

METRO ONE TELECOMMUNICATIONS INC
Form 10-K
April 01, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ý **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE**
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2001

or

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE**
SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 0-27024

METRO ONE TELECOMMUNICATIONS, INC.

(Exact name of registrant as specified in its charter)

Oregon

(State or other jurisdiction of incorporation or
organization)

93-0995165

(I.R.S. Employer Identification No.)

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11200 Murray Scholls Place, Beaverton, OR 97007
(Address of principal executive offices)

Registrant's telephone number, including area code: **503-643-9500**

Securities registered pursuant to Section 12(b) of the Act:
NONE

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, No Par Value
(Title of Class)

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of registrant's common stock held by non-affiliates, based on the closing price of the common stock as reported by the Nasdaq stock market on March 21, 2002, was \$648,762,865.

The number of shares outstanding of the registrant's common stock, as of March 21, 2002, was 24,509,364.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for its 2002 Annual Meeting, to be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year end, are incorporated by reference into Part III of this Report.

METRO ONE TELECOMMUNICATIONS, INC.

2001 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS.

Metro One is a leading developer and provider of Enhanced Directory Assistance® and information services for the telecommunications industry. We primarily contract with wireless carriers to provide our services to their subscribers. In 1989, we opened our first call center and began testing and offering our enhanced directory assistance and information services. In 1991, we entered into our first contract with a wireless carrier to provide our services to that carrier's subscribers on a charge per call basis. Our customers include many of the leading wireless telecommunications carriers such as Sprint PCS, AT&T Wireless Services, Nextel Communications, Cingular Wireless and ALLTEL Communications. In addition, we have expanded into the landline telecommunications market and provide our services to regional competitive local exchange carriers.

Telecommunications Industry

The U.S. telecommunications industry is generally characterized by strong growth and increased competition due to new technologies, a more favorable regulatory environment and, for carriers, an increasingly sophisticated and demanding subscriber. Telecommunications carriers face increasing competitive pressures to differentiate their products and establish brand loyalty. With rising costs to acquire new subscribers, carriers are seeking ways to minimize subscriber turnover through the use of, among other things, value-added services and features. In addition, carriers are increasingly offering local, long distance, wireless, cable and Internet services bundled into one package in order to appeal to a wider market. Competitive pressures are particularly acute for wireless and newer landline carriers, such as competitive local exchange carriers. The industry has also experienced a considerable amount of consolidation and investment in new technologies and alternative methods of delivery, including cable and the Internet.

Wireless Telecommunications. The U.S. wireless telecommunications market has experienced dramatic growth over the last decade. This growth has been largely due to technological advances that give callers affordable, high-quality mobile services. According to industry analysts, the number of wireless subscribers in the United States approached 130 million at the end of 2001, and experts estimate that by 2005, there will be over 200 million wireless phone users in the United States. A relatively small number of carriers dominate the wireless telecommunications market. In terms of estimated number of subscribers, the largest U.S. wireless carriers include AT&T Wireless Services, Cingular Wireless and Verizon Wireless. Other nationwide carriers include Sprint PCS, VoiceStream and Nextel Communications.

In most of the major U.S. markets, at least five carriers compete for wireless subscribers. As a result, carriers are seeking to differentiate themselves from their competitors. While price continues to be an important competitive factor, carriers increasingly focus on value-added services and features as a means of differentiating themselves.

Landline Telecommunications. The U.S. landline telecommunications market is significantly larger than the U.S. wireless market. For example, in 1999, domestic landline services generated approximately \$221 billion in revenues as compared to approximately \$48 billion in revenues

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generated by wireless services, according to the Federal Communications Commission. Like the wireless market, the landline market is dominated by a relatively small number of major carriers. Carriers providing local service include the regional Bell operating companies, such as SBC Communications, independent telephone companies, such as ALLTEL Communications, and competitive local exchange carriers, such as Time Warner and Integra Telecom. Carriers providing long distance service include AT&T, MCI WorldCom and Sprint Corp.

Local and long distance carriers competing in each other's markets, as well as against newer and smaller independent carriers, have added to competition in the landline market. With deregulation, the entry of new landline competitors and the increasing affordability of wireless services, subscribers who were historically bound to local carriers as a matter of geography are now increasingly able to choose their carriers. This includes the opportunity to select a competitive local exchange carrier. These companies compete with incumbent local carriers to provide a variety of services, including local, long distance and Internet and other data services. As a result, the landline telecommunications market is rapidly becoming subscriber-based and carriers must find ways to differentiate their services to attract and retain subscribers. In addition, to maintain operational focus, competitive local exchange carriers often outsource non-core operations, including directory assistance services. While many incumbent carriers provide directory assistance services on an outsourced basis, the competitive local exchange carriers may prefer to outsource their directory assistance needs to independent companies rather than use the services of their competitors.

International Telecommunications. The international telecommunications market is characterized by increasing privatization, competition and, in the wireless market, rapid growth. As governments privatize their national telecommunications companies, these companies face increased competition from large international carriers who have access to and interest in the newly opened markets.

Directory Assistance Market

Revenues generated by the wireless directory assistance market in the United States are estimated to grow significantly through 2003, according to various industry sources, and among which individual estimates vary widely. Wireless subscribers tend to be heavy users of directory assistance services. According to Frost & Sullivan, growth in the wireless directory assistance market is driven by a number of factors, including growth in the wireless subscriber base, rising wireless penetration, increasing subscriber mobility and the offering of enhanced directory assistance services by wireless carriers.

The landline directory assistance market is significantly larger than the wireless directory assistance market. Revenue generated by the landline directory assistance market is estimated to grow to \$4.3 billion in 2003, according to Frost & Sullivan. Growth in the landline directory services market is driven by a number of factors, including the growing information needs of subscribers and the offering by landline carriers of call completion services.

Our Business Strategy

Metro One's business strategy includes the following key elements:

Build on our current carrier relationships, while seeking new domestic and international customers, including landline carriers and other corporate customers

We are continuing to expand our relationships with our existing carrier customers. We believe that our services can increase carriers' revenues by minimizing subscriber turnover, increasing the number of calls made and, in the case of wireless and long distance carriers, increasing billable airtime. Further, our national call center network, integrated search engines and database systems allow carriers operating in multiple markets to offer consistent enhanced directory assistance and other information services on a nationwide basis. This consistency permits greater system-wide marketing opportunities and brand identification for these carriers. We believe that our existing relationships and the quality of our services will allow us to expand our business with our existing customers, providing us an opportunity to deliver our services to them and their affiliates in additional markets, including international markets.

We are also aggressively pursuing business opportunities with additional wireless and landline carriers with a view to leveraging our reputation for high quality service and our nationwide call center network. We believe increasing competition among landline carriers is leading to an increasingly subscriber-based business, which will result in the need to differentiate their product offerings. Our services provide an opportunity to do so and, accordingly, could help us expand into the significantly larger landline directory assistance market.

The information content that resides in our database systems, along with our ability to store, maintain, manipulate and deliver it, provides an opportunity to pursue other business customers and provide them with our services over private networks or otherwise.

Develop and offer additional value-added services and features

We believe we are well positioned to continue developing and providing the types of services and features that enhance the utility of the telephone and other communications devices. For example, our MetroDex® service is designed to provide individual callers and corporate users with the ability to quickly and efficiently access their personal or corporate contact databases, including otherwise unpublished numbers, and potentially take advantage of additional services such as accessing a personal assistant over the telephone. Such innovative features will permit our customers to distinguish themselves further from their competitors and increase their subscriber satisfaction.

Expand our national call center network and its capabilities, while adding greater bandwidth, storage capacity, speed and efficiency to our systems

We intend to continue to expand our network capacity and efficiency, including adding to our call routing flexibility, redundancy and signaling systems. We may also build additional call centers as required by demand and customer commitments. In addition, we intend to add to our storage capacity both for purposes of database backup and for delivery of personal database, concierge and other personalized and fulfillment-oriented services. We may build or license specialty call centers to deliver special products such as customer service and fulfillment assistance, as well as international call centers, should attractive opportunities arise.

Enhance the quantity and quality of our current content databases

We intend to continue to improve the breadth and depth of the information content within our database systems. We intend to seek additional content to make our directory listings and other data more useful and to enhance our ability to provide other services. Additions to this content may be virtual, through the Internet or other links that allow us to license or barter content. Some of this information will be deliverable to subscribers through portals other than the voice telephony portal, such as those available on the Internet.

Leverage our voice telephony portal by delivering greater volumes of existing and new services through our call center network as well as through other portals

Our strength has been to provide enhanced services through the voice telephony portal we have created. We are seeking opportunities to provide access to some of the content we acquire, develop and maintain, as well as our applications and related features, to other portals, including those available through the Internet. We believe that telephone carriers and other customers could use our content, applications and features to provide high quality services that are consistent across various portals and geographic areas. In so doing, these customers, particularly the telephone carriers, could further bind their subscribers to them as competition in their markets becomes increasingly subscriber-based.

Customers

Metro One provides enhanced directory assistance and information services to several of the nation's leading wireless carriers in all or a portion of their service areas. Our customers include Sprint PCS, AT&T Wireless Services, Nextel Communications, Cingular Wireless (formerly Pacific Bell Wireless), and ALLTEL Communications. In addition, we have expanded into the landline telecommunications market and provide our services to competitive local exchange carriers. Customers that accounted for more than 10% of our revenues during any of the periods indicated are as follows:

| Customer | 2001 | 2000 | 1999 |
|--|------|------|------|
| Sprint PCS | 32 % | 31 % | 40 % |
| AT&T Wireless Services | 30 | 29 | 30 |
| Nextel Communications | 23 | 21 | 5 |
| Cingular Wireless (formerly Pacific Bell Wireless) | 7 | 7 | 11 |
| Verizon Wireless | 3 | 6 | 11 |

We offer our services to a carrier's subscribers under a brand name selected by the carrier, such as AT&T Connect or Sprint PCS Directory Assistance. The carrier establishes its own fee structure with its subscribers. Subscribers typically pay the carrier's fees ranging from \$0.75 to \$1.40 plus airtime charges for our services. Metro One charges carriers directly and bears no subscriber collection risk. We charge our carriers on a per call basis. To stimulate increased call volume and to attract and expand customer commitments, we offer volume pricing discounts to our customers. Our success with this program resulted in significant call volume increases in 2001, 2000 and 1999 which, in turn, caused volume-based pricing in our existing contracts to become a factor in determining our average revenue per call.

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We have service contracts with 13 carriers, which include services provided to various affiliates of AT&T Wireless Services and Sprint PCS. The terms of these contracts are generally similar, with variations in the geographic market to be served, the services and features we are to provide the carriers' subscribers and the term, which is generally up to five years. None of these contracts preclude us from providing services to other carriers. The carriers agree to route some or all of their directory assistance and/or alphanumeric messaging calls to us.

Call Center Network

We operate 30 call centers located in strategic local markets throughout the United States, and expect to add at least one additional new call center by the end of 2002. Our call center network enables us to provide enhanced directory assistance and information services nationwide. We are situated in or near major metropolitan areas and therefore are located locally for more than one-half of the U.S. population. We believe that the local nature of our call centers and operators permits us to offer more accurate and valuable service than would be available through a single or a few call centers attempting to serve the entire U.S. market. We operate our call centers 24 hours a day, seven days a week, 365 days a year.

We continually upgrade our network and systems to allow greater utility, speed and efficiency in processing calls. We are also continually expanding capacity to store, manipulate and manage the additional data that we acquire. In addition, our telephone switching systems allow scalability, including the ability to join multiple switches together or configure switches so that they can handle large volumes of calls in tandem. These systems are monitored from our network operations center located at our corporate headquarters, which provides 24-hour support for our call center network. Our systems are designed to permit redundancy and avoid downtime from natural disasters or other adverse events.

Because a carrier offers our services to its subscribers under its brand name, we believe quality and reliability are important considerations in a carrier's decision to use our services. To ensure high quality and consistency, we emphasize training, monitoring and customer support. We maintain a national training force with training personnel in each call center. Our operators undergo extensive training and testing on search techniques, etiquette and local information, including landmarks, major thoroughfares and geography. We continually monitor, test and evaluate call center performance. We also monitor our call centers for compliance with contract performance standards and report this information to the carriers on a regular basis. In addition to accessing our systems maintenance and support personnel, carriers can obtain extensive customer usage information.

Our Services and Features

We use a customized array of hardware and software, along with proprietary database search engines, to provide our enhanced directory assistance and information services. We receive incoming calls by means of assigned telephone numbers, which are 411, 555-1212 or 00 in almost all cases. Our operators answer incoming calls and identify the service using the appropriate carrier's brand name. Upon receiving information requests from callers, operators search applicable databases using one or more of our search engines. The operator then connects the caller to the called party or supplies the caller with the requested information. We offer a variety of information and services, including the following:

Directory listings information, which may be retrieved by methods that include reverse and category searches;

Time, weather and traffic information;

Movie and restaurant information;

TeleConcierge® services;

Local events and venue information; and

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Turn-by-turn driving instructions.

Our enhanced directory assistance and information services also incorporate connectivity features that make the telephone more useful and easier to use. These connectivity features include the following:

Call completion allows a caller to be directly connected to the number requested without the need to redial;

StarBack® allows the caller to return to a live operator simply by pressing a key, such as the star [*] key or by otherwise issuing a command at any time during a call;

AutoBack® automatically returns the caller to a live operator or other options upon a busy signal, ring-no-answer or other common situations without pressing a single key;

MessageBack® delivers a caller's message to a desired party and, when configured with AutoBack, provides a convenient tool for ensuring communication;

NumberBack® sends the caller the called number simply by pressing the number [#] key; and

QuickSend® a short messaging service that allows our operators to send customized alphanumeric messages on behalf of a caller.

We are developing, testing and improving new services that add new content and connectivity features, such as MetroDex, which allows callers to use their telephone or the Internet to access their personal or corporate contact databases, and PersonalProfiler, which allows subscribers to customize how our services are delivered to them as well as allowing them to have access to personal assistant types of services. Other features under development include on-line research and verification utilities for use by businesses with a direct private connection to us. Equipment at our corporate headquarters facilitates this development and testing by simulating normal call center operations.

Database Systems and Content

We believe the quality of our services is, in large measure, related to the scope, quality and quantity of the information content that resides in our database systems. The majority of the information that we acquire, develop and maintain is telephone listings data. We obtain these listings data from multiple sources, including the regional Bell operating companies, independent telephone companies and other commercial sources, to ensure high quality and accuracy. These data are enhanced by our direct data collection efforts and a principal database of local information is developed for each call center or region.

Our proprietary operator interface software allows operators to efficiently search and reverse-search both their local databases and other national databases. We use proprietary database management systems to maintain and update our directory listings. We continually acquire additional content or access to content that will, in many cases, build on these listings data to make them more useful. Acquisitions are made from a variety of sources and are supplemented with information relating to local events and amenities.

In February 2001, we completed the purchase of a developer of web-based data extraction and processing technology. This group builds application-specific databases for a variety of portals, be they wired or wireless, voice or data. Our proprietary data extraction and processing technology enables the creation and ongoing maintenance of high quality databases from distributed and fragmented data on the web and elsewhere. We believe that these capabilities will contribute to the expansion of our services and data offerings to our wireless and other customers.

Marketing

We market directly to telecommunications carriers. The marketing process involves a considerable amount of time and attention by our senior management. Call center managers also play a key role in maintaining and developing carrier relationships. Some of our contracts provide for customer promotion of the services we provide to their subscribers. In addition, we occasionally assist our carrier customers in the promotion of these services.

We communicate on a regular basis with our existing carrier customers through our quality assurance and customer service programs. We have developed proprietary programs that allow us and our customers to monitor the quality of our performance and the volume and duration of directory assistance and information requests on a real-time basis. These programs also give us an opportunity to learn more about our carriers evolving needs.

Technology

Our ability to provide enhanced directory assistance and information services is dependent to a great extent on our proprietary technology. Our proprietary software applications enhance our call handling and delivery capabilities and provide the basis for our connectivity features. We have developed search engines to quickly access information from our databases. We continue to upgrade our operator interface software, database management systems and search engines to increase the efficiency and broaden the search capability of our operators.

Our call processing systems incorporate programmable switching equipment, host computers, voice response units and database servers. Our advanced technology is based on customized software running Sun Microsystems and Dell servers and Lucent switching equipment. One of the characteristics of our call processing systems is the ability to take all calls from a carrier's switch and have them run through our switch for the entire length of the call so that we are able to provide a full range of our services to the caller.

We are also monitoring technological advances in the methods of delivery of information and data and are working to insure that our systems are compatible with, and we can take advantage of, these developments. As an example, wireless application protocol (or WAP) allows telephone users with a certain type of telephone to access the Internet. Opportunities that this may present include using the content we have available to

us in this format. We believe that by expanding reliance on the telephone as a source of information, the application of this technology will also benefit our enhanced directory and information services business.

Intellectual Property

We rely on a combination of trademark, patent and trade secrets laws and confidentiality procedures to protect our intellectual property rights. We have nine U.S. patents issued, including three relating to our StarBack technology and another associated with our turn-by-turn directions service. We have approximately 31 applications pending for additional U.S. patents and ten applications pending for foreign patents. We also have U.S. and foreign registered trademarks for, among others, Metro One Telecommunications, Metro One, Enhanced Directory Assistance, StarBack, TeleConcierge, LocationPro, AutoBack, MetroDex and NumberBack, and applications pending for U.S. trademark registration among others, InfoPro and PersonalProfiler.

Competition

The directory assistance and information services markets are characterized by rapidly changing market forces, technological advancements and increasing competition from large carrier-affiliated companies and small, independent companies. Our principal competitors include regional Bell operating companies and other independent providers. Telephone carriers provide directory assistance or information services both in and outside their own operating regions. Although we believe that none of these competitors offers a form of directory assistance that incorporates all of our features, they may have substantially greater financial, technical and marketing resources than us and may be able to offer features similar to ours in the future. We also face competition from independent companies seeking to offer forms of directory assistance and, in some cases, other information services.

We believe the principal competitive factors in the directory assistance market are quality and range of features, technological innovation, experience, responsiveness to customers and price. Historically, we have sought to distinguish ourselves from our competitors based on the quality of our services, the development of useful features, the breadth of the content provided and our extensive national network of call centers.

Government Regulation

While our principal business is not directly regulated, it is dependent upon relationships with companies that are regulated by the Federal Communications Commission and state public utility commissions. This regulation applies to all communications common carriers, such as AT&T, the regional Bell operating companies and other long distance and local exchange carriers.

Employees

As of December 31, 2001, Metro One had approximately 6,500 employees, including approximately 28% who were employed on a part-time basis. Most of our employees are operators, and the number of full-time and part-time operators varies from time to time reflecting fluctuations in the volume of calls. None of our employees are subject to a collective bargaining agreement. Our management considers relations with our employees to be good.

We invest significant resources in the recruitment, training and retention of qualified operators. Our organizational structure provides opportunities and encourages talented individuals to take on roles of increasing responsibility. We also invest considerable resources in personnel motivation, including providing incentive plans for our operators, management and corporate staff.

ITEM 2. PROPERTIES.

We lease our principal executive and administrative offices, consisting principally of two adjacent locations totaling approximately 57,000 square feet of space, in Beaverton, Oregon. The terms of the leases extend through 2009.

We also lease office facilities for our call center operations, which generally range in size from 5,000 to 30,000 square feet. We have 34 leases for call centers and other remote facilities, with remaining terms of up to seven years. We believe that expansion of our call center network may require us to lease additional office facilities within the next year. From time to time, we are required to move our call centers or lease additional space to meet expanding volume from existing or new customers.

ITEM 3. LEGAL PROCEEDINGS.

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In August 1999, we commenced an action against a competitor in the United States District Court in Delaware claiming infringement of one of our patents relating to our StarBack feature. The defendant denied that it infringed the patent and asserted, among other things, that our patent was invalid and unenforceable. In February 2000 the competitor and another plaintiff counter-sued us in the United States District Court, Eastern District of Texas. During 2001, our suit and the counter-suit were settled. While terms of the settlement agreement are confidential, court orders were issued barring the competitor from offering the StarBack-like feature. In conjunction with the settlement, our suit and the counter-suit were dismissed with prejudice.

We are not aware of any other pending legal proceedings other than routine litigation that is incidental to the business.

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

No matters were submitted during the quarter ended December 31, 2001 to a vote of security holders.

PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.**

Metro One's common stock trades on the NASDAQ National Market under the symbol MTON. The high and low closing sales prices as reported on the Nasdaq National Market for each quarterly period within the two most recent fiscal years were as follows:

| 2001 | | High | | Low |
|----------------------------------|----|-------------|----|------------|
| Quarter ended December 31, 2001 | \$ | 39.30 | \$ | 22.20 |
| Quarter ended September 30, 2001 | | 45.75 | | 21.50 |
| Quarter ended June 30, 2001 | | 44.27 | | 17.38 |
| Quarter ended March 31, 2001 | | 23.67 | | 13.67 |
| 2000 | | High | | Low |
| Quarter ended December 31, 2000 | \$ | 16.67 | \$ | 8.29 |
| Quarter ended September 30, 2000 | | 9.92 | | 6.50 |
| Quarter ended June 30, 2000 | | 8.58 | | 6.00 |
| Quarter ended March 31, 2000 | | 10.92 | | 7.38 |

On May 16, 2001, the Board of Directors approved a three-for-two stock split in the form of a 50% stock dividend, distributing approximately 8,100,000 shares on June 29, 2001. All share and per share data presented in the table above and elsewhere in this report have been adjusted to give effect to the stock split.

The approximate number of shareholders of record as of March 21, 2002 was 150. We believe we have approximately 11,000 shareholders including an estimate of shareholders with shares held in street name. On March 21, 2002, the closing price of our common stock, as reported on the Nasdaq National Market, was \$26.47 per share.

We have never declared or paid cash dividends on our common stock. We intend to retain earnings from operations for use in the operation and expansion of our business and do not anticipate paying cash dividends with respect to our common stock in the foreseeable future.

ITEM 6. SELECTED FINANCIAL DATA.

The selected financial data presented below for, and as of the end of, each of the years in the five-year period ended December 31, 2001 have been derived from our audited financial statements. The financial data should be read in conjunction with the Financial Statements and related Notes that appear elsewhere in this Annual Report and Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Item 7.

| | Years Ended December 31, | | | | |
|-------------------------------------|--|------------|-----------|-----------|-----------|
| | 2001 | 2000 | 1999 | 1998 | 1997 |
| | (In thousands, except per share amounts) | | | | |
| Operations data: | | | | | |
| Revenues | \$ 233,318 | \$ 156,981 | \$ 77,831 | \$ 45,139 | \$ 26,090 |
| Direct operating expenses | 131,851 | 97,438 | 46,494 | 23,107 | 13,017 |
| General and administrative expenses | 65,246 | 45,892 | 28,711 | 18,334 | 11,702 |
| Income from operations | 36,221 | 13,651 | 2,626 | 3,698 | 1,371 |
| Net income | 28,422 | 9,742 | 1,906 | 3,603 | 1,432 |
| Basic income per share | 1.20 | .56 | .11 | .22 | .09 |
| Diluted income per share | 1.15 | .54 | .11 | .21 | .09 |
| Cash flow from operations | 49,862 | 5,350 | 3,326 | 6,546 | 3,293 |
| Balance sheet data (1): | | | | | |
| Cash and cash equivalents | \$ 54,592 | \$ 6,463 | \$ 9,564 | \$ 7,570 | \$ 8,554 |
| Working capital | 73,747 | 17,066 | 11,750 | 8,414 | 9,844 |
| Total assets | 169,759 | 106,641 | 65,475 | 36,311 | 29,125 |
| Long-term obligations | 3,844 | 29,074 | 18,940 | 719 | 1,416 |
| Shareholders' equity | 147,369 | 45,404 | 31,979 | 28,242 | 23,676 |

- (1) In February 2001, we completed a transaction with Sonera Media Holding B. V. (Sonera), a wholly owned subsidiary of Sonera Corporation of Helsinki, Finland, whereby Sonera purchased six million newly-issued shares of our common stock at a price of \$11.33 per share, for an aggregate price of \$64.6 million and an approximate 25.5% ownership position at that time. Sonera develops and provides mobile value-added services. A portion of the proceeds from this transaction was used to pay off all outstanding debt.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

All statements and trend analyses contained in this item and elsewhere in this report on Form 10-K relative to the future constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to the business and economic risks faced by us, and our actual results of operations may differ materially from those contained in the

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forward looking statements. For a discussion of such risks, see Issues and Uncertainties. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Results of operations for the periods discussed below should not be considered indicative of the results to be expected in any future period and fluctuations in operating results may also result in fluctuations in the market price of our common stock. Our quarterly and annual operating results have in the past and may in the future vary significantly depending on factors such as changes in the telecommunications market, the addition or expiration of customer contracts, increased competition, changes in pricing policies by us or our competitors, lengthy sales cycles, lack of market acceptance or delays in the introduction of new versions of our products or features, the timing of the initiation of wireless services or their acceptance in new market areas by telecommunications customers, the timing and expense of the expansion of our national call center network, the general employment environment, general economic conditions and the other factors discussed under the heading Issues and Uncertainties in this Item 7.

Overview

We are a leading developer and provider of enhanced directory assistance and information services for the telecommunications industry. We primarily contract with wireless carriers to provide these services to their subscribers.

Under our contracts, the carriers agree to route some or all of their directory assistance and/or alphanumeric messaging calls to us. We also offer our services to multiple carriers within the same market. When a carrier's subscribers dial a typical directory assistance number, such as 411, 555-1212 or 00, the calls are answered by our operators identifying the service by that carrier's brand name, such as AT&T Connect, or Sprint PCS Directory Assistance.

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Each carrier establishes its own directory assistance fee structure for its subscribers. Wireless subscribers typically pay fees ranging from \$0.75 to \$1.40 plus airtime charges for our services. We bear no subscriber collection risk.

We charge our carriers directly on a per call basis, with prices varying in some cases based on call volume. In order to encourage our customers to route more of their calls to us, our long-term strategy has been based in part on reducing the price we charge our customers. Our average revenue per call decreased in 2001 as call volume increased. We expect a decrease in average revenue per call to continue in 2002, although at a lower rate than that of prior years, as we believe this reduced pricing better positions us to retain and expand service with existing carrier customers, to attract new wireless and landline carriers, and to achieve greater operating margins over time.

In 2002, we expect to continue our call center and network expansion to prepare for anticipated growth. This growth is expected to come from existing customers in the form of new markets acquired, as well as from increased usage within geographic markets currently being served. We will also continue to opportunistically pursue additional significant new business. Our call center and network expansion efforts will increase our local service coverage and our capacity to process additional call volume.

Our growth plan involves both capital expenditures and operating expenses, as we build infrastructure and recruit and train qualified personnel. To better serve our customers and strengthen our relationships, we attempt to match the operating readiness of our call centers to the timing of when our customers transition call volume to us. At times, our customers have experienced delays, and may experience some additional delays in the future, in the timing of delivery of call volume to us. These delays can increase our ongoing operating expenses with no corresponding increase in revenues. The result under these conditions has been, and will likely continue to be, near-term reported earnings that vary widely. However, we intend to continue to pursue and prepare for significant additional call volume in order to seek to achieve greater earnings over the long run.

Results of Operations

The following table shows selected items of our statements of operations data expressed as a percentage of revenues:

| | Years Ended December 31, | | |
|---------------------------------------|--------------------------|--------|--------|
| | 2001 | 2000 | 1999 |
| Revenues | 100.0% | 100.0% | 100.0% |
| Direct operating expenses | 56.5 | 62.1 | 59.7 |
| General and administrative expenses | 28.0 | 29.2 | 36.9 |
| Income from operations | 15.5 | 8.7 | 3.4 |
| Other income (expense) | 0.5 | (0.0) | 0.1 |
| Interest and loan fees | (0.3) | (2.1) | (1.0) |
| Income before income taxes | 15.7 | 6.6 | 2.5 |
| Income tax expense | 3.5 | 0.4 | 0.1 |
| Net income | 12.2% | 6.2% | 2.4% |
| Call centers in operation at year-end | 30 | 28 | 24 |

2001 Compared to 2000

Revenues. Revenues increased 48.6% to \$233.3 million in 2001 from \$157.0 million in 2000. We have offered volume discount pricing for the last several years in order to encourage customers to send additional call volume to us. As an ongoing result of this pricing policy, as well as numerous other factors including the quality of our services, call volume has continued to increase each year. Call volume grew to approximately 472 million calls in 2001 from approximately 302 million calls in 2000. This increase resulted from growth in call volume under existing contracts and markets, as well as new call volume from new contracts and new markets. Our average revenue per call was approximately \$0.49 in 2001 compared to \$0.52 in 2000.

Direct operating expenses. Direct operating expenses consist of call center personnel and listings data and content acquisition costs. These expenses increased 35.3%, to \$131.9 million in 2001 from \$97.4 million in 2000. This increase was primarily due to the costs of servicing increased call volumes. As a percentage of revenues, direct operating expenses decreased to 56.5% in 2001 from 62.1% in 2000, due primarily to operating efficiencies realized from greater call volumes and lower costs of accessing information content.

General and administrative expenses. General and administrative expenses increased 42.2%, to \$65.2 million in 2001 from \$45.9 million in 2000. This increase resulted primarily from additional costs necessary to support our larger base of call centers and increased call volumes. As a percentage of revenues, general and administrative expenses decreased to 28.0% in 2001 from 29.2% in 2000. This decrease resulted primarily from efficiencies associated with the growth of our business.

Depreciation and amortization. Depreciation and amortization increased by 51.2% to \$15.8 million in 2001 from \$10.5 million in 2000, due primarily to equipment purchased for new call centers, for upgrades and expansions of existing call centers, product development activities and amortization related to business acquisition.

Other income (expense). Other income for the year ended December 31, 2001 consisted primarily of interest income of approximately \$1.3 million partially offset by losses on disposal of assets. Other expense for the year ended December 31, 2000 consisted primarily of losses on the disposition of assets of \$220,000 and other miscellaneous non-operating expenses of \$106,000 offset by interest income of \$301,000. The increase in interest income resulted primarily from increases in cash and cash equivalents due to the issuance of common stock to Sonera Media Holding B.V. (see "Significant Events").

Interest expense and loan fees. Interest expense and loan fees decreased 72.1%, to \$895,000 in 2001 from \$3.2 million in 2000. This decrease resulted from a decrease in average debt outstanding during the year. All debt was paid in full as of March 31, 2001.

Income tax expense. Income tax expense for the year ended December 31, 2001 was \$8.1 million for an effective tax rate of approximately 22.2%. Income tax expense for the year ended December 31, 2000 was \$678,000 for an effective tax rate of approximately 6.5%. These rates differ from the combined federal and state statutory rate of approximately 38% due primarily to the use of net operating loss carryforwards and the use of various federal and state tax credits.

2000 Compared to 1999

Revenues. Revenues increased 101.6% to \$156.9 million in 2000 from \$77.8 million in 1999. Call volume grew to approximately 302 million calls in 2000 from approximately 142 million calls in 1999. This increase resulted from growth in call volume under existing contracts and markets, as well as new call volume from new contracts and new markets. Our average revenue per call was approximately \$0.52 in 2000 compared to \$0.55 in 1999.

Direct operating expenses. Direct operating expenses consist of call center personnel and listings data and content acquisition costs. These expenses increased 109.6%, to \$97.4 million in 2000 from \$46.5 million in 1999. This increase was primarily due to the costs of servicing increased call volumes. As a percentage of revenues, direct operating expenses increased to 62.1% in 2000 from 59.7% in 1999, due primarily to the reduction in the average revenue per call.

General and administrative expenses. General and administrative expenses increased 59.8%, to \$45.9 million in 2000 from \$28.7 million in 1999. This increase resulted primarily from costs associated with the start-up of new call centers and the investment in infrastructure necessary to support additional call volume and the increase in depreciation expense associated with additional call centers. As a percentage of revenues, general and administrative expenses decreased to 29.2% in 2000 from 36.9% in 1999. This decrease resulted primarily from efficiencies associated with the expansion of our operations.

Depreciation and amortization. Depreciation and amortization increased by 68.1%, to \$10.5 million in 2000 from \$6.2 million in 1999, due primarily to equipment purchased for new call centers, for upgrades and expansions of existing call centers and corporate operations.

Other income (expense). Other expense for the year ended December 31, 2000 consisted primarily of losses upon the disposition of assets of \$220,000 and other miscellaneous non-operating expenses of \$106,000 offset by interest income of \$301,000. Other income for the year ended December 31, 1999 was \$128,000 and consisted primarily of interest income of \$192,000, offset by losses upon the disposition of assets of \$67,000.

Interest expense and loan fees. Interest expense and loan fees increased 314.7%, to \$3.2 million from \$773,000. This increase was attributable to an increase in average debt outstanding during 2000.

Income tax expense. Income tax expense for the year ended December 31, 2000 was \$678,000 for an effective tax rate of approximately 6.5%. December 31, 1999 was \$75,000, for an effective tax rate of approximately 3.8%. These rates differ from the combined federal and state statutory rate of approximately 38% due primarily to the use of net operating loss carryforwards.

Liquidity and Capital Resources

Cash and cash equivalents are recorded at cost which approximates their fair market value. As of December 31, 2001, we had approximately \$54.6 million in cash and cash equivalents compared to approximately \$6.5 million at December 31, 2000. The net increase of \$48.1 million resulted primarily from the investment by Sonera and cash generated from operations offset by the payment of debt and cash paid in business acquisition. Total capital expenditures for the year ended December 31, 2001 were approximately \$28.0 million. All debt was paid in full as of March 31, 2001.

Working capital was \$73.7 million at December 31, 2001, compared to \$17.1 million at December 31, 2000. This increase was primarily due to working capital provided by the investment by Sonera and from working capital generated from operations, offset by the use of working capital for capital expenditures, the repayment of debt and cash paid in business acquisition.

Cash flow from operations. Net cash provided by operating activities was \$49.9 million for the year ended December 31, 2001 resulting primarily from net income, the effect of non-cash depreciation and amortization, decreases in accounts receivable and increases in accounts payable and accrued expenses, offset by increases in prepaid expenses and other assets. Net cash provided by operating activities was \$5.4 million and \$3.3 million for the years ended December 31, 2000 and 1999, respectively, resulting primarily from net income, the effect of non-cash depreciation and amortization and increases in accounts payable, offset by increases in accounts receivable.

Cash flow from investing activities. Cash used in investing activities was \$31.4 million, \$26.8 million and \$23.3 million for the years ended December 31, 2001, 2000 and 1999, respectively and was related primarily to capital expenditures for the purchase of equipment for new call centers, the upgrade and expansion of existing call centers, upgrades and expansions of corporate networks and infrastructure and, in 2001, cash paid in the acquisition of a data extraction and processing company as discussed below in "Significant Events."

Cash flow from financing activities. Cash provided by financing activities was \$29.6 million for the year ended December 31, 2001 resulting primarily from the proceeds of the investment by Sonera and the receipt of cash proceeds from the exercise of stock options, offset by the repayment of all outstanding debt. Net cash provided by financing activities was \$18.3 million in 2000 and \$23.5 million in 1999, resulting primarily from borrowings under credit facilities and the receipt of cash proceeds from the exercise of stock options, offset by the repayment of debt obligations

Future capital needs and resources. The primary uses of our capital in the near future are expected to be the development or acquisition of technologies, features and content complementary to our business and to expand our call center and network capacity to serve existing and potential new customers and for general corporate purposes, including possible acquisitions and other corporate development activities and working capital. We anticipate that our capital expenditures will be approximately \$25 to \$30 million in 2002, resulting primarily from projected call center expansions, increased network capacity and corporate development activities.

We believe our existing cash and cash equivalents and cash from operations will be sufficient to fund our operations for the next twelve months.

Commitments. We generally lease our facilities through non-cancelable operating leases extending for up to ten years. Annual payments on non-cancelable operating lease commitments are detailed in Note 5 of the financial statements.

From time to time, in the normal course of our business, we issue standby letters of credit and bank guarantees. At December 31, 2001, we had one letter of credit outstanding in the amount of \$900,000 related to our workers' compensation program. The letter of credit is secured by a certificate of deposit for the same amount. This commitment expires on April 1, 2002 and is typically renewed on an annual basis.

In accordance with accounting principles generally accepted in the United States of America, these commitments are not reflected in our balance sheets.

Significant Events

In February 2001, we completed a transaction with Sonera Media Holding B. V. (Sonera), a wholly owned subsidiary of Sonera Corporation of Helsinki, Finland, whereby Sonera purchased six million newly-issued shares of our common stock at a price of \$11.33 per share, for an aggregate price of \$64.6 million and an approximate 25.5% ownership position at that time. Sonera develops and provides mobile value-added services. A portion of the proceeds from this transaction was used to pay off all outstanding debt.

In February 2001, we acquired Enthusiasm Technologies, Inc., a Seattle-based developer of web-based data extraction and processing technology which has become our Content Development department, for a combination of cash and stock. This group builds application-specific databases for a variety of portals, be they wired or wireless, voice or data. Our proprietary data extraction and processing technology enables the creation and ongoing maintenance of high quality databases from distributed and fragmented data on the web and elsewhere. We believe that these capabilities will contribute to the expansion of our services and data offerings to our wireless and other customers. The purchase price in this transaction was not material to our financial position.

Significant Accounting Policies

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. Management believes that of our significant accounting policies (see Note 1 to the financial statements), those governing accounts receivable and the lives and recoverability of the carrying amount of equipment and other long-lived assets, such as existing intangibles, internally developed software and goodwill, may involve a higher degree of judgment, estimation and uncertainty.

Our customer base consists of mostly very large wireless telephone carriers in the United States. As such, management believes we have minimal risk of uncollectibility, at any point in time, related to outstanding accounts receivable. We have not experienced significant collection issues or write-offs related to these customers, consequently, we do not maintain an allowance for doubtful accounts. Since our accounts receivable are concentrated in relatively few customers, a significant change in the liquidity or financial position of any one of these customers could adversely impact collection of our accounts receivable and therefore have a material adverse effect on our financial position and future operating results.

We evaluate the remaining life and recoverability of equipment and other assets, including patents and trademarks and internally developed software, whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. At such time, we estimate the future cash flows expected upon eventual disposition and, if lower than the carrying amount, adjust the carrying amount of the asset to its estimated fair value.

Purchased goodwill, which represents the excess of cost over the fair value of net assets acquired in a business combination, was amortized on a straight-line basis, over the estimated economic life, through December 31, 2001.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations . The statement discontinues the use of the pooling of interests method of accounting for business combinations. The statement is effective for all business combinations occurring after June 30, 2001. We believe the impact of this statement will not have a material impact on our financial statements.

In June 2001, the FASB issued SFAS No. 142, Goodwill and Other Intangible Assets . This new statement addresses financial accounting and reporting for goodwill and other intangible assets. Under this new standard, goodwill and other intangible assets that are deemed to have an indefinite life will no longer be amortized. However, goodwill and other intangible assets will be tested for impairment on an annual basis by applying a fair value based test. We are evaluating the impact of SFAS No. 142, and, other than cessation of amortization of goodwill, we believe the impact of adoption will not have a material impact on our financial position or results of operations. The amount of amortization expense related to goodwill and other intangible assets with indefinite lives was \$517,819 in 2001.

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets . The provisions of this statement are effective with fiscal years beginning after December 15, 2001. SFAS No. 144 establishes a single accounting model for long-lived assets to be disposed of and replaces SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-lived Assets to Be Disposed of," and Accounting Principals Bulletin No. 30, "Reporting Results of Operations - Reporting the Effects of Disposal of A Segment of Business." We believe the impact of this statement will not have a material impact on our financial position or results or operations.

Effect of Inflation

Inflation did not materially affect our business during the last several years.

Issues and Uncertainties

While management is optimistic about our long-term prospects, the following issues and uncertainties, among others, should be considered in evaluating our outlook.

Our quarterly and annual operating results may vary significantly in part due to factors outside our control.

In the future, as in the past, our quarterly and annual operating results may vary significantly as a result of a number of factors. We cannot control many of these factors, which include, among others:

Changes in the telecommunications market, including the addition or withdrawal of carriers from the market, changes in technology and increased competition from existing and new competitors;

The timing of the commencement of our services under new or existing contracts with our carrier customers, which depends in part on the customers' ability to adapt their networks and billing systems to allow them to transfer calls to us;

The timing and expense of our call center network expansion, including increased staffing and infrastructure expenses related to anticipated new call volume;

The addition or expiration of contracts with carrier customers;

Changes in our or our competitors', customers' or suppliers' pricing policies;

Lengthy sales cycles for new and extended contracts;

Lack of market acceptance or delays or increased development costs related to the introduction of our services or features;

and

General economic conditions.

For these reasons, you should not rely on period-to-period comparisons of our financial results as an indication of any future results. Our future operating results could fall below the expectations of securities industry analysts or investors. Any such shortfall could result in a decline in the market price of our common stock. Fluctuations in our operating results would likely increase the volatility of our common stock price.

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The rapidly changing telecommunications market could unfavorably affect us.

The telecommunications market is subject to rapid change and uncertainty that may result in competitive situations which could unfavorably affect us. These changes and uncertainties are due to, among other factors:

Mergers, acquisitions and alliances among carriers and among our competitors, which can result in fewer carriers in the marketplace, lost carrier customers, increased negotiating leverage for newly affiliated carriers and more effective competitors;

Changes in the regulatory environment, which may affect us directly, by affecting our ability to access and update listings data at a reasonable cost, or indirectly, by restricting our carrier customers' ability to operate or provide a competitive service;

Increasing availability of alternative methods for delivery of directory assistance and other information services, including the Internet; and

Evolving industry standards, including frequent technological changes and new product introductions.

We have contracts with a limited number of carrier customers. If we fail to extend or renew these contracts, or if these contracts are terminated prior to their expiration, our business could be adversely affected.

A limited number of customers account for substantially all our revenues. For example, our top five customers accounted for approximately 96% of our revenues in 2001. Our two largest customers, Sprint PCS and AT&T Wireless Services accounted for approximately 32% and 30% of our revenues, respectively, in 2001. Our business would be adversely affected by the loss of either Sprint PCS or AT&T Wireless Services and could be adversely affected by the loss of any other significant customer.

Of our contracts with significant customers, two expire in 2002, including Sprint PCS. The remainder, including AT&T Wireless Services and Nextel Communications, expire in 2003 and beyond. Some contracts contain performance and other standards and may be terminated prior to their scheduled expiration dates under specified circumstances.

If we fail to extend or replace our contracts, or our contracts are terminated prior to their expiration, our business could be adversely affected. Although we seek to increase the number of our customers, and maintain good relationships with our existing customers, a small number of companies dominate the telecommunications market. This limits the potential customer base and our expansion opportunities.

We have a long sales cycle which may cause delays that adversely affect our revenue growth and operating results.

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A customer's decision to contract for our directory assistance and information services involves a significant commitment of technical and other resources. As a result, we have a long sales cycle for both new and extended contracts, particularly with large customers. The selling process involves demonstrating the value-added benefits of outsourcing directory assistance and using our services rather than those of our competitors. Any delays due to lengthy sales cycles could significantly affect our revenue growth and operating results.

Our operating results are significantly affected by our ability to accurately estimate the amount and timing of call volume. The actual amount and timing of call volume is often subject to factors outside of our control.

Our operating results are significantly affected by costs incurred for staffing and expanding infrastructure. We incur significant staffing and general and administrative costs in anticipation of call volume under our customer contracts. If such call volume does not arrive as scheduled, in the amount anticipated, or at all, our operating results can be adversely affected. This could increase our operating expenses without a corresponding increase in revenues from the anticipated call volume.

We face substantial competition from a number of other companies.

Many of our competitors in the directory assistance market, including the regional Bell operating companies, have far greater resources and better name recognition. The regional Bell operating companies also may have the advantage of being the local telephone carrier in their area of operation. Some of these companies are or may be developing their own versions of enhanced directory assistance services. We also face competition from a number of other independent directory assistance providers. If we are unable to compete successfully, it could have an adverse effect on our business, financial condition and results of operations. Our ability to compete successfully depends, in part, on our ability to anticipate and appropriately respond to many factors, including the introduction of new services and products by our competitors, changes in subscriber preferences, changes in economic conditions and discount pricing strategies by our competitors.

Our inability to achieve desired pricing levels could adversely affect our profitability and operations.

We are subject to competitive pressures with respect to pricing, which could adversely affect our profitability and operations. The prices that we charge our carrier customers are subject to the terms of our contracts. The changing telecommunications market, the relative leverage of the negotiating parties and the overall competitive landscape can significantly impact contract pricing negotiations. We charge our carriers on a per call basis, with prices varying in some cases based on call volume. Our long-term strategy is based in part on reducing the price we charge our customers. Generally, our pricing levels have declined and, in the future, will likely continue to decline as call volumes increase. If we were to substantially reduce our prices without correspondingly increasing volume, there could be an adverse impact on our ability to operate profitably.

We are dependent on the wireless telecommunications industry, and a decrease in wireless usage by subscribers could have an adverse impact on our results of operations.

Almost all of our revenues come from providing enhanced directory assistance and information services to our wireless customers' subscribers. A decrease in wireless usage in general, or of our products in particular, could have an adverse effect on our results of operations. Wireless usage by subscribers appears to be affected by a number of factors, many of which are beyond our control, including pricing, safety concerns, reliability and availability of the wireless network, government regulation and reliability and availability of alternative technologies.

We need to expand call volume and increase efficiencies in order to be successful.

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In order to successfully execute our business strategies, we need to increase the volume of calls made to our call center network, while realizing the benefits of operating leverage. We intend to increase call volume by seeking additional customers, including landline carrier customers, as well as seeking additional business from our existing customers. We have limited experience in the landline market, which is dominated by the regional Bell operating companies. If we are unable to expand our wireless business or attract significant landline business, on a cost effective basis or at all, we may be unable to increase profitability or sustain past growth rates.

If we are unable to anticipate changes in technology and industry standards and to develop new services and features, we may not succeed.

Our success depends, in part, on our ability to anticipate changes in technology and industry standards and to develop and introduce new services and features that are accepted by the marketplace and cost effective for us to provide as a part of our overall service offerings. The development of new services and features can be very expensive. Further, given rapid technological changes, frequent introduction of new products, services and features, and changing consumer demands that characterize our industry, it can be difficult to correctly anticipate future changes in technology and industry standards. If we fail to develop new services and features, encounter difficulties that delay the introduction of such services and features, or incorrectly anticipate future changes and develop services and features that are not accepted by the marketplace or are not cost effective for us to provide as a part of our overall service offerings, we may not succeed at our business.

Alternative methods for delivery of directory assistance and information services could reduce the demand for our services.

Our business comes primarily from providing enhanced directory assistance and information services to telephone users. However, information can be transmitted in other ways, including more intelligent communications devices and other technologies and protocols, and over the Internet. For example, as the Internet continues to develop and becomes easier to use and access, technologies may be developed that decrease or eliminate the demand for telephone-based or voice-based directory or information services. Widespread acceptance of existing and developing technologies and protocols, such as voice recognition and wireless application protocol, could adversely affect our business. Our call volume could decline if telephone users change their usage habits and rely on the Internet or other alternatives as their primary source for information.

Systems failures, delays and other problems could harm our reputation and business, cause us to lose customers and expose us to customer liability.

Our success also depends on our ability to provide reliable services. Our operations could be interrupted by significant damage to or failure of our network, our connections to third parties, our computer hardware or software or our customers' or suppliers' computer hardware or software. Any such significant damage or failure could disrupt the operations of our network and the provision of our services and result in the loss of current and potential customers. In addition, as call volume increases, we will need to expand and upgrade our technology and network hardware and software in order to provide services. Capacity limits on our technology and network hardware and software may make it difficult for us to expand and upgrade our systems in a timely and economical manner.

If we are unable to obtain or adequately update directory or information content at an economical cost, we may be unable to provide current levels of service or improve our service.

Our operations depend on our access to the names, telephone numbers and other information that we supply directly to callers or we use in providing our services. The availability, cost, quality and usefulness of such data varies widely across geographic regions. If we are unable to obtain or update directory or information content at an economical cost, we may be unable to provide current levels of service, improve our enhanced directory assistance service or provide new services and features. Ultimately, the satisfaction of our carrier customers, and our ability to renew and extend our current customer contracts and enter into new customer contracts, depends on the quality of services we provide to the carriers' subscribers. The quality of our services is directly related to the quality of our listings data and other information content.

As we rely on a limited number of suppliers, an abrupt loss of any key supplier could adversely affect our business operations or delay our development efforts.

We rely on some key suppliers to provide us with programming and engineering services and to license us their technology. An abrupt loss of any current key supplier could cause a disruption in our operations or a delay in our development efforts, including the planned expansion of our call center network, and could adversely affect our business operations.

If we are unable to continue to attract and retain qualified senior management, technical personnel and call center operators, or our call center staff is unionized, our operations could be adversely affected.

Our success depends to a significant extent on the efforts and abilities of our senior management, technical personnel and call center operators. The loss of the services of our senior management and technical personnel could have a material adverse effect on our business and our ability to meet our strategic objectives. We also depend on the continued service of our call center operators, who we hire from the available labor pool. As we continue to expand our call center network, the ability to attract and retain qualified senior management, technical personnel, operators and other skilled employees is extremely important to the operation of our business. If we are unable to attract and retain qualified individuals, or we are required to pay significantly higher wages and other benefits to such individuals, or if our call center staff is unionized, it could adversely affect our business operations. We find it more difficult to recruit and retain qualified individuals during periods of low unemployment and, therefore, may be subject to increasing pressure to offer higher wages and other benefits during such periods. In our call center hiring, we may also feel the effects of the telecommunications industry in general, which has widespread union membership among its operators and other workers.

If we are unable to use and protect our intellectual property, we may be unable to provide some of our enhanced directory assistance and information services or profitably operate our business.

We regard aspects of our enhanced directory assistance and information services and their features and processes to be proprietary. If we are unable to use and protect our intellectual property, we may be unable to provide some of our enhanced directory assistance and information services or profitably operate our business. To a limited extent, we rely on a combination of trade secret, patent and other intellectual property law, nondisclosure agreements and other protective measures to protect our intellectual property. However, these measures may be difficult and costly to meaningfully enforce. In addition, attempts to enforce our intellectual property rights may bring into question the validity of these rights. Litigation with respect to patents or other intellectual property rights can result in substantial costs and diversion of management and other resources.

Future acquisitions may strain our operations.

We intend to evaluate, and in the future may pursue, acquisition opportunities that are consistent with our business strategy. If we fail to adequately address financial and operational risks associated with such acquisitions, future acquisitions may adversely harm our business.

These risks can include, among other things:

Difficulties in assimilating the operations, technology, information systems and personnel of the acquired company, including the inability to maintain uniform standards, controls and policies, and the loss of key employees of the acquired company;

Diversion of management's attention from other business concerns;

Impairment of relationships with licensors, customers and suppliers;

Difficulties in entering into markets in which we have no direct prior experience;

Use of cash resources, potentially dilutive issuances of equity securities and incurrence of additional debt and contingent liabilities; and

Significant write-offs and amortization expenses related to goodwill and other intangible assets.

If we expand our business into international markets, we will encounter risks which could adversely affect us.

We currently operate only in the United States; however, an element of our business strategy is to continue to explore international business opportunities. If we expand into one or more international markets, we will encounter significant risks and uncertainties. These risks and uncertainties include increased operational difficulties arising from, among other things:

Our ability to attract sufficient business or locate a suitable partner or joint venture candidate to enable us to overcome logistical and economic barriers to entry;

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Our ability and cost to gather sufficient information content and listings data, properly modify our features and services to meet applicable standards, and hire and train personnel;

Fluctuations in foreign currency exchange rates; and

Political, regulatory and economic developments and cultural differences.

Regulations affecting our customers and suppliers and future regulations to which we may be subject may adversely affect our business.

Although we are not directly subject to telecommunications industry regulation, the business of our customers and certain suppliers is subject to regulation that indirectly affects our business. We cannot predict when, or upon what terms and conditions, further regulation or deregulation might occur or the effect of regulation or deregulation on our business.

We may need additional capital in the future, and it may not be available on acceptable terms.

We may require more capital in the future to fund our operations, finance investments in equipment and infrastructure needed to maintain and expand our call center and network capabilities, enhance and expand the range of services and features we offer, and respond to competitive pressures and potential opportunities, such as investments, acquisitions and international expansion. We cannot be certain that additional financing will be available on terms favorable to us or at all. The terms of available financing may place limits on our financial and operating flexibility. If adequate funds are not available on acceptable terms, we may be forced to reduce our operations or abandon expansion opportunities.

Our common stock price is volatile.

The market price of our common stock has experienced volatility and is likely to continue to experience significant fluctuations in response to a number of factors. These factors include, among others:

Announcements of extensions, expirations or changes in our contracts and the opening of new call centers to support such activity;

Announcements relating to material events concerning our customers;

Actual or anticipated variations in our results of operations;

Changes in financial estimates by securities analysts;

Obsolescence of technologies that we or our customers use;

Introductions of new technologies; and

General market conditions.

From January 1, 2001 through December 31, 2001, our common stock price fluctuated from \$13.67 per share to \$45.75 per share and has on several days fluctuated more than 10%. Similar market fluctuations have affected the market prices of equity securities of many telecommunications companies and other public companies generally. These trading prices and valuations may change significantly and arbitrarily. In addition, broad market factors affecting telecommunications or technology stocks may adversely affect the market price of our common stock. General economic, political and market conditions, including interest rate changes and recession, may also adversely affect our stock price.

Our results of operations could be impacted by a significant increase in the rate of inflation.

Inflation has not historically had a material effect on our business. Operating expenses such as salaries, employee benefits and occupancy costs are, however, subject to normal inflationary pressures which could adversely affect our operating results.

Oregon law and provisions of our charter could make the acquisition of our company more difficult.

We are authorized to issue up to 10,000,000 shares of preferred stock, and the board of directors has the authority to fix the preferences, limitations and relative rights of those shares without any vote or action by the shareholders. The potential issuance of preferred stock may delay or prevent a change in control of our company, may discourage bids for the common stock at a premium over the market price and may adversely affect the market price of, and the voting and other rights of the holders of, our common stock. In addition, provisions under Oregon law limit the ability of parties who acquire a significant amount of voting stock to exercise control over our company. These provisions may have the effect of lengthening the time required for a person to acquire control of our company through a proxy contest or the election of a majority of the board of directors and may deter efforts to obtain control of our company.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Substantially all of our liquid investments are invested in money market instruments, and therefore, the fair market value of these investments is affected by changes in market interest rates. However, substantially all of our investments at December 31, 2001 were invested in overnight money market instruments and were redeemable on a daily basis. All of the underlying investments in the money market fund had maturities of three months or less. As a result, we believe the market risk arising from our holdings of financial instruments is minimal. In addition, we may be exposed to interest rate risk primarily through use of short-term and long-term borrowings to finance operations. A hypothetical 1% fluctuation in interest rates would not have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

See pages 24 through 35.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The information required by Item 10 is incorporated by reference to the Proxy Statement for our 2002 Annual Meeting, to be filed with the Securities and Exchange Commission within 120 days of our fiscal year end, under the captions "Management" and "Nominees and Directors."

ITEM 11. EXECUTIVE COMPENSATION.

The information required by Item 11 is incorporated by reference to the Proxy Statement for our 2002 Annual Meeting, to be filed with the Securities and Exchange Commission within 120 days of our fiscal year end.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The information required by Item 12 is incorporated by reference to the Proxy Statement for our 2002 Annual Meeting, to be filed with the Securities and Exchange Commission within 120 days of our fiscal year end.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information required by Item 13 is incorporated by reference to the Proxy Statement for our 2002 Annual Meeting, to be filed with the Securities and Exchange Commission within 120 days of our fiscal year end.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a)(1) Financial Statements

- Pg. 23 Independent Auditors Report
- Pg. 24 Statements of Income for each of the years ended December 31, 2001, 2000 and 1999
- Pg. 25 Balance Sheets at December 31, 2001 and 2000
- Pg. 26 Statements of Shareholders' Equity for each of the years ended December 31, 2001, 2000 and 1999
- Pg. 27 Statements of Cash Flows for each of the years ended December 31, 2001, 2000 and 1999
- Pg 28 Notes to Financial Statements

(a)(2) Exhibits

- 3.1 Third Restated Articles of Incorporation of Metro One Telecommunications, Inc. (4)
- 3.2 Amended and Restated Bylaws of Metro One Telecommunications, Inc. (1)
- 10.1 Form of Enhanced Directory Assistance Agreement (6)

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- 10.5 1995 Employment Agreement with Timothy A. Timmins (5)*
- 10.6 Lease Agreement between and among Petula Associates, Ltd., Koll Creekside Associates and the Company (2)
- 10.7 Enhanced Directory Assistance Agreement between Sprint Spectrum L.P. and the Company dated October 23, 1996 (3)(8)
- 10.11 Lease Agreement between and among Murray Scholls, LLC, Gramor Development Northwest, Inc. and the Company (3)
- 10.12 Amendment #1 to Specific Agreement between Sprint Spectrum L.P. and the Company dated December 9, 1998 (3)(8)

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- 10.18 Amendment to 1995 Employment Agreement with Timothy A. Timmins (7)*
- 10.19 Stock Purchase Agreement between the Company and Sonera Media Holding B.V. dated as of November 8, 2000 (9)
- 10.20 Investment Agreement between the Company and Sonera Media Holding B.V. dated as of February 2, 2001 (10)
- 10.21 Registration Rights Agreement between the Company and Sonera Media Holding B.V. dated as of February 2, 2001 (10)
- 10.22 Commercial Lease Agreement between Murray Scholls, LLC and the Company (11)
- 10.23 Deferred Compensation Plan Document (11)*
- 10.24 Agreement for Enhanced Directory Assistance Services between Metro One and AT&T Wireless Services, Inc. dated December 1, 2000 (8)
- 10.25 1999 Employee Stock Purchase Plan (11)*
- 10.27 1994 Stock Incentive Plan (12)*
- 23.1 Consent of Deloitte & Touche LLP, independent auditors

* Management contract or compensatory plan

- (1) Incorporated herein by reference to the Company's Registration Statement on Form S-1 dated August 22, 1996, File No. 333-05183.
- (2) Incorporated herein by reference to the Company's Registration Statement on Form SB-2, File No. 33-88926-LA.
- (3) Incorporated herein by reference to the Company's Annual Report on Form 10-K dated March 31, 1999, Commission No. 0-27024.
- (4) Incorporated herein by reference to the Company's Annual Report on Form 10-KSB dated March 31, 1998, Commission No. 0-27024.
- (5) Incorporated herein by reference to the Company's Annual Report on Form 10-KSB dated August 20, 1996, Commission No. 0-27024.
- (6) Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q dated October 22, 1999, Commission No. 0-27024.

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- (7) Incorporated herein by reference to the Company's Annual Report on Form 10-K dated March 30, 2000, Commission No. 0-27024.
- (8) Certain portions of Exhibits 10.7, 10.12, 10.14 and 10.24 are the subject of a request for confidential treatment and have been omitted from the Exhibit and have been filed separately with the Commission.
- (9) Incorporated herein by reference to the Company's Current Report on Form 8-K dated November 20, 2000, Commission No. 0-27024.
- (10) Incorporated herein by reference to the Company's Current Report on Form 8-K dated February 15, 2001, Commission No. 0-27024.
- (11) Incorporated herein by reference to the Company's Annual Report on Form 10-K dated April 2, 2001, Commission No. 0-27024.
- (12) Incorporated herein by reference to the Company's Form S-8 dated February 12, 2002, Commission No. 0-27024.

(b) Reports Filed on Form 8-K

No reports on Form 8-K were filed during the quarter ended December 31, 2001.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Metro One Telecommunications, Inc.

By: /s/ Timothy A. Timmins
 Timothy A. Timmins
 President and Chief Executive Officer

Date: March 29, 2002

Pursuant to the requirements of the Exchange Act, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the date indicated:

| Signature | Title | Date |
|--|--|----------------|
| /s/ Timothy A. Timmins Timothy A. Timmins | President, Chief Executive Officer and Director (Principal Executive Officer) | March 29, 2002 |
| /s/ Dale N. Wahl Dale N. Wahl | Senior Vice President, Chief Financial Officer (Principal Financial Officer) | March 29, 2002 |
| /s/ Duane C. Fromhart Duane C. Fromhart | Vice President, Finance (Principal Accounting Officer) | March 29, 2002 |
| /s/ William D. Rutherford William D. Rutherford | Chairman of the Board of Directors | March 29, 2002 |
| /s/ A. Jean de Grandpré A. Jean de Grandpré | Director | March 29, 2002 |
| /s/ Heikki Jämsänen Heikki Jämsänen | Director | March 29, 2002 |
| /s/ Aimo Olkkonen Aimo Olkkonen | Director | March 29, 2002 |
| /s/ James M. Usdan James M. Usdan | Director | March 29, 2002 |

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/s/ David A. Williams
David A. Williams

Director

March 29, 2002

INDEPENDENT AUDITORS REPORT

To The Board of Directors and Shareholders of

Metro One Telecommunications, Inc.

Beaverton, Oregon

We have audited the accompanying balance sheets of Metro One Telecommunications, Inc. as of December 31, 2001 and 2000 and the related statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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 audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Metro One Telecommunications, Inc. as of December 31, 2001 and 2000 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE LLP

Portland, Oregon

February 6, 2002

Metro One Telecommunications, Inc.**Statements of Income** (In thousands, except per share amounts)

| | Years ended December 31, | | |
|------------------------------|--------------------------|------------|-----------|
| | 2001 | 2000 | 1999 |
| Revenues | \$ 233,318 | \$ 156,981 | \$ 77,831 |
| Costs and expenses: | | | |
| Direct operating | 131,851 | 97,438 | 46,494 |
| General and administrative | 65,246 | 45,892 | 28,711 |
| | 197,097 | 143,330 | 75,205 |
| Income from operations | 36,221 | 13,651 | 2,626 |
| Other income (expense) | 1,212 | (25) | 128 |
| Interest and loan fees | (895) | (3,206) | (773) |
| Income before income taxes | 36,538 | 10,420 | 1,981 |
| Income tax expense | 8,116 | 678 | 75 |
| Net income | \$ 28,422 | \$ 9,742 | \$ 1,906 |
| Net income per common share: | | | |
| Basic | \$ 1.20 | \$.56 | \$.11 |
| Diluted | \$ 1.15 | \$.54 | \$.11 |

The accompanying notes are an integral part of these financial statements

Metro One Telecommunications, Inc.**Balance Sheets** (In thousands)

| | December 31, | |
|---|-------------------|-------------------|
| | 2001 | 2000 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 54,592 | \$ 6,463 |
| Accounts receivable | 32,794 | 36,559 |
| Prepaid costs and other current assets | 4,907 | 6,207 |
| Total current assets | 92,293 | 49,229 |
| Furniture, fixtures and equipment, net | 69,066 | 54,749 |
| Other assets | 8,400 | 2,663 |
| Total assets | \$ 169,759 | \$ 106,641 |
| Liabilities and Shareholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,276 | \$ 2,633 |
| Accrued liabilities | 6,180 | 6,088 |
| Accrued payroll and related costs | 11,090 | 9,181 |
| Line of credit payable | | 4,750 |
| Current portion of long-term debt | | 9,511 |
| Total current liabilities | 18,546 | 32,163 |
| Long-term debt | | 24,731 |
| Other long-term liabilities | 3,844 | 4,343 |
| Total liabilities | 22,390 | 61,237 |
| Commitments and contingencies | | |
| Shareholders equity: | | |
| Preferred stock, no par value; 10,000 shares authorized, no shares issued or outstanding | | |
| Common stock, no par value; 50,000 shares authorized, 24,463 and 17,747 shares issued and outstanding at December 31, 2001 and 2000, respectively | 117,534 | 43,991 |
| Retained earnings | 29,835 | 1,413 |
| Shareholders equity | 147,369 | 45,404 |

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| | | | | |
|--|----|---------|----|---------|
| Total liabilities and shareholders' equity | \$ | 169,759 | \$ | 106,641 |
|--|----|---------|----|---------|

The accompanying notes are an integral part of these financial statements

Metro One Telecommunications, Inc.

Statements of Shareholders' Equity(In thousands)

| | Common Stock | | Shareholders' Equity | Retained Earnings | Shareholders' Equity |
|---------------------------------------|--------------|------------|-----------------------|-------------------|----------------------|
| | Shares | Amount | (Accumulated Deficit) | | |
| Balances at December 31, 1998 | 16,782 | \$ 38,477 | \$ (10,235) | \$ | 28,242 |
| Employee stock options exercised, net | 339 | 1,831 | | | 1,831 |
| Net income | | | 1,906 | | 1,906 |
| Balances at December 31, 1999 | 17,121 | 40,308 | (8,329) | | 31,979 |
| Employee stock options exercised, net | 587 | 3,426 | | | 3,426 |
| Employee stock purchase plan | 39 | 257 | | | 257 |
| Net income | | | 9,742 | | 9,742 |
| Balances at December 31, 2000 | 17,747 | 43,991 | 1,413 | | 45,404 |
| Issuance of common stock, net | 6,000 | 64,607 | | | 64,607 |
| Shares issued in business combination | 155 | 3,200 | | | 3,200 |
| Employee stock options exercised | 510 | 3,300 | | | 3,300 |
| Tax benefit from stock plans | | 1,730 | | | 1,730 |
| Employee stock purchase plan | 51 | 706 | | | 706 |
| Net income | | | 28,422 | | 28,422 |
| Balances at December 31, 2001 | 24,463 | \$ 117,534 | \$ 29,835 | \$ | 147,369 |

The accompanying notes are an integral part of these financial statements

Metro One Telecommunications, Inc.

Statements of Cash Flows (In thousands)

| | Years ended December 31, | | |
|---|--------------------------|-----------------|-----------------|
| | 2001 | 2000 | 1999 |
| Cash flows from operating activities: | | | |
| Net income | \$ 28,422 | \$ 9,742 | \$ 1,906 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 15,824 | 10,465 | 6,225 |
| Loss on disposal of fixed assets | 176 | 220 | 67 |
| Deferred income taxes | 1,775 | (96) | (8) |
| Tax benefit from employee stock plans | 1,730 | | |
| Changes in certain assets and liabilities: | | | |
| Accounts receivable | 3,765 | (21,202) | (7,929) |
| Prepaid expenses and other assets | (2,727) | (2,543) | (728) |
| Accounts payable and other liabilities | 897 | 8,764 | 3,793 |
| Net cash provided by operating activities | 49,862 | 5,350 | 3,326 |
| Cash flows from investing activities: | | | |
| Capital expenditures | (27,966) | (27,168) | (24,397) |
| Acquisition of business | (3,388) | | |
| Purchase of short-term investments | | | (400) |
| Maturity of short-term investments | | 400 | 1,507 |
| Net cash used in investing activities | (31,354) | (26,768) | (23,290) |
| Cash flows from financing activities: | | | |
| Net proceeds from (repayment of) line of credit | (4,750) | 4,750 | (1,400) |
| Proceeds from issuance of debt | | 16,637 | 31,800 |
| Repayment of debt | (34,242) | (6,577) | (8,474) |
| Repayment of capital lease obligations | | (176) | (292) |
| Proceeds from issuance of common stock, net | 64,607 | | |
| Proceeds from exercise of stock options and employee stock purchases | 4,006 | 3,683 | 1,831 |
| Net cash provided by financing activities | 29,621 | 18,317 | 23,465 |
| Net increase (decrease) in cash and cash equivalents | 48,129 | (3,101) | 3,501 |
| Cash and cash equivalents, beginning of year | 6,463 | 9,564 | 6,063 |
| Cash and cash equivalents, end of year | \$ 54,592 | \$ 6,463 | \$ 9,564 |

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Summary of non-cash investing and financing activities:

| | | | | |
|--|----|-------|----|----|
| Issuance of 155 shares of common stock in business combination | \$ | 3,200 | \$ | \$ |
|--|----|-------|----|----|

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

Metro One Telecommunications, Inc.

Notes To Financial Statements

1. Summary of Operations and Significant Accounting Policies

Nature of Operations. We provide enhanced directory assistance services to telecommunications carriers and their customers. Revenues are derived principally through fees charged to telecommunications carriers. We operate call centers located in many metropolitan areas throughout the United States.

Cash and Cash Equivalents. Cash and cash equivalents include cash deposits in banks and highly liquid investments with maturity dates of three months or less at the date of acquisition.

Major Customers. In each of the years ended December 31, 2001, 2000 and 1999, twelve customers accounted for substantially all revenue and accounts receivable reported. Our three largest customers accounted for approximately 32%, 30% and 23% of revenue in 2001. Our three largest customers accounted for approximately 31%, 29% and 21% of revenue in 2000. Our four largest customers accounted for approximately 40%, 30%, 11% and 11% of revenue in 1999. We have historically not incurred significant losses related to our accounts receivable.

Furniture, Fixtures and Equipment. Furniture, fixtures and equipment are stated at cost and are depreciated over their estimated useful lives of three to seven years using the straight-line method. Leasehold improvements are amortized over the lesser of the remaining lease term or the useful life. Expenses for repairs and maintenance are expensed as incurred. Accumulated amortization for capital leases is included in accumulated depreciation. In the event that facts and circumstances indicate that the cost of furniture, fixtures and equipment may be impaired, an evaluation of recoverability would be performed and the asset's carrying amount would be reduced to market value or discounted cash flow value.

Other Assets. Other assets include goodwill, patents, patents pending and trademarks. These assets are carried at cost less accumulated amortization. Other assets are amortized over the estimated useful lives of the related assets of five to ten years. The related accumulated amortization was \$820,257 and \$92,885 for the years ended December 31, 2001 and 2000, respectively. In the event that facts and circumstances indicate that the recorded value of goodwill, patents or trademarks may be impaired, an evaluation of recoverability would be performed and the asset's carrying amount would be reduced to market value or discounted cash flow value.

Fair Value of Financial Instruments. The carrying value of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and line of credit payable approximate fair value due to the short-term maturities of these assets and liabilities.

Revenue Recognition. Under existing contracts with telecommunications carriers, we record revenue for the number of calls processed at the agreed upon price per call, calculated on a monthly basis. Revenue per call may vary based on monthly volumes achieved. Revenue is

recognized as services are provided.

Net Income Per Share. We report basic and diluted net income per share in accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share . Basic net income per share is calculated based on the weighted average number of common shares outstanding during each period. Diluted net income per share is calculated based on these same shares plus dilutive potential shares issuable upon assumed exercise of outstanding stock options based on the treasury stock method.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that effect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the fiscal year. Actual results could differ from those estimates.

Commitments and Contingencies. We are party to various legal actions and administrative proceedings arising in the ordinary course of business. We believe the disposition of these matters will not have a material adverse effect on our financial position, results of operations, or cash flows.

From time to time, in the normal course of our business, we issue standby letters of credit and bank guarantees. At December 31, 2001, we had one letter of credit outstanding in the amount of \$900,000 related to our workers' compensation program. The letter of credit is secured by a certificate of deposit for the same amount. This commitment expires on April 1, 2002 and is typically renewed on an annual basis.

Recent Accounting Pronouncements. In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations . The statement discontinues the use of the pooling of

interests method of accounting for business combinations. The statement is effective for all business combinations occurring after June 30, 2001.

In June 2001, the FASB issued SFAS No. 142, *Goodwill and Other Intangible Assets*. This new statement addresses financial accounting and reporting for goodwill and other intangible assets. Under this new standard, goodwill and other intangible assets that are deemed to have an indefinite life will no longer be amortized. However, goodwill and other intangible assets will be tested for impairment on an annual basis by applying a fair value based test. We are evaluating the impact of SFAS No. 142, and, other than cessation of amortization of goodwill, we believe the impact of adoption will not have a material impact on our financial position or results of operations. The amount of amortization expense related to goodwill and other intangible assets with indefinite lives was \$517,819 in 2001.

In August 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The provisions of this statement are effective with fiscal years beginning after December 15, 2001. SFAS No. 144 establishes a single accounting model for long-lived assets to be disposed of and replaces SFAS No. 121 *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of*, and Accounting Principals Bulletin No. 30, *Reporting Results of Operations - Reporting the Effects of Disposal of A Segment of Business*. We believe the impact of this statement will not have a material impact on our financial position and results of operations.

Reclassification. Certain balances in the 2000 and 1999 financial statements have been reclassified to conform to 2001 presentations. Such reclassifications had no effect on reported net income.

2. Acquisition

In February 2001, we completed the purchase of a company involved in developing web-based data extraction and processing technology. The transaction has been recorded using the purchase method of accounting. The purchase price has been allocated to the assets acquired, which consisted primarily of proprietary technology and intangibles and goodwill. Pro forma financial information is not presented, as the impact on our results of operations was not material.

3. Furniture, Fixtures and Equipment

Furniture, fixtures and equipment by major classification are summarized as follows:

| | | December 31, | | |
|------------------------|------|----------------|----|--------|
| | 2001 | (In thousands) | | 2000 |
| Equipment | \$ | 86,914 | \$ | 63,232 |
| Furniture and fixtures | | 11,991 | | 9,794 |
| Leasehold improvements | | 6,436 | | 5,037 |

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| | | | | |
|--------------------------|----|----------|----|----------|
| | | 105,341 | | 78,063 |
| Accumulated depreciation | | (36,275) | | (23,314) |
| | \$ | 69,066 | \$ | 54,749 |

4. Credit Facilities

Long-term debt consisted of the following:

| | 2001 | December 31, (In thousands) | 2000 |
|-----------------------------------|------|--------------------------------|---------|
| Secured Equipment Financing Loans | \$ | \$ | 34,242 |
| Current portion of long-term debt | | | (9,511) |
| | \$ | \$ | 24,731 |

Loan Agreements. At various times during 2001 and 2000, we had equipment financing loan arrangements with an equipment financing lender. The arrangements provided us with borrowing capacity to fund the expansion of our call center network and for other equipment needs. The arrangements provided for fixed or floating rate options and all assets purchased pursuant to the arrangements were pledged as collateral. Individual borrowings under the arrangements had terms of 48 months each, and prepayment of outstanding borrowings was allowable 12 months after the funding dates, or, with certain restrictions, at any time prior, for a 1% fee. Outstanding individual borrowings bore interest at fixed rates ranging from 8.10% to 10.09%. As of December 31, 2001, we had no outstanding borrowings under these arrangements (see Note 6).

Line of Credit. During December 1999, we entered into a line of credit agreement with a commercial bank that replaced certain prior agreements. The agreement consisted of a \$10 million revolving line of credit bearing interest based on the bank's prime rate and our debt to cash flow ratio. The line was secured by all accounts receivable and was subject to an unused facility fee and various financial and restrictive covenants. The line of credit was paid in full as of January 31, 2001 and the facility expired at December 31, 2001 with no amounts outstanding (see Note 6).

5. Lease Obligations

We lease operating facilities and equipment under operating leases with unexpired terms of one to eight years. Rental expense for operating leases was approximately \$7,496,000, \$5,418,000 and \$3,497,000 for 2001, 2000 and 1999, respectively.

Minimum annual rentals for the five years subsequent to 2001 and in the aggregate thereafter are as follows:

| Year Ending December 31, | Annual lease payments (In thousands) |
|-----------------------------|---|
| 2002 | \$ 8,430 |

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| | |
|------------------------------|-----------|
| 2003 | 8,190 |
| 2004 | 7,523 |
| 2005 | 6,275 |
| 2006 | 4,349 |
| Thereafter | 4,577 |
| Total minimum lease payments | \$ 39,344 |

6. Shareholders Equity

Significant transactions. On January 31, 2001, our shareholders approved the issuance and sale to Sonera Media Holding B.V. of 6,000,000 shares of common stock for a net amount of approximately \$64,600,000, which represented approximately 25.5% of our outstanding common stock after the issuance. Sonera Media Holding B.V. is a wholly-owned subsidiary of Sonera Corporation, a publicly traded telecommunications company organized in Finland. This transaction was completed in February 2001. During February and March 2001, we paid all outstanding debt with a portion of the proceeds from this transaction.

In addition, in conjunction with the Sonera transaction, on January 31, 2001, the shareholders approved an amendment of our 1994 Stock Incentive Plan to increase the number of shares available for issuance by 870,000 shares, from 3,450,000 to 4,320,000 shares of common stock.

On May 16, 2001, the Board of Directors approved a three-for-two stock split in the form of a 50% stock dividend, distributing approximately 8,100,000 shares on June 29, 2001. All share and per share data presented in the accompanying financial statements and notes thereto have been restated for the stock split.

Preferred Stock. We have authorized 10,000,000 shares of preferred stock for issuance. Our board of directors has the authority to issue one or more series of preferred shares and the authority to fix and determine the rights and preferences of such shares. No preferred shares were issued or outstanding as of December 31, 2001.

Common Stock Options. We have a Stock Incentive Plan (the Plan), approved by the shareholders, which provides for the award of incentive stock options to key employees and the award of non-qualified stock options, stock sales and grants to employees, outside directors, independent contractors and consultants. As of December 31, 2001, 479,000 shares of common stock were reserved for issuance under the Plan. It is intended that the Plan will be used principally to attract and retain key employees.

The option price per share of an incentive stock option may not be less than the fair market value of a share of common stock as of the date such option is granted. The option price per share of a non-qualified stock option may be at any price established by the board of directors or a committee thereof established for purposes of administering the plan. Options become exercisable at the times and subject to the conditions prescribed by the board of directors. Generally, options vest over a period of four years and the term of each option may not exceed ten years. Payment for shares purchased pursuant to options may be made in cash or, subject to approval by the board of directors, by delivery of shares of common stock having a market value equal to the exercise price of the options.

In 1999, our stockholders approved the Metro One Telecommunications, Inc. 1999 Employee Stock Purchase Plan (the ESPP). The purpose of the ESPP is to attract and retain qualified employees essential to our success, and to provide such persons with an incentive to perform in our best interests. The ESPP allows qualified employees to purchase shares of our common stock on a semi-annual basis, limited to 10% of pre-tax compensation. The purchase price is set at 85% of the lower of the stock price at the beginning or ending of each purchase period. As of December 31, 2001, 225,000 shares of common stock were reserved for issuance under the ESPP. Under the ESPP, during 2001, employees purchased approximately 51,000 shares at an average price of \$13.69 per share. During 2000, employees purchased approximately 39,000 shares at an average of \$6.63 per share.

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We have elected to continue to account for stock options according to Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Accordingly, no compensation cost has been recognized in the financial statements related to stock options issued under the Plan. If compensation cost on stock options granted in 2001, 2000 and 1999 under this Plan had been determined based on the fair value of the options granted as of the grant date in a method consistent with that described in Statement of Financial Accounting

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Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, our net income and earnings per share would have been changed to the pro forma amounts indicated below for the years ended December 31:

| | 2001 | | 2000 | | 1999 |
|---|--|--------|------|-------|----------|
| | (In thousands, except per share amounts) | | | | |
| Net income, as reported | \$ | 28,422 | \$ | 9,742 | \$ 1,906 |
| Diluted earnings per share, as reported | | 1.15 | | 0.54 | 0.11 |
| Net income, pro forma | \$ | 25,618 | \$ | 8,747 | \$ 1,014 |
| Diluted earnings per share, pro forma | | 1.03 | | 0.48 | 0.06 |

The pro forma amounts may not be indicative of the effects on reported net income for future periods due to the effect of options vesting over a period of years and the awarding of stock compensation in future years.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions for the years ending December 31:

| | 2001 | | 2000 | | 1999 |
|--|------|-------|------|-------|---------|
| Dividend yield | | 0.0% | | 0.0% | 0.0% |
| Risk free interest rate | | 4.4% | | 5.0% | 5.9% |
| Expected volatility | | 87.0% | | 75.4% | 73.6% |
| Expected life in years | | 4.0 | | 4.0 | 4.0 |
| Weighted-average fair value of options granted | \$ | 15.59 | \$ | 3.95 | \$ 5.41 |

A summary of the status of our stock option plan as of December 31, and changes during the years ending on those dates is as follows:

| | 2001 | | 2000 | | 1999 | |
|----------------------------------|--|------------------------------|--------|------------------------------|--------|------------------------------|
| | Shares | Weighted-Average Exer. Price | Shares | Weighted-Average Exer. Price | Shares | Weighted-Average Exer. Price |
| | (In thousands, except per share amounts) | | | | | |
| Outstanding at beginning of year | 2,056 | \$ 6.75 | 2,315 | \$ 6.12 | 2,647 | \$ 5.92 |
| Granted | 668 | 24.43 | 510 | 8.67 | 82 | 10.50 |
| Exercised | (510) | 6.47 | (587) | 5.84 | (340) | 5.39 |
| Forfeited | (11) | 9.81 | (182) | 6.98 | (74) | 7.45 |
| Outstanding at end of year | 2,203 | \$ 12.16 | 2,056 | \$ 6.75 | 2,315 | \$ 6.12 |
| Options exercisable at year-end | 1,448 | | 1,509 | | 1,817 | |

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| | | | | | | |
|--|----|------|----|------|----|------|
| Weighted-average fair value of options exercisable at year end | \$ | 9.15 | \$ | 6.28 | \$ | 5.95 |
|--|----|------|----|------|----|------|

The following table summarizes information about stock options outstanding and exercisable under the Plan at December 31, 2001:

| Range of Exercise Prices | Number of Options | Outstanding | | Exercisable | |
|--|-------------------|---|---------------------------------|-------------------|---------------------------------|
| | | Weighted-Average Contractual Life (yrs) | Weighted-Average Exercise Price | Number of Options | Weighted-Average Exercise Price |
| (In thousands, except per share amounts) | | | | | |
| \$ 5.37 - 8.00 | 1,199 | 5.33 | \$ 6.16 | 1,014 | \$ 5.90 |
| 8.42 - 12.00 | 346 | 7.84 | 9.56 | 225 | 9.45 |
| 22.55 - 23.00 | 577 | 9.15 | 22.95 | 184 | 22.85 |
| 30.00 - 38.00 | 81 | 9.61 | 35.05 | 25 | 37.40 |
| \$ 5.37 - 38.00 | 2,203 | 6.88 | \$ 12.16 | 1,448 | \$ 9.15 |

7. Other Income and Expense

Included in other income (expense) are certain items that do not relate directly to current ongoing business activity. Included in this classification for the year ended December 31, 2001 is interest income of \$1,337,000 offset by losses on asset dispositions of \$176,000 and other miscellaneous non-operating expenses of \$51,000. For the year ended December 31, 2000, other expense consisted primarily of losses on asset dispositions of \$220,000 and other miscellaneous non-operating expenses of \$106,000 offset by interest income of \$301,000. For the year ended December 31, 1999, other income consisted primarily of interest income of \$192,000 offset by losses on asset dispositions of \$67,000.

8. Income Taxes

The components of income tax expense for the years ended December 31 are as follows:

| | 2001 | 2000 | 1999 |
|-------------------|----------------|--------|-------|
| | (In thousands) | | |
| Current: | | | |
| Federal | \$ 5,671 | \$ 96 | \$ 8 |
| State | 670 | 678 | 75 |
| | 6,341 | 774 | 83 |
| Deferred: | | | |
| Federal | 1,775 | (96) | (8) |
| State | | | |
| | 1,775 | (96) | (8) |
| Total tax expense | \$ 8,116 | \$ 678 | \$ 75 |

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Income tax expense differs from the amount that would result by applying the U.S. statutory rate to income before taxes. A reconciliation of this difference is as follows:

| | 2001 | December 31, 2000 | 1999 |
|--|-------|----------------------|--------|
| Federal statutory rate | 34.0% | 34.0% | 34.0% |
| State income taxes, net of federal benefit | 3.0 | 6.6 | 3.9 |
| Net operating loss carryforwards | (7.0) | (34.8) | (36.8) |
| Federal and state tax credits | (6.0) | | |
| Other | (1.8) | 0.7 | 2.7 |
| Effective tax rate | 22.2% | 6.5% | 3.8% |

The reconciliation reflects permanent items that impact income tax expense. Items that increase income tax expense include state income taxes and various non-deductible expenses, whereas items that decrease income tax expense include net operating loss carryforwards and various federal and state tax credits.

Net deferred tax assets and liabilities are included in the following balance sheet line items:

| | 2001 | December 31, (In thousands) | 2000 |
|--|------|--------------------------------|----------|
| Prepaid costs and other current assets | \$ | 2,008 | \$ 4,534 |
| Other long-term liabilities | | (3,591) | (4,343) |
| Net deferred tax (liability) asset | \$ | (1,583) | \$ 191 |

The temporary differences and carryforwards that give rise to deferred tax assets and liabilities are as follows:

| | 2001 | December 31, (In thousands) | 2000 |
|-----------------------------------|------|--------------------------------|----------|
| Deferred tax asset: | | | |
| Net operating loss carryforwards | \$ | 827 | \$ 4,441 |
| Expenses not currently deductible | | 1,136 | 800 |
| Tax credit carryforwards | | 2,307 | 223 |
| Gross deferred tax assets | | 4,270 | 5,464 |
| Valuation allowance | | | (930) |

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| | | |
|------------------------------------|------------|--------|
| Deferred tax assets | 4,270 | 4,534 |
| Deferred tax liability: | | |
| Accumulated depreciation | 5,853 | 4,343 |
| Net deferred tax (liability) asset | \$ (1,583) | \$ 191 |

At December 31, 2001, we had approximately \$2,200,000 of net operating loss carryforwards expiring during the years 2005 to 2010. Ownership changes as defined by section 382 of the Internal Revenue Code could limit the amount of net operating loss carryforwards used in any one year or in the aggregate.

9. Net Income Per Share

Basic net income per share is based on the weighted average number of common shares outstanding. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. There were no adjustments to net income for the calculation of both basic and diluted net income per share for all periods.

The calculation of weighted-average outstanding shares is as follows:

| | 2001 | Average Shares 2000 (In thousands) | 1999 |
|---|--------|--|--------|
| Weighted average common shares outstanding (used in computing Basic net income per share) | 23,589 | 17,520 | 17,086 |
| Common stock equivalents | 1,223 | 665 | 896 |
| Weighted average common shares outstanding (used in computing Diluted net income per share) | 24,812 | 18,185 | 17,982 |

Options to purchase approximately 32,000, 85,000 and 8,000 shares of common stock were outstanding at December 31, 2001, 2000 and 1999, respectively, but were not included in the computation of diluted net income per share because their effect would be anti-dilutive.

All common shares have been restated for a three-for-two stock split effective June 29, 2001.

10. Benefit Plans

We have a deferred compensation savings plan for the benefit of our eligible employees. The plan permits certain voluntary employee contributions to be excluded from the employees' current taxable income under the provisions of Internal Revenue Code Section 401(k). Each employee becomes eligible to participate in the savings plan six months following the initial date of employment. The employee must also complete at least 500 hours of service in any twelve-month period. Under the plan, we can make discretionary contributions to the plan as approved by the board of directors.

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Participants' interest in company contributions to the plan vest over a four-year period. We made contributions of approximately \$159,000, \$83,000 and \$55,000 during 2001, 2000 and 1999, respectively.

11. Statement of Cash Flows

Supplemental disclosure of Cash Flow information:

| | 2001 | December 31, 2000 | 1999 |
|----------------------------|----------|----------------------|--------|
| | | (In thousands) | |
| Cash paid for interest | \$ 993 | \$ 3,130 | \$ 718 |
| Cash paid for income taxes | \$ 4,395 | \$ 366 | \$ 78 |

Quarterly Financial Summary (Unaudited)

| | Quarter ended | | | |
|---|---------------|-----------|--------------|-------------|
| | March 31 | June 30 | September 30 | December 31 |
| (In thousands except per share amounts) | | | | |
| 2001 | | | | |
| Revenues | \$ 50,216 | \$ 59,162 | \$ 60,868 | \$ 63,072 |
| Direct operating expense | 28,778 | 32,875 | 35,194 | 35,005 |
| General and administrative expense | 14,474 | 16,761 | 16,954 | 17,058 |
| Income from operations | 6,964 | 9,526 | 8,720 | 11,009 |
| Net income | 5,003 | 7,760 | 7,575 | 8,083 |
| Basic net income per share | .22 | .32 | .31 | .33 |
| Diluted net income per share | .22 | .31 | .30 | .32 |
| 2000 | | | | |
| Revenues | \$ 29,711 | \$ 36,589 | \$ 42,953 | \$ 47,728 |
| Direct operating expense | 18,523 | 24,036 | 26,879 | 27,999 |
| General and administrative expense | 9,319 | 10,668 | 12,219 | 13,686 |
| Income from operations | 1,869 | 1,885 | 3,855 | 6,043 |
| Net income | 1,121 | 1,156 | 2,764 | 4,702 |
| Basic net income per share | .07 | .07 | .16 | .27 |
| Diluted net income per share | .06 | .06 | .15 | .25 |