrant issued 93,750 shares of common stock for cash of $75,000. Effective June 2005, registrant issued 1,196,875 shares of common stock for cash of $949,500. Effective June 2005, registrant issued 1,440,000 shares of common stock for services provided to the company. Effective June 2005, registrant issued 16,434,470 shares of common stock for the acquisition of Caerus, Inc. and its subsidiaries. Effective June 2005, registrant issued 1,623,153 shares of common stock for a subsidiary debt conversion. On July 5, 2005, Registrant issued and sold $2,855,381 principal amount of Convertible Notes to five accredited investors, for a purchase price of $2,483,346. Effective July 2005, registrant issued 826,750 shares of common stock for cash of $576,400. Effective July 2005, registrant issued 250,326 shares of common stock for services provided to the company. Effective August 2005, registrant issued 62,500 shares of common stock for cash of $50,000. Effective August 2005, registrant issued 476,250 shares of common stock for services provided to the company. Effective August 2005, registrant issued 1,643,750 shares of common stock for cash of $1,472,500. in connection with the exercise of warrants. Effective September 2005, registrant issued 4,888,250 shares of common stock for cash of $3,910,600. Effective September 2005, registrant issued 30,500 shares of common stock for cash of $25,925 in connection with the exercise of employee stock options. Effective September 2005, registrant issued 1,501,001 shares of common stock for the conversion of 2,200,000 warrants. Effective September 2005, registrant issued 222,278 shares of common stock for services provided to the company. All such shares were issued pursuant to exemptions provided by Section 4(2) of the Securities Act of 1933 and Regulation D. Item 27. Exhibits (b) Exhibits (3) 2.1 Stock Contribution Agreement dated May 25, 2004, between Registrant and Steven Ivester (11) 2.2 Agreement and Plan of Merger with Caerus, Inc. dated as of May 31, 2005 (12) 2.3 Asset Purchase Agreement dated as of August 3, 2005, by and between VoIP, Inc. Acquisition Company and WQN, Inc. (1) 3.1.1 Articles of Incorporation (3) 3.1.2 Amendment of Articles of Incorporation (1) 3.2 Bylaws (3) 4.1 Specimen Stock Certificate 5.1 Opinion of Andrews Kurth LLP (3) 10.1 2004 Stock Option Plan (2) 10.2 Stock Purchase Agreement dated February 27, 2004 between Registrant and Steven Ivester

(4) 10.3 Stock Purchase Agreement dated June 25, 2004 among Registrant, DTNet Technologies and Marc Moore (5) 10.4 Stock Purchase Agreement among Carlos Rivas, Albert Rodriguz, Registrant and Vox Consulting Group Inc. (6) 10.5.1 Subscription Agreement (6) 10.5.2 Form of Class A Warrant (6) 10.5.3 Form of Class B Warrant (7) 10.6.1 Stock Purchase Warrant issued to Ivano Angelaftri (7) 10.6.2 Stock Purchase Warrant issued to Ebony Finance (8) 10.7 Net Exercise Agreement with John Todd (9) 10.8 Asset Purchase Agreement dated February 23, 2005 (10) 10.9.1 Subscription Agreement (10) 10.9.2 Form of Class C Warrant (10) 10.9.3 Form of Class D Warrant (10) 10.9.4 Form of Convertible Note (10) 10.9.5 Security Agreement (10) 10.9.6 Security and Pledge Agreement (10) 10.9.7 Guaranty 10.10 Caerus, Inc. Merger Documents dated May 31, 2005: (11) 10.10.1 Option Exchange Agreement (11) 10.10.2 Registration Rights Agreement (11) 10.10.3 Exchange Agreement (11) 10.10.4 Registration Rights Agreement (11) 10.10.5 Consent and Waiver Agreement (11) 10.10.6 Guaranty (11) 10.10.7 Security Agreement (11) 10.10.8 Employment Agreement 10.11 WQN, Inc. Documents dated August 3, 2005: (12) 10.11.1 Warrant (12) 10.11.2 Security Agreement between VoIP, Inc. and WQN, Inc. (12) 10.11.3 Consent, Waiver and Acknowledgement by and among Cedar Boulevard Lease Funding, Inc., VoIP, Inc. and certain subsidiaries of VoIP, Inc. (12) 10.11.4 Third Amendment to Subordinated Loan and Security Agreement by and among Cedar Boulevard Lease Funding, Inc., VoIP, Inc. and certain subsidiaries of VoIP, Inc. (12) 10.11.5 Security Agreement between Cedar Boulevard Lease Funding, Inc. and VoIP Acquisition Company (12) 10.11.6 Guaranty between Cedar Boulevard Lease Funding, Inc. and VoIP Acquisition Company Promissory Note (13) 21.1 Subsidiaries of the Registrant (13) 23.1 Consent of Tschopp, Whitcomb & Orr, P.A. (13) 23.2 Consent of Berkovits, Lago & Company, LLP (13) 23.3 Consent of Andrews Kurth LLP -- included in Exhibit 5.1 (13) 23.4 Consent from Moore Stephens Lovelace, P.A. (13) 23.5 Consent of M. Adler (13) 23.6 Consent of S. Kosh (13) 23.7 Consent of T. Reeves (1) Filed as exhibits to Registrant's Form 10SB filed January 19, 2000 (2) Filed as exhibit to Form 8-K filed March 3, 2004 (3) Filed as exhibit to Form 8-K filed June 9, 2004 (4) Filed as exhibit to Form 8-K filed July 7, 2001 (5) Filed as exhibit to Form 8-K filed September 16, 2004 (6) Filed as exhibit to form 8-K filed November 17, 2004 (7) Filed as exhibit to form 8-K filed December 15, 2004 (8) Filed as exhibit to form 8-K filed February 16, 2005 (9) Filed as exhibit to form 8-K filed March 1, 2005 (10) Filed as exhibit to form 8-K filed June 6, 2005 (11) Filed as exhibit to form 8-K filed July 11, 2005 (12) Filed as exhibit to form 8-K filed August 9, 2005 (13) Filed herewith Item 28. Undertakings The undersigned Registrant hereby undertakes as follows: (a) (1) To file, during any period in which it offers or sells securities, a post-effective amendment to this Registration Statement to: (i) Include any prospectus required by Section 10(a)(3) of the Securities Act; (ii) Reflect in the prospectus any facts or events which, individually or together, represent a fundamental change in the information set forth in the Registration Statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective Registration Statement; and (iii) Include any additional or changed material information on the plan of distribution. (2) For determining liability under the Securities Act, treat each post-effective amendment as a new registration statement of the securities offered and the offering of the securities at that time to be the initial bona fide offering. (3) File a post-effective amendment to remove from registration any of the securities being registered that remain unsold at the end of the offering. SIGNATURES In accordance with the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements of filing on Form SB-2 and authorized this registration statement to be signed on its behalf by the undersigned, in the City of Fort Lauderdale, State of Florida, on October 14, 2005. VoIP, INC. By: /s/ Steven Ivester ---------------------------------- Steven Ivester, President and Chief Executive Officer In accordance with requirements of the Securities Act of 1933, this registration statement was signed by the following persons in the capacities and on the dates stated: SIGNATURE TITLE DATE ----------------------- --------------------------------- ---------------- /s/ Steven Ivester Chairman, Chief Executive Officer, October 14, 2005 ----------------------- Director, and President Steven Ivester /s/ Osvaldo Pitters Chief Financial Officer October 14, 2005 ----------------------- Osvaldo Pitters /s/ George Firestone Director October 14, 2005 ----------------------- George Firestone