

YP CORP  
Form 10-Q  
February 20, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2006

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-24217

**YP CORP.**

(Exact Name of Registrant as Specified in Its Charter)

**Nevada**

(State or Other Jurisdiction of Incorporation or  
Organization)

**85-0206668**

(IRS Employer Identification No.)

**4840 East Jasmine St. Suite 105**

**Mesa, Arizona**

(Address of Principal Executive Offices)

**85205**

(Zip Code)

**(480) 654-9646**

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has 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 registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS**

The number of shares of the issuer's common equity outstanding as of February 1, 2007 was 50,115,094 shares of common stock, par value \$.001.



**INDEX TO FORM 10-Q FILING  
FOR THE QUARTER ENDED DECEMBER 31, 2006**

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## ITEM 1. FINANCIAL STATEMENTS

**YP CORP. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET**

|  | <b>December 31,<br/>2006<br/>(unaudited)</b> | <b>September 30,<br/>2006</b> |
|--|--|-------------------------------|
| <b>Assets</b>  |  |                               |
| Cash and equivalents   | \$ 6,563,969                                 | \$ 7,210,560                  |
| Certificates of deposit and other investments  | 2,090,752                                    | 2,266,268                     |
| Accounts receivable, net   | 6,583,348                                    | 7,991,781                     |
| Prepaid expenses and other current assets  | 352,502                                      | 259,069                       |
| Income tax receivable  | 429,050                                      | -                             |
| Deferred tax asset   | 896,041                                      | 1,781,736                     |
| <b>Total current assets</b>  | <b>16,915,662</b>                            | <b>19,509,414</b>             |
| Accounts receivable, long term portion, net  | 1,756,715                                    | 1,140,179                     |
| Property and equipment, net  | 237,753                                      | 178,883                       |
| Deposits and other assets  | 104,267                                      | 91,360                        |
| Intangible assets, net   | 5,870,346                                    | 5,722,604                     |
| Deferred tax asset, long term  | 1,431,514                                    | 1,334,787                     |
| <b>Total assets</b>  | <b>\$ 26,316,257</b>                         | <b>\$ 27,977,227</b>          |
| <b>Liabilities and Stockholders' Equity</b>  |  |                               |
| Accounts payable   | \$ 654,961                                   | \$ 773,653                    |
| Accrued liabilities  | 2,432,177                                    | 4,565,439                     |
| Income taxes payable   | -  | 261,762                       |
| <b>Total current liabilities</b>   | <b>3,087,138</b>                             | <b>5,600,854</b>              |
| Series E convertible preferred stock, \$.001 par value, 200,000 shares authorized, 127,840 issued and outstanding, liquidation preference \$38,202 | 10,866                                       | 10,866                        |
| Common stock, \$.001 par value, 100,000,000 shares authorized, 50,020,094 and 50,021,594 issued and outstanding                                    | 50,020                                       | 50,022                        |
| Treasury stock   | (2,407,158)                                  | (2,407,158)                   |
| Paid in capital  | 9,762,594                                    | 9,395,044                     |
| Retained earnings  | 15,812,797                                   | 15,327,599                    |
| <b>Total stockholders' equity</b>  | <b>23,229,119</b>                            | <b>22,376,373</b>             |
| <b>Total liabilities and stockholders' equity</b>  | <b>\$ 26,316,257</b>                         | <b>\$ 27,977,227</b>          |

See accompanying notes to consolidated financial statements.

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**YP CORP. AND SUBSIDIARIES**  
**UNAUDITED CONSOLIDATED STATEMENT OF OPERATIONS**

|  | <b>Three Months ended December 31,</b> |              |
|--|--|--------------|
|  | <b>2006</b>                            | <b>2005</b>  |
| Net revenues                                       | \$ 7,795,405                           | \$ 7,626,776 |
| Cost of services                                   | 1,498,531                              | 1,116,346    |
| Gross profit                                       | 6,296,874                              | 6,510,430    |
| <b>Operating expenses:</b>                         |  |              |
| General and administrative expenses                | 3,133,899                              | 3,758,849    |
| Sales and marketing expenses                       | 2,086,033                              | 2,750,485    |
| Depreciation and amortization                      | 336,887                                | 397,004      |
| Total operating expenses                           | 5,556,819                              | 6,906,338    |
| Operating income (loss)                            | 740,055                                | (395,908)    |
| <b>Other income (expense):</b>                     |  |              |
| Interest income                                    | 78,234                                 | 39,636       |
| Other income (expense)                             | 15,065                                 | (188,545)    |
| Total other income (expense)                       | 93,299                                 | (148,909)    |
| Income (loss) before income taxes                  | 833,354                                | (544,817)    |
| Income tax benefit (provision)                     | (348,156)                              | 217,725      |
| Net income (loss)                                  | \$ 485,198                             | \$ (327,092) |
| <b>Net income (loss) per common share:</b>         |  |              |
| Basic  | \$ 0.01                                | \$ (0.01)    |
| Diluted  | \$ 0.01                                | \$ (0.01)    |
| <b>Weighted average common shares outstanding:</b> |  |              |
| Basic  | 45,528,264                             | 44,885,425   |
| Diluted  | 46,761,202                             | 44,885,425   |

See accompanying notes to consolidated financial statements.

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**YP CORP. AND SUBSIDIARIES**  
**UNAUDITED CONSOLIDATED STATEMENT OF CASH FLOWS**

|  | <b>Three Months Ended December 31,</b> |                     |
|--|--|---------------------|
|  | <b>2006</b>                            | <b>2005</b>         |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |  |                     |
| Net income (loss)  | \$ 485,198                             | \$ (327,092)        |
| Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities: |  |                     |
| Depreciation and amortization  | 336,887                                | 397,004             |
| Amortization of deferred stock compensation  | 367,548                                | 446,474             |
| Deferred income taxes  | 788,968                                | (184,132)           |
| Provision for uncollectible accounts   | (805,065)                              | 339,446             |
| Changes in assets and liabilities:   |  |                     |
| Accounts receivable  | 1,596,962                              | (397,295)           |
| Prepaid and other current assets   | (93,433)                               | (25,548)            |
| Deposits and other assets  | (12,907)                               | (38,973)            |
| Accounts payable   | (118,692)                              | 233,836             |
| Accrued liabilities  | (2,133,262)                            | 599,951             |
| Income taxes payable   | (690,812)                              | 5,204               |
| <b>Net cash (used in) provided by operating activities</b>   | <b>(278,608)</b>                       | <b>1,048,875</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |  |                     |
| Sales of certificates of deposits and other investments  | 175,516                                | -                   |
| Purchase of certificates of deposits and other investments   | -                                      | (13,252)            |
| Expenditures for intangible assets   | (446,757)                              | (39,577)            |
| Purchases of equipment   | (96,742)                               | -                   |
| <b>Net cash used for investing activities</b>  | <b>(367,983)</b>                       | <b>(52,829)</b>     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |  |                     |
| Purchase of treasury stock   | -                                      | (90,026)            |
| <b>Net cash used for financing activities</b>  | <b>-</b>                               | <b>(90,026)</b>     |
| <b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>  | <b>(646,591)</b>                       | <b>906,020</b>      |
| <b>CASH AND CASH EQUIVALENTS, beginning of period</b>  | <b>7,210,560</b>                       | <b>6,114,311</b>    |
| <b>CASH AND CASH EQUIVALENTS, end of period</b>  | <b>\$ 6,563,969</b>                    | <b>\$ 7,020,331</b> |

See accompanying notes to consolidated financial statements

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**YP CORP. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

1. ORGANIZATION AND BASIS OF PRESENTATION

The accompanying consolidated financial statements include the accounts of YP Corp., a Nevada Corporation, and its wholly owned subsidiaries (collectively the "Company"). The Company is an Internet-based provider of yellow page directories and advertising space on or through www.YP.com, www.YP.net and www.Yellow-Page.net. No material or information contained on these websites is a part of the notes or the quarterly report to which notes are attached. All material intercompany accounts and transactions have been eliminated.

The accompanying unaudited financial statements as of December 31, 2006 and for the three months ended December 31, 2006 and 2005, respectively, have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for audited financial statements. In the opinion of the Company's management, the interim information includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. The footnote disclosures related to the interim financial information included herein are also unaudited. Such financial information should be read in conjunction with the consolidated financial statements and related notes thereto as of September 30, 2006 and for the year then ended included in the Company's annual report on Form 10-K for the year ended September 30, 2006.

All amounts, except share and per share amounts, are rounded to the nearest thousand dollars.

Due to the short term nature and market rates of interest for the certificates of deposit and other investments, the carrying costs approximate the fair value for these investments.

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Significant estimates and assumptions have been used by management in conjunction with establishing allowances for customer refunds, non-paying customers, dilution and fees, analyzing the recoverability of the carrying amount of intangible assets, estimating amortization periods for direct response advertising costs, estimating forfeitures of restricted stock and evaluating the recoverability of deferred tax assets. Actual results could differ from these estimates. Certain prior period amounts have been revised to conform to the current period presentation. These changes had no impact on previously reported net income or stockholders' equity.

2. ACCOUNTING CHANGES

Historically, the Company has capitalized customer acquisition costs and amortized them on a straight-line basis over the average expected life of the related customers based on historical IAP advertiser attrition rates and other factors.

Prior to fiscal 2006, the majority of the capitalized customer acquisition costs related to the Company's mailing campaigns. During fiscal 2006, the Company began increasing its expenditures for telemarketing campaigns. The capitalization of such costs requires that the Company amortize them over the average expected life of acquired customers on a cost-pool by cost-pool basis; however, the Company's systems were not equipped to monitor customer lives by method of acquisition. Therefore, the Company was unable to determine the average expected life of those customers acquired via telemarketing versus those acquired via mailing campaigns and cannot assess the value of the future benefits. As it could not effectively evaluate such costs on a cost-pool by cost-pool basis, the Company determined in fiscal 2006 that the preferable method of accounting for these costs was to expense them when incurred.

The Company enacted this change in accounting principle during the fourth quarter of fiscal 2006 and, in accordance with FAS 154, it has restated all periods presented to reflect this new method of accounting for such costs.

The following tables set forth the impact of such a change on the Company's previously reported financial results:

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**YP CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

**Income Statement****Quarter Ended December 31, 2005**

|                                     | As Originally<br>Reported | As Adjusted  | Effect of change |
|-------------------------------------|---------------------------|--------------|------------------|
| Sales and marketing expense         | \$ 1,534,000              | \$ 2,750,000 | \$ 1,217,000     |
| Income tax expense (benefit)        | \$ 237,000                | \$ (218,000) | \$ (455,000)     |
| Net income (loss)                   | \$ 435,000                | \$ (327,000) | \$ (762,000)     |
| Net income (loss) per common share: |                           |              |                  |
| Basic                               | \$ 0.01                   | \$ (0.01)    | \$ (0.02)        |
| Diluted                             | \$ 0.01                   | \$ (0.01)    | \$ (0.02)        |

**Statement of Cash Flows****Quarter Ended December 31, 2005**

|   | As Originally<br>Reported | As Adjusted  | Effect of change |
|---|---------------------------|--------------|------------------|
| Net income (loss)   | \$ 435,000                | \$ (327,000) | \$ (762,000)     |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                           |              |                  |
| Deferred income taxes   | \$ 270,000                | \$ (184,000) | \$ (455,000)     |
| Changes in assets and liabilities:  |                           |              |                  |
| Customer acquisition costs  | \$ (1,217,000)            | \$ -         | \$ 1,217,000     |
| Net cash provided by operating activities   | \$ 1,009,000              | \$ 1,009,000 | \$ -             |

3. **BALANCE SHEET INFORMATION**

Balance sheet information is as follows:

|                                 | <b>December 31, 2006</b> |              |               |
|---------------------------------|--------------------------|--------------|---------------|
|                                 | Current                  | Long-Term    | Total         |
| Gross accounts receivable       | \$ 8,954,000             | \$ 1,849,000 | \$ 10,803,000 |
| Allowance for doubtful accounts | (2,371,000)              | (92,000)     | (2,463,000)   |
| Net                             | \$ 6,583,000             | \$ 1,757,000 | \$ 8,340,000  |

|                                 | <b>September 30, 2006</b> |              |               |
|---------------------------------|---------------------------|--------------|---------------|
|                                 | Current                   | Long-Term    | Total         |
| Gross accounts receivable       | \$ 11,027,000             | \$ 1,374,000 | \$ 12,401,000 |
| Allowance for doubtful accounts | (3,035,000)               | (234,000)    | (3,269,000)   |
| Net                             | \$ 7,992,000              | \$ 1,140,000 | \$ 9,132,000  |

Components of allowance for doubtful accounts are as follows:

|   | <b>December 31,<br/>2006</b> | <b>September 30,<br/>2006</b> |
|---|------------------------------|-------------------------------|
| Allowance for dilution and fees on amounts due from billing aggregators | \$ 1,827,000                 | \$ 2,465,000                  |
| Allowance for customer refunds  | 636,000                      | 804,000                       |
|   | \$ 2,463,000                 | \$ 3,269,000                  |



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**YP CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

|                                | December 31,<br>2006 | September 30,<br>2006 |
|--------------------------------|----------------------|-----------------------|
| Property and equipment:        |                      |                       |
| Leasehold improvements         | \$ 448,000           | \$ 448,000            |
| Furnishings and fixtures       | 296,000              | 296,000               |
| Office and computer equipment  | 1,152,000            | 1,055,000             |
| Total                          | 1,896,000            | 1,799,000             |
| Less: Accumulated depreciation | (1,658,000)          | (1,620,000)           |
| Property and equipment, net    | \$ 238,000           | \$ 179,000            |

|                                | December 31,<br>2006 | September 30,<br>2006 |
|--------------------------------|----------------------|-----------------------|
| Intangible assets:             |                      |                       |
| Domain name                    | \$ 5,709,000         | \$ 5,709,000          |
| Non-compete agreements         | 3,465,000            | 3,465,000             |
| Website development            | 1,030,000            | 1,009,000             |
| Software licenses              | 854,000              | 428,000               |
| Total                          | 11,058,000           | 10,611,000            |
| Less: Accumulated amortization | (5,188,000)          | (4,888,000)           |
| Intangible assets, net         | \$ 5,870,000         | \$ 5,723,000          |

|  | December 31,<br>2006 | September 30,<br>2006 |
|--|----------------------|-----------------------|
| Accrued liabilities:                           |                      |                       |
| Litigation accrual, including customer refunds | 1,400,000            | 3,737,000             |
| Deferred revenue                               | 153,000              | 188,000               |
| Accrued expenses - other                       | 879,000              | 640,000               |
| Accrued liabilities                            | \$ 2,432,000         | \$ 4,565,000          |

4. **COMMITMENTS AND CONTINGENCIES**

At December 31, 2006, future minimum annual lease payments under operating lease agreements for fiscal years ended September 30 are as follows:

|             |            |
|-------------|------------|
| Fiscal 2007 | \$ 219,000 |
| Fiscal 2008 | 160,000    |
| Fiscal 2009 | 117,000    |
| Fiscal 2010 | 117,000    |
| Fiscal 2011 | 88,000     |
| Thereafter  | -          |
|             | \$ 701,000 |

Litigation

The Company is party to certain legal proceedings incidental to the conduct of its business. Management believes that the outcome of pending legal proceedings will not, either individually or in the aggregate, have a material adverse effect on its business, financial position, results of operations, cash flows or liquidity.

In the past, the Company has received numerous inquiries from the Attorney General offices of several states investigating its promotional activities, specifically, the use of its check mailer for customer activation. On December

14, 2006, the Company voluntarily entered into a settlement with thirty-four states' attorneys general to address their inquiries and bring finality to the process. The Company voluntarily agreed to the following:

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**YP CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

- The Company paid a settlement fee of \$2,000,000 to the state consortium, which they may distribute among themselves;
- The Company discontinued the use of activation checks as a promotional incentive;
- The Company suspended billing of any active customer that was acquired in connection with the use of an activation check until a letter was mailed notifying the customer of their legal rights to cancel the service and providing them a 60-day opportunity to receive a refund equivalent to the customer's last two payments; and
- The Company will not employ any collection efforts with respect to past-due accounts of customers that were secured through the use of an activation check, nor will it represent its ability to do so.

The Company recorded a charge of \$3,525,000 in other income and expense in the fourth quarter of fiscal 2006, consisting of a settlement accrual of \$2,000,000, a reserve for refunds to existing customers covered by the 60 day opportunity mentioned above and other related costs of \$1,250,000 and legal fees of \$275,000. Management has analyzed the number of customers eligible and applied probabilities to estimate the additional \$1,250,000 in refunds and costs. Customers have through February 2007 to apply for these refunds. Actual refunds may differ from these estimates.

Through December 31, 2006, the Company paid the settlement fee of \$2,000,000 but had not paid any refunds to existing customers. Such refunds will be distributed during the second quarter of fiscal 2007.

Other Contractual Commitments

During the second quarter of fiscal 2006, the Company entered into a contractual arrangement with an attorney to settle previous claims and to engage the future services of this attorney. Under the terms of the agreement, the Company is obligated to make future payments over the next two years totaling \$189,000 in exchange for future services. Such amounts have not been accrued in the accompanying financial statements as such payments are for future services.

During the third quarter of fiscal 2006, the Company entered into a contractual arrangement with a consulting firm to provide strategic and operational related consulting services. Under the terms of the agreement, the Company is obligated to make future payments through February 2010 that vary based on the Company's billed customer count, subject to a minimum of \$20,000 per month. Current payments are approximately \$90,000 per month. Such amounts have not been accrued in the accompanying financial statements as such payments are for future services.

5. **NET INCOME PER SHARE**

Net income per share is calculated using the weighted average number of shares of common stock outstanding during the year. Preferred stock dividends are subtracted from net income to determine the amount available to common stockholders.

The following table presents the computation of basic and diluted income per share:

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**YP CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

|   | <b>Three Months Ended December 31,</b> |              |
|---|--|--------------|
|   | <b>2006</b>                            | <b>2005</b>  |
| Income (loss) before cumulative effect of accounting change | \$ 485,000                             | \$ (327,000) |
| Less: preferred stock dividends                             | -                                      | -            |
| Income (loss) applicable to common stock                    | \$ 485,000                             | \$ (327,000) |
| Cumulative effect of accounting change                      | -                                      | -            |
| Net income applicable to common stock                       | \$ 485,000                             | \$ (327,000) |
| Basic weighted average common shares outstanding            | 45,528,264                             | 44,885,425   |
| Add incremental shares for:                                 |  |              |
| Unvested restricted stock                                   | 1,170,980                              | -            |
| Series E convertible preferred stock                        | 61,957                                 | -            |
| Outstanding warrants  | -                                      | -            |
| Diluted weighted average common shares outstanding          | 46,761,202                             | 44,885,425   |
| Net income per share:                                       |  |              |
| Basic   | \$ 0.01                                | \$ (0.01)    |
| Diluted   | \$ 0.01                                | \$ (0.01)    |

The following potentially dilutive securities were excluded from the calculation of net income per share because the effects are antidilutive:

|   | <b>Three Months Ended December 31,</b> |             |
|---|--|-------------|
|   | <b>2006</b>                            | <b>2005</b> |
| Warrants to purchase shares of common stock | -                                      | 500,000     |
| Unvested restricted stock                   | -                                      | 223,918     |
| Series E convertible preferred stock        | -                                      | 33,663      |
| Shares of non-vested restricted stock       | 905,200                                | 2,837,364   |
|   | 905,200                                | 3,594,945   |

6. **CONCENTRATION OF CREDIT RISK**

The Company maintains cash balances at major nationwide institutions in Arizona and Nevada. Accounts are insured by the Federal Deposit Insurance Corporation up to \$100,000. At December 31, 2006, the Company had bank balances exceeding those insured limits by approximately \$8,134,000.

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily trade accounts receivable. The trade accounts receivable are due primarily from business customers over widespread geographical locations within the Local Exchange Carrier ("LEC") billing areas across the United States. The Company historically has experienced significant dilution and customer credits due to billing difficulties and uncollectible trade accounts receivable. The Company estimates and provides an allowance for uncollectible accounts receivable. The handling and processing of cash receipts pertaining to trade accounts receivable is maintained primarily by four third-party billing companies. The net receivable due from three of these billing service providers represented 30%, 28% and

26%, respectively, of the Company's total net accounts receivable (excluding non-specific reserves) at December 31, 2006.

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**YP CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

7. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the FASB issued FASB Interpretation No. 48 “Accounting For Uncertain Tax Positions” (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109 “Accounting for Income Taxes”. It prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of FIN 48 to its financial position and results of operations.

8. SUBSEQUENT EVENTS

In January, the Company paid bonuses of \$150,000 and \$5,000 to its Chief Executive Officer and Chief Operating Officer, respectively. The Company also transferred title to a vehicle with a net book value of \$91,905 from the Company to the Chief Executive Officer as an additional bonus. Except for the cash bonus paid to the Company’s Chief Executive Officer, such amounts were not accrued as of December 31, 2006.

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

For a description of our significant accounting policies and an understanding of the significant factors that influenced our performance during the three months ended December 31, 2006, this "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" (hereafter referred to as "MD&A") should be read in conjunction with the Consolidated Financial Statements, including the related notes, appearing in Item 1 of this Quarterly Report, as well as our Annual Report on Form 10-K for the year ended September 30, 2006.

**Forward-Looking Statements**

This portion of this Annual Report on Form 10-Q, includes statements that constitute "forward-looking statements." These forward-looking statements are often characterized by the terms "may," "believes," "projects," "expects," or "anticipates" and do not reflect historical facts. Specific forward-looking statements contained in this portion of the Annual Report include, but are not limited to our (i) our expectation that the settlement with the attorneys general will limit our exposure to significant legal fees and costs that may otherwise have been incurred; (ii) our expectation of expanding our telemarketing campaigns in the future and that such campaigns will be our primary source of sales and marketing expenditures; and (iii) the belief that our existing cash on hand will provide us with sufficient liquidity to meet our operating needs for the next twelve months.

Forward-looking statements involve risks, uncertainties and other factors, which may cause our actual results, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. Factors and risks that could affect our results and achievements and cause them to materially differ from those contained in the forward-looking statements include those identified in our Annual Report on Form 10-K for the fiscal year ended September 30, 2006 under Item 1A "Risk Factors", as well as other factors that we are currently unable to identify or quantify, but that may exist in the future.

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

**Executive Overview**

This section presents a discussion of recent developments and summary information regarding our industry and operating trends only. For further information regarding the events summarized herein, you should read this MD&A in its entirety.

*Recent Developments and Outlook*

During fiscal 2006, we received numerous inquiries from the Attorney General offices of several states investigating our promotional activities, specifically, the use of our check mailer for customer activation. On December 14, 2006, we voluntarily entered into a settlement with thirty-four states' attorneys general to address their inquiries and bring finality to the process. We have voluntarily agreed to the following:

- We paid a settlement fee of \$2,000,000 in December 2006 to the state consortium, which they may distribute among themselves;
- We discontinued the use of activation checks as a promotional incentive;
- We suspended billing of any active customer that was acquired in connection with the use of an activation check until a letter was mailed notifying the customer of their legal rights to cancel the service and providing them a

60-day opportunity to receive a refund equivalent to the customer's last two payments; and

· We will not employ any collection efforts with respect to past-due accounts of customers that were secured through the use of an activation check, nor will we represent our ability to do so.

To date, we have received refund requests totaling approximately \$900,000. No refunds were paid until after December 31, 2006.

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The success of our business model is based on our ability to retain, add and efficiently bill our subscribers.

The following represent our counts for billed listings over the last six quarters:

| <b>Quarter Ended</b> | <b>Average Billed Listings During Quarter</b> | <b>Gross Revenue</b> | <b>Returns &amp; Allowances (% of Gross Revenue)</b> | <b>Net Revenues</b> | <b>Average Monthly Gross Revenue per Average Billed Listing</b> |
|----------------------|---|----------------------|--|---------------------|---|
| December 31st, 2006  | 99,758  | \$ 8,489,609         | 6.88%  | \$ 7,905,405        | \$ 28.37  |
| September 30th, 2006 | 130,627                                       | \$ 10,672,074        | 5.52%  | \$ 10,082,487       | \$ 27.23  |
| June 30th, 2006      | 134,264                                       | 10,869,020           | 6.41%  | 10,172,705          | \$ 26.98  |
| March 31st, 2006     | 116,622                                       | 9,823,664            | 8.39%  | 8,999,196           | \$ 28.08  |
| December 31st, 2005  | 90,809  | 8,328,583            | 8.43%  | 7,626,776           | \$ 30.57  |
| September 30th, 2005 | 81,342  | 6,856,082            | 11.71%   | 6,052,936           | \$ 28.10  |

Due to the terms of the attorneys' general settlement, we experienced a decline in our average customer count during the first quarter of fiscal 2007.

*Recent Operating Results*

We bill our customers through four primary channels: LEC billing, ACH billing, recurring credit card and direct invoice. During the end of 2004 and throughout 2005, we had been reducing our use of LEC billing channels as the LEC's policies regarding the use of our check mailer as our primary letter of authorization prevented us from billing many existing customers through this particular billing channel. Additionally, the major LECs (i.e. Regional Bell Operating Companies or RBOCs) prevented us from billing any new customers acquired via check mailers. As such, we transitioned a significant number of our customers to alternate billing means, the most significant of which was ACH billing. ACH billing is less expensive than LEC billing; however, many of our customers view this as a less desirable billing method, leading to increased cancellations.

In fiscal 2006, we began acquiring new customers via telemarketing campaigns, which are allowed to be billed via LECs. These telemarketing campaigns have reopened certain LEC billing channels as a viable billing channel. Additionally, our monthly billing rates are higher for customers acquired via telemarketing campaigns. For these reasons, as well as the cessation of the use of our activation checks, we expect to continue to expand our telemarketing campaigns in the future.

The following represents a summary of recent financial results:

|                    | <b>Q1 2007</b> | <b>Q4 2006</b> | <b>Q3 2006</b> | <b>Q2 2006</b> | <b>Q1 2006</b> |
|--------------------|----------------|----------------|----------------|----------------|----------------|
| Net Revenues       | \$ 7,795,405   | \$ 10,082,487  | \$ 10,172,705  | \$ 8,999,196   | \$ 7,626,776   |
| Gross margin       | 6,296,874      | 7,047,642      | 7,843,120      | 7,410,732      | 6,510,430      |
| Operating expenses | 5,556,819      | 5,878,319      | 6,613,886      | 7,288,932      | 6,906,338      |

|                   |         |             |           |         |           |
|-------------------|---------|-------------|-----------|---------|-----------|
| Operating income  |         |             |           |         |           |
| (loss)            | 740,055 | 1,169,322   | 1,229,234 | 121,800 | (395,908) |
| Net income (loss) | 485,198 | (1,680,673) | 826,847   | 129,998 | (327,092) |

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(1) The following non-recurring items are relevant to our recent quarterly operating results, each of which are further described herein:

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- First quarter of fiscal 2007 - includes approximately \$1,000,000 of direct response advertising costs incurred in October 2006 for which we derived no substantial benefit based on the attorneys' general settlement that was agreed to in December 2006.
- Fourth quarter of fiscal 2006 - includes the following charges associated with the voluntary agreement with various regulatory agencies surrounding the use of activation checks (described in Recent Developments and Outlook above):
  - o \$2,000,000 payment to cover regulatory and related expenses
  - o \$1,250,000 of accrued refunds and processing fees for existing customers that wish to cancel their service in response to the correspondence to be sent per the terms of the agreement
    - o \$275,000 of legal and professional fees
- Third quarter of fiscal 2006 - no significant non-recurring expenses were incurred.
- Second quarter of fiscal 2006 - includes an increase of general and administrative expenses of approximately \$80,000 related to separation costs with our former Chief Financial Officer and \$39,000 related to separation costs with other employees.
- First quarter of fiscal 2006 - includes an increase of general and administrative expenses totaling approximately \$338,000 related to separation costs with our former Chief Executive Officer and an increase in other expenses associated with an additional expense of \$162,000 relating to an outstanding legal matter.

The following represents the breakdown of net billings by channel during recent fiscal quarters:

|                | Q1 2007 | Q4 2006 | Q3 2006 | Q2 2006 | Q1 2006 |
|----------------|---------|---------|---------|---------|---------|
| LEC billing    | 59%     | 63%     | 62%     | 49%     | 35%     |
| ACH billing    | 37%     | 33%     | 33%     | 43%     | 54%     |
| Direct billing | 4%      | 4%      | 5%      | 8%      | 11%     |

**Results of Operations***Net Revenues*

|                    | Net Revenues |              |            |         |
|--------------------|--------------|--------------|------------|---------|
|                    | 2006         | 2005         | Change     | Percent |
| Three Months Ended |              |              |            |         |
| December 31,       | \$ 7,795,405 | \$ 7,626,776 | \$ 168,629 | 2%      |

The increase in revenues for the quarter ended December 31, 2006, as compared to the quarter ended December 31, 2005, was largely due to an increased customer count attributable to expanded marketing efforts, the reintroduction of the LEC billing channel for new customers, and new fulfillment contracts that occurred during the first three quarters of fiscal 2006, offset by a decline in billed customers associated with the attorneys general settlement that occurred in the fourth quarter of fiscal 2006.



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Although we have concentrations of risk with our billing aggregators (see Note 6 of our Consolidated Unaudited Financial Statements) these aggregators bill via many underlying LECs, thereby reducing our risk associated with credit concentrations. However, there are a few LECs that service a significant number of our customers. To the extent that future changes in their billing practices cause a disruption in our ability to bill through these channels, our revenues could be adversely affected.

The majority of our IAP customers pay between \$27.50 and \$39.95 per month.

*Cost of Services*

|                                    | <b>Cost of Services</b> |              |               |                |
|------------------------------------|-------------------------|--------------|---------------|----------------|
|                                    | <b>2006</b>             | <b>2005</b>  | <b>Change</b> | <b>Percent</b> |
| Three Months Ended<br>December 31, | \$ 1,498,531            | \$ 1,116,346 | \$ 382,185    | 34%            |

The increase in cost of services for the quarter ended December 31, 2006 as compared to the quarter ended December 31, 2005, is largely due to our increasing usage of LEC channels. We have increased our percentage of customers billed through LEC channels to 58% of net billings in the quarter ended December 31, 2006 as compared to 35% in the quarter ended December 31, 2005.

*Gross Profit*

|                                    | <b>Gross Profit</b> |              |               |                |
|------------------------------------|---------------------|--------------|---------------|----------------|
|                                    | <b>2006</b>         | <b>2005</b>  | <b>Change</b> | <b>Percent</b> |
| Three Months Ended<br>December 31, | \$ 6,296,874        | \$ 6,510,430 | \$ (213,556)  | (3)%           |

The decrease in our gross profits was due primarily to an increase in cost of sales fueled by our increased usage of LEC billing channels, offset by increased revenues, each of which is described above.

*General and Administrative Expenses*

|                                    | <b>General and Administrative Expenses</b> |              |               |                |
|------------------------------------|--|--------------|---------------|----------------|
|                                    | <b>2006</b>                                | <b>2005</b>  | <b>Change</b> | <b>Percent</b> |
| Three Months Ended<br>December 31, | \$ 3,133,899                               | \$ 3,758,849 | \$ (624,950)  | (17)%          |

General and administrative expenses decreased for the quarter ended December 31, 2006 compared to the quarter ended December 31, 2005. This decrease in general and administrative expenses is largely due to the following:

- A decrease in compensation expense of \$574,000 stemming from: a) a non-recurring charge of \$337,500 in the quarter ended December 31, 2005 associated with the termination of our former Chief Executive Officer and b) general headcount reductions in our customer service workforce.
- An increase in consulting and professional fees of approximately \$262,000 associated with operational and strategic consulting and director and officer turnover (temporary and placement services).

- A decrease in mailing and other customer costs of approximately \$468,000 associated with discontinued mailing programs that occurred in the quarter ended December 31, 2005 associated with reconfirmation projects as well as paper invoices and other methods of correspondence with customers for which payment is unlikely to be received.
  - An increase in rent and office related expenses associated with the expansion of our telemarketing efforts.
- Additional expenses of \$39,000 primarily attributable to travel and related costs associated with the attorneys' general settlement.



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Our general and administrative expenses consist largely of fixed expenses such as compensation, rent, utilities, etc. Therefore, we do not consider short-term trends of general and administrative expenses as a percent of revenues to be meaningful indicators for evaluating operational performance.

The following table sets forth our recent operating performance for general and administrative expenses:

|  | Q1 2007      | Q4 2006      | Q3 2006      | Q2 2006      | Q1 2006      |
|--|--------------|--------------|--------------|--------------|--------------|
| Compensation for employees, leased employees, officers and directors | \$ 1,873,582 | \$ 2,073,646 | \$ 1,908,099 | \$ 2,475,244 | \$ 2,476,713 |
| Professional fees  | 678,089      | 697,784      | 649,706      | 479,696      | 416,088      |
| Reconfirmation, mailing, billing and other customer-related costs    | 23,715       | 39,180       | 245,597      | 396,883      | 491,947      |
| Other general and administrative costs                               | 558,513      | 389,093      | 326,405      | 360,276      | 374,099      |

*Sales and Marketing Expenses*

|                                 | 2006         | 2005         | Change       | Percent |
|---------------------------------|--------------|--------------|--------------|---------|
| Three Months Ended December 31, | \$ 2,086,033 | \$ 2,750,485 | \$ (664,452) | (24)%   |

As discussed in Note 2 of our Consolidated Unaudited Financial Statements, we enacted a change in accounting principle in the fourth quarter of fiscal 2006 to expense such costs when they are incurred and have retroactively restated all period presented to reflect such a change.

Sales and marketing expense decreased in the quarter ended December 31, 2006 as compared to the quarter ended December 31, 2005 primarily due to the cessation of activation checks in November 2006. As previously discussed, in connection with the attorneys general settlement, we have ceased utilizing activation checks. However, we did incur approximately \$1,000,000 of expenses associated with check mailers for which we derived no substantial benefit based on the attorneys general settlement described above. We expect telemarketing campaigns to be our primary source of sales and marketing expenditures in fiscal 2007.

*Depreciation and Amortization*

|                                 | 2006       | 2005       | Change      | Percent |
|---------------------------------|------------|------------|-------------|---------|
| Three Months Ended December 31, | \$ 336,887 | \$ 397,004 | \$ (60,117) | (15)%   |

Depreciation and amortization decreased for the quarter ended December 31, 2006 as compared to the quarter ended December 31, 2005 as a substantial amount of our fixed assets are now fully depreciated.

*Operating Income*

|                         | 2006 | 2005 | Change | Percent |
|-------------------------|------|------|--------|---------|
| Operating Income (Loss) |      |      |        |         |

|                                    |    |         |    |           |    |           |        |
|------------------------------------|----|---------|----|-----------|----|-----------|--------|
| Three Months Ended<br>December 31, | \$ | 740,055 | \$ | (395,908) | \$ | 1,135,963 | (287)% |
|------------------------------------|----|---------|----|-----------|----|-----------|--------|

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Our operating income increased substantially due primarily to an approximate \$214,000 decrease in gross profit, a reduction of approximately \$595,000 of sales and marketing expenses, and a reduction of approximately \$625,000 of general and administrative expenses, each of which is described above.

*Other Income (Expense)*

|                                    | <b>Other Income (Expense)</b> |              |               |                |
|------------------------------------|-------------------------------|--------------|---------------|----------------|
|                                    | <b>2006</b>                   | <b>2005</b>  | <b>Change</b> | <b>Percent</b> |
| Three Months Ended<br>December 31, | \$ 15,065                     | \$ (188,545) | \$ 203,610    | (108)%         |

Other income (expense) increased in the quarter ended December 31, 2006 compared to the quarter ended December 31, 2005. During the quarter ended December 31, 2006, this income consisted primarily of interest on cash and short term investments. During the quarter ended December 31, 2005, this also contained a charge of \$172,000 associated with a litigation settlement with a former vendor.

*Income Tax Benefit (Provision)*

|                                    | <b>Income Tax Benefit (Provision)</b> |             |               |                |
|------------------------------------|---------------------------------------|-------------|---------------|----------------|
|                                    | <b>2006</b>                           | <b>2005</b> | <b>Change</b> | <b>Percent</b> |
| Three Months Ended<br>December 31, | \$ (348,156)                          | \$ 217,725  | \$ (565,881)  | (260)%         |

The changes in our income tax benefit (provision) for the three months ended December 31, 2006 as compared to the three months ended December 31, 2005 is due almost entirely to our increase in profitability. We have not experienced a significant change in our effective tax rates during these periods.

*Net Income (Loss)*

|                                    | <b>Net Income (Loss)</b> |              |               |                |
|------------------------------------|--------------------------|--------------|---------------|----------------|
|                                    | <b>2006</b>              | <b>2005</b>  | <b>Change</b> | <b>Percent</b> |
| Three Months Ended<br>December 31, | \$ 485,198               | \$ (327,092) | \$ 812,290    | (248)%         |

The increase in net income for the three months ended December 31, 2006 as compared to the three months ended December 31, 2005 is due to reduced general and administrative and sales and marketing expenses, and increased other income, offset by decreased gross profit and increased income tax expense, each of which is described above.

**Liquidity and Capital Resources**

Net cash provided by (used in) operating activities decreased \$1,327,483 or 127%, to (\$278,608) for the first three months of fiscal 2007, compared to \$1,048,875 for the first three months of fiscal 2006. This was due primarily to the payment of our \$2,000,000 settlement fee with the attorneys' general and other miscellaneous changes in operating cash flows, offset by increased net income of \$812,000.

Our primary source of cash inflows is net remittances from our billing channels, including LEC billings and ACH billings. For LEC billings, we receive collections on accounts receivable through the billing service aggregators under contracts to administer this billing and collection process. The billing service aggregators generally do not remit funds until they are collected. Generally, cash is collected and remitted to us (net of dilution and other fees and expenses) over a 60- to 120-day period subsequent to the billing dates. Additionally, for each monthly billing cycle, the billing aggregators and LECs withhold certain amounts, or “holdback reserves,” to cover potential future dilution and bad debt expense. These holdback reserves lengthen our cash conversion cycle as they are remitted to us over a 12- to 18-month period of time. We classify these holdback reserves as current or long-term receivables on our balance sheet, depending on when they are scheduled to be remitted to us. For ACH billings, we generally receive the net proceeds through our billing service processors within 15 days of submission. Additionally, the net receivable due from three of our billing services providers represented 30%, 26% and 26%, respectively, of our total net accounts receivable (excluding non-specific reserves) at December 31, 2006.

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Our most significant cash outflows include payments for marketing expenses and general operating expenses. Marketing costs have historically included direct response mailing costs and telemarketing costs, but we no longer expect to incur significant mailing costs in the future due to the attorneys' general settlement. General operating cash outflows consist of payroll costs, professional fees income taxes, and general and administrative expenses that typically occur within close proximity of expense recognition.

Cash used for investing activities was \$367,983 for the quarter ended December 31, 2006 consisting of \$446,757 of expenditures for intangible assets for website development costs, online customer service and customer relationship management software and \$96,742 of equipment purchases, offset by reductions in certificates of deposits and other investments of \$175,516. During the quarter ended December 31, 2005, cash used for investing was \$52,829, consisting of \$39,577 of website development costs and \$13,252 of purchases of certificates of deposits and other investments.

There were no financing cash flows for the quarter ended December 31, 2006. For the quarter ended December 31, 2005, cash flows used in financing activities consisted of \$90,026 of acquisitions of our common stock through our stock repurchase program.

We had working capital of \$13,828,524 as of December 31, 2006, compared to \$13,908,560 as of September 30, 2006.

Until April 1, 2005, we were contractually obligated to pay a \$0.01 per share dividend each quarter, subject to compliance with applicable laws, to all common stockholders, including those who hold unvested restricted stock. We are no longer required to pay quarterly dividends. Future dividend payments will be evaluated by the Board of Directors based upon earnings, capital requirements and financial position, general economic conditions, alternative uses of capital and other pertinent factors.

During fiscal 2006, we entered into a contractual arrangement with an attorney to settle previous claims and to engage the future services of this attorney. We are obligated to make future payments over the next two years totaling \$189,000 in exchange for future services. Such amounts have not been accrued in the accompanying financial statements as such payments are for future services.

During fiscal 2006, we entered into a contractual arrangement with a consulting firm to provide strategic and operational related consulting services. Under the terms of the agreement, we are obligated to make future payments through February 2010 that vary based on the Company's billed customer count subject to a minimum of \$20,000 per month. Current payments are approximately \$90,000 per month. Such amounts have not been accrued in the accompanying financial statements as such payments are for future services.

The following table summarizes our contractual obligations at December 31, 2006 and the effect such obligations are expected to have on our future liquidity and cash flows:

|                                 | Total     | Payments Due by Fiscal Year |         |         |         | Thereafter |
|---------------------------------|-----------|-----------------------------|---------|---------|---------|------------|
|                                 |           | 2007                        | 2008    | 2009    | 2010    |            |
| Operating lease commitments     | 701,000   | 219,000                     | 160,000 | 117,000 | 117,000 | -          |
| Noncancelable service contracts | 789,000   | 322,000                     | 287,000 | 180,000 | -       | -          |
|                                 | 1,490,000 | 541,000                     | 447,000 | 297,000 | 117,000 | -          |

We believe that our existing cash on hand and cash flow from operations will provide us with sufficient liquidity to meet our operating needs for the next twelve months.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of December 31, 2006, we did not participate in any market risk-sensitive commodity instruments for which fair value disclosure would be required under Statement of Financial Accounting Standards No. 107. We believe that we are not subject in any material way to other forms of market risk, such as foreign currency exchange risk or foreign customer purchases (of which there were none in the periods set forth in this report) or commodity price risk.

ITEM 4. CONTROLS AND PROCEDURES

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

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

Based on their review and evaluation as of the end of the period covered by this Form 10-Q, and subject to the inherent limitations all as described above, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective as of the end of the period covered by this report. They are not aware of any significant changes in our disclosure controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses. During the period covered by this Form 10-Q, there have not been any changes in our internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II - OTHER INFORMATION**

ITEM 1. LEGAL PROCEEDINGS

See Note 4 of the Company's Notes to Consolidated Unaudited Financial Statements

ITEM 6. EXHIBITS

The following exhibits are either attached hereto or incorporated herein by reference as indicated:

Exhibit

Number

Description

|           |   |
|-----------|---|
| 3.1       | Amended and Restated Articles of Incorporation of YP Corp. (incorporated by reference to the Company's Annual Report on Form 10-K, filed December 29, 2006) |
| 3.2       | Amended and Restated Bylaws (incorporated by reference to the Company's Annual Report on Form 10-K, filed December 29, 2006)                                |
| <u>31</u> | Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| <u>32</u> | Certifications pursuant to 18 U.S.C. Section 1350   |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

YP.CORP.

Dated: February 20 , 2007

*/s/ Gary L. Perschbacher*  
Gary L. Perschbacher  
Chief Financial Officer

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