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9278 COMMUNICATIONS INC  
Form 10-Q  
June 27, 2003

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended March 31, 2003  
-----

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

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

Commission file number: 333-37654  
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9278 COMMUNICATIONS, INC.  
(Exact name of registrant as specified in its charter)

Delaware	13-4165136
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1942 Williamsbridge Road, Bronx, New York 10461  
-----

(Address of principal executive offices)

(718) 887-9278  
-----

(Registrant's telephone number, including area code)

Not applicable

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

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

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1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 after the distribution of securities under a plan confirmed by a court.

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date:

Common Stock, \$.001 par value - 100 shares issued and outstanding as of June 20, 2003

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

9278 Communications, Inc. and Subsidiaries

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### 9278 Communications, Inc. and Subsidiaries

#### CONSOLIDATED CONDENSED BALANCE SHEETS

	March 31, 2003	December 31, 2002
	-----	-----
	(UNAUDITED)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 6,974,587	\$ 7,527,098
Restricted cash	-	1,020,809
Accounts receivable, net of allowance of \$678,000 at March 31, 2003 and \$760,000 at December 31, 2002	15,092,164	14,711,918
Accounts receivable-related party	4,964,653	4,963,508
Inventories	19,932,413	18,041,063
Prepaid expenses and other current assets	141,315	32,622
	-----	-----
Total current assets	47,105,132	46,297,018
PROPERTY AND EQUIPMENT, NET	1,720,405	1,801,798
NOTE RECEIVABLE - STRATEGIC PARTNER	3,982,823	1,530,975
GOODWILL, NET	3,624,071	3,624,071
OTHER ASSETS	730,830	690,831
	-----	-----
	\$57,163,261	\$53,944,693
	=====	=====

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The accompanying notes are an integral part of these statements.

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9278 Communications, Inc. and Subsidiaries

CONSOLIDATED CONDENSED BALANCE SHEETS

	March 31, 2003 ---- (UNAUDITED)	De
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 61,984,754	\$ 57
Accounts payable - related party	2,700	
Current maturities of capital lease obligations	31,779	
Current maturities of convertible notes payable	52,520	
Income taxes payable	-	
	-----	-----
Total current liabilities	62,071,753	57
CAPITAL LEASE OBLIGATIONS, less current maturities	23,460	
CONVERTIBLE NOTES PAYABLE, less current maturities	75,126	
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY (DEFICIT)		
Common stock - \$.001 par value; 40,000,000 shares authorized; 23,932,912 shares issued and outstanding at March 31,2003 and December 31,2002	23,933	
Additional paid-in capital	8,247,458	8
Accumulated deficit	(13,278,469)	(12
	-----	-----
Total Shareholders' Equity (deficit)	(5,007,078)	(3
	-----	-----
	\$ 57,163,261	\$ 53
	=====	=====

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The accompanying notes are an integral part of these statements.

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9278 Communications, Inc. and Subsidiaries  
 CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS  
 (UNAUDITED)

	Three Months Ended March 31,	
	2003	2002
	----	----
Net sales	\$ 72,949,014	\$ 57,365,454
Cost of sales	67,986,011	53,069,185
	-----	-----
Gross profit	4,963,003	4,296,269
	-----	-----
Operating expenses		
Selling	3,151,419	1,466,587
General and administrative	2,859,017	2,418,929
Depreciation and amortization	111,732	72,606
Provision for bad debts	-	51,792
	6,122,168	4,009,914
	-----	-----
Operating profit/(loss)	(1,159,165)	286,355
Other expenses		
Interest expense, net	482	10,778
	-----	-----
	482	10,778
	-----	-----
Earnings/(loss) before income taxes	(1,159,647)	275,577
Income tax provision	-	15,000
	-----	-----
Net income/(loss)	\$ (1,159,647)	\$ 260,577
	=====	=====
Earnings/(loss) per common share		
Basic and diluted	\$ (0.05)	\$ 0.01
	=====	=====

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Weighted-average shares		
Basic and diluted	23,932,912	23,932,912
	=====	=====

The accompanying notes are an integral part of these statements.

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9278 Communications, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENT OF SHAREHOLDERS' EQUITY

Three months ended March 31, 2003

	Common stock		Additional paid-in capital
	Shares	Amount	
	-----	-----	-----
Balance at January 1, 2002	22,932,912	\$ 22,933	\$ 8,248,458
Issuance of common stock in connection with acquisition of Reliable Networks, Inc.	1,000,000	1,000	(1,000)
Net loss for the year ended December 31, 2002	-----	-----	-----
Balance at December 31, 2002	23,932,912	23,933	8,247,458
Net loss for the three months ended March 31, 2003	-----	-----	-----
Balance at March 31, 2003	23,932,912	\$ 23,933	\$ 8,247,458
	=====	=====	=====

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The accompanying notes are an integral part of this statement.

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9278 Communications, Inc. and Subsidiaries  
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	March 31, 2003 ----	March 31, 2002 ----
Cash flows from operating activities		
Net income (loss)	\$(1,159,647)	\$ 260,577
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	111,732	72,606
Provision for doubtful accounts	-	51,792
Changes in assets and liabilities		
Restricted cash	1,020,809	(4,629)
Accounts receivable	(381,391)	339,235
Inventories	(1,891,350)	(6,239,028)
Prepaid expenses and other current assets	(108,693)	(218,610)
Other assets	(40,000)	(11,569)
Accounts payable and accrued expenses	4,435,606	4,572,826
Income taxes payable	(14,145)	(44,250)
	-----	-----
Net cash provided by (used in) operating activities	1,972,921	(1,221,050)
	-----	-----
Cash flows from investing activities		
Acquisition of property and equipment	(30,340)	(195,312)
Notes Receivable, Strategic Partner	(2,451,848)	-
	-----	-----
Net cash used in investing activities	(2,482,188)	(195,312)
	-----	-----
Cash flows from financing activities		
Notes and advances payable, shareholder, net	-	(292,825)
Principal payments on capital lease obligations	(30,744)	(9,412)

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Principal payments on convertible notes payable, net	(12,500)	(10,689)
	-----	-----
Net cash used in financing activities	(43,244)	(312,926)
	-----	-----
Net decrease in cash and cash equivalents	(552,511)	(1,729,288)
Cash and cash equivalents, beginning of period	7,527,098	4,335,936
	-----	-----
Cash and cash equivalents, end of period	\$ 6,974,587	\$ 2,606,648
	=====	=====

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9278 Communications, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (continued)  
(UNAUDITED)

	March 31, 2003 ----	March 31, 2002 ----
Supplemental disclosures of cash flow information:		
Cash paid during the period for		
Interest	\$ 482	\$ 17,130
	-----	-----
Income taxes	\$ 14,145	\$ 67,381
	=====	=====



The accompanying notes are an integral part of these statements.

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9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTION

The accompanying consolidated unaudited financial statements of 9278 Communication Inc. and subsidiaries (collectively, the "Company") have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for quarterly reports on Form 10-Q and do not include all of the information and footnote disclosures generally required by accounting principles generally accepted in the United States and should be read in conjunction with our consolidated financial statements and notes thereto for the fiscal year ended December 31, 2002, included in the Company's Form 10-K as filed with the SEC. The accompanying condensed consolidated unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States and reflect all adjustments (consisting of normal recurring accruals) which are, in the opinion of the management, considered necessary for a fair presentation of results for these interim periods. Operating results for the three month periods ended March 31, 2003 and 2002 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2003.

The accompanying condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The Company sustained substantial losses from operations and its current liabilities exceeded its current assets by approximately \$14,967,000 as of March 31, 2003. The company is largely dependent upon the extension of credit from its vendors, in particular on credit granted by a significant supplier. These factors raise substantial doubt about the Company's ability to continue as a going concern.

In the event sufficient vendor credit is no longer available, the Company would be required to seek other financing, however there can be no assurance that the Company will be able to obtain such financing on commercially reasonable terms, or otherwise or that the Company would be able to satisfy short-term cash flow needs. The Company is continuously renegotiating credit terms with its suppliers and, to date, has received favorable terms. The Company believes its relationships with its vendors are satisfactory; however, the Company's creditors currently have the right

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to modify credit terms.

### NOTE 2 - NATURE OF BUSINESS

The Company distributes prepaid telephone calling cards to distributors and retail establishments through its various sales locations throughout the United States. In addition, the Company markets certain prepaid calling cards directly to consumers via its internet websites.

On January 31, 2003, the Company announced the execution of a Merger Agreement with NTSE Holding Corp., a corporation wholly owned by the Chairman, Chief Executive Officer and the principal stockholder, which will result in the Company becoming a privately held corporation, owned by the Company's Chairman. Pursuant to this agreement, all of the existing stockholders will receive a cash payment of \$0.10 per share. The transaction was approved by its public stockholders on June 3, 2003 and the merger was consummated on June 4, 2003. Total payment in terms of the merger agreement amounted to approximately \$1,092,000.

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9278 Communications, Inc. and Subsidiaries

### NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

### NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows:

#### PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of 9278 Communications, Inc. and its wholly owned subsidiaries, 9278 Distributors, Inc., 9278 Dot Com Inc., E-Store Solutions Inc., Inc., 9278 Mobile, Inc., 9278 Technologies, Inc., NTSE Communications, Inc., 9278 Distributors Illinois, Inc., 9278 California, Inc., 9278 Distributors Maryland Inc., 9278 Distributors New Jersey Inc., Reliable Acquisition Corp., 9278 Distributors Ohio Inc., 9278 Distributors Florida Inc., and 9278 Distributors North Carolina Inc. (hereinafter, the "Company"). All significant inter-company transactions and balances have been eliminated in consolidation.

#### CASH AND CASH EQUIVALENTS

Cash and cash equivalents include all cash and highly liquid investments with an original maturity of three months or less.

#### INVENTORIES

Inventories, which consist of prepaid telephone cards, are stated at the lower of cost (first-in, first-out) or market.

#### PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation and amortization

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are provided for, using straight-line and accelerated methods, in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives. Leased property under capital leases is amortized over the shorter of the service lives of the assets or the term of the lease. Repairs and maintenance are charged to operations as incurred.

### INCOME TAXES

Income taxes are accounted for under the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 109 ("SFAS No. 109"), "Accounting of Income Taxes." Under SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are

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9278 Communications, Inc. and Subsidiaries

### NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

#### NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The company has made provision for various minimum state and local taxes. The provision, in 2002, for federal taxes has been offset against the company's net operating losses carried forward from prior years. A valuation allowance has been established as the likelihood of realizing net deferred tax benefits is presently doubtful.

### EARNINGS/LOSS PER SHARE

Basic earnings per share are determined by dividing the Company's net earnings/loss by the weighted-average shares outstanding. Diluted earnings per share include the dilutive effects of outstanding stock option and warrants. Excluded from the calculation of diluted earnings per share are 210,000 options and warrants to purchase the Company's common stock as their inclusion would have been antidilutive.

### GOODWILL

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141 ("SFAS No. 141"), "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). For all business combinations initiated after June 30, 2001, SFAS No. 141 eliminates the pooling-of-interests method of accounting and requires the purchase method of accounting, including revised recognition criteria for intangible assets other than goodwill. Under SFAS No. 142, which is effective for years beginning after December 15, 2001, goodwill and indefinite-lived intangible assets are no longer amortized but are reviewed annually, or more frequently if impairment indicators arise,

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for impairment. Intangible assets that have finite lives will continue to be amortized over their useful lives and reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." The Company has adopted SFAS No. 142 for the year beginning January 1, 2002.

### LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or group of assets may not be fully recoverable. If an impairment indicator is present, we evaluate recoverability by a comparison of the carrying amount of the assets to future undiscounted net cash flows that we expect to generate from these assets. If the assets are impaired, we recognize an impairment charge equal to the amount by which the carrying amount exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying values or fair values, less estimated costs of disposal.

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9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2002, the FASB issued SFAS No.148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No.123." SFAS No.148 amends SFAS No.123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for an entity that voluntarily changes to the fair value-based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No.25 and related interpretations as provided for under SFAS No.148. Accordingly, compensation expense is only recognized when the market value of the Company's stock at the date of the grant exceeds the amount an employee must pay to acquire the stock.

Proforma earnings (loss) and earnings (loss) per share are not presented as the proforma information is equal to the Company's reported results.

In January 2003, the FASB issued FASB Interpretation No.46 "Consolidation of Variable Interest Entities." In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. A variable interest entity often holds financial assets, including loans or receivables real estate or other property. A variable interest entity may be essentially passive or it may engage in activities on behalf of another company. Until now, a company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN No.46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a

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majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN No. 46's consolidation requirements apply immediately to variable interest entities created or acquired after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year on interim period beginning after June 15, 2003. Certain of the disclosure requirements apply to all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Company has not adopted FIN No.46 for the three months ended March 31, 2003, however the Company has provided for the required disclosures required by FIN No. 46 (see Note 5). The Company has not completed its Decembers 31, Estimated useful life March 31, of the effects of adopting FIN No. 46.

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9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### REVENUE RECOGNITION

Revenue is recognized from sales when products are shipped and title passes to the customer. Sales incentives in the form of free products given to the Company's distributors are classified as a reduction of revenues.

#### ADVERTISING

Advertising costs are expensed as incurred and totaled \$1,051,149 and \$776,317 for the three months ended March 31, 2003 and 2002, respectively.

#### SHIPPING AND HANDLING FEES AND COSTS

The Company includes fees billed to a customer relating to shipping and handling costs in net sales. All shipping and handling expenses incurred by the Company are included in cost of sales.

#### USES OF ESTIMATES AND FAIR VALUE OF FINANCIAL INSTRUMENTS

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

Management of the Company believes that the fair value of financial instruments, consisting of cash, accounts receivable and debt, approximates carrying value due to the immediate or short-term maturity associated with its cash and accounts receivable and the interest rates associated with its debt.

#### ACCOUNTS RECEIVABLE

Accounts receivable are due within contractual payment terms and are stated at amounts due from customers net of an allowance for doubtful accounts. Credit is extended based on evaluation of a customer's financial condition.

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Accounts outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they become uncollectible, and payment subsequently received on such receivables are credited to the allowance for doubtful debts.

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9278 Communications, Inc. and Subsidiaries

### NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

#### NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	Estimated useful life (years) -----	March 31, 2003 ----	Dece
Furniture and equipment	5 - 7	\$ 709,945	\$
Automobiles	5 - 7	270,065	
Computer equipment	5	1,287,920	1,
Leasehold improvements	3 - 8	325,100	
		-----	-----
		2,593,030	2,
Less accumulated depreciation and amortization		872,625	
		-----	-----
		\$ 1,720,405	\$ 1,
		-----	-----

Depreciation and amortization expense for property and equipment for the three months ended March 31, 2003 and 2002 was approximately \$111,732 and \$72,606 respectively.

#### NOTE 5 - NOTE RECEIVABLE - STRATEGIC PARTNER

On December 1, 2002, the Company entered into an agreement with a newly established telecommunications carrier ("Telecom") whereby the Company agreed to advance a minimum of \$3 million to establish a switching platform (the "platform") to provide telecommunication services in exchange for

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certain preferential rights to the said services. Such advances are evidenced by a promissory note which bears interest at 10% and is collateralized by all current and future assets of Telecom. The Company further agreed to utilize a minimum of \$10 million of these services during the year ended December 31, 2003.

In the event that Telecom is not successful in establishing the platform or does not provide the aforementioned services to the Company in terms of the agreement, they will be required to repay all monies previously advanced to them and all equipment and infrastructure purchased with the said funds will revert to the Company.

Presently, the Company is Telecom's sole source of funds and sole customer. As a result, the operations of Telecom may be required to be consolidated with those of the Company in terms of FASB Interpretation No.46, "Consolidation of Variable Interest Entities". As of March 31, 2003, the Company had advanced approximately \$4.0 million to Telecom. In addition, as of March 31, 2003, the Company had outstanding billings from Telecom for services aggregating approximately \$2.6 million.

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9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

### NOTE 6 - RELATED PARTY TRANSACTIONS

Sales of inventory to a customer who is related to an officer of the Company were approximately \$9,261,000 and \$6,171,000 for the three months ended March 31, 2003 and 2002, respectively. The Company also purchased inventory from this customer in the amount of \$240,000 and \$2,763,000 during the nine months ended March 31, 2003 and 2002, respectively.

### NOTE 7 - CONTINGENCIES

The Company from time to time is subject to other certain legal proceedings and claims which have arisen in the ordinary course of its business. These aforementioned actions when ultimately concluded will not, in the opinion of management, have a material adverse effect upon the financial position, results of operations or liquidity of the Company.

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ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto set forth in Item 1 of this Quarterly Report. In addition to historical information, this discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions, which could cause actual results to differ materially from Management's expectations. Factors that could cause differences include, but are not limited to, expected market demand for the Company's products, fluctuations in pricing for products distributed by the Company and products offered by competitors, as well as general conditions of the telecommunications marketplace.

OVERVIEW

To date, our principal source of revenue has been the marketing and distribution of prepaid phone cards. We market and distribute branded prepaid phone cards, which are produced by a variety of telecommunications long distance carriers and resellers, as well as private label proprietary prepaid phone cards produced exclusively for us by various long distance carriers and/or resellers.

Prepaid phone cards are distributed through a vast network of retail outlets, including convenience stores, newsstands, grocery stores and discount stores. The retail outlets are serviced by independent distributors, which often distribute newspapers or other items to the retail outlets. We purchase large volumes of branded prepaid phone cards from the long distance carrier or reseller and sell the cards in smaller quantities, together with cards from other carriers and/or private label cards we distribute, to the independent distributor, for ultimate distribution to retailer outlet.

We purchase branded cards at a discount from the face value of the card, and resell them to the distributor at a slightly lower discount. The difference between the two discount rates, typically from 1% to 8%, represents the gross margin we retain. We purchase branded cards on varying terms, from C.O.D. to an as used basis. Sales of our products are generally made on a net 21 day basis.

Private label cards are generally designed and produced by us, utilizing card numbers and PINs provided by the telecommunications carrier or reseller providing the long distance service for the card. We incur the upfront expense of printing the phone cards. However, we do not pay the long distance carrier until it activates the cards, which occurs upon our sale to the distributor. Accordingly, through the use of private label cards, our cost of inventory is significantly reduced, as purchases are effectively made on an as-needed basis. In addition, private label cards generally provide us with the ability to achieve a greater gross margin percentage, typically ranging from 3% to 8%. During the past two years, we have continued to increase our sales of private label cards, both on an absolute dollar volume and as a percentage of our sales. During the three months ended March 31, 2003, we sold over 300 varieties of private label cards, which accounted for in excess of 80% of our total revenues.



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We continue to seek to expand our geographic reach and to increase our sales. In recent years, we have established distribution centers in California, Connecticut, Florida, Illinois, Maryland, Michigan, North Carolina, Ohio, Upstate New York, as well as additional distribution centers in the New York metropolitan area, and we have established strategic relationships with distributors in Canada and United Kingdom. In addition, in 2001, we commenced pre-paid phone card sales through our Internet Websites. Through our websites, consumers worldwide can purchase 9278 phone cards over the Internet from a selection of over 100 cards, searchable by various criteria, e.g., rates, brand name, country, etc., and receive immediate delivery of the card's access number and PIN codes via e-mail.

We are seeking to develop and acquire rights to additional prepaid telecommunications services and other prepaid products or services to diversify our product offerings and increase our overall gross margin. In the short-term, additional costs related to the development or acquisition of such products may have an impact on our net profits.

### RESULTS OF OPERATIONS

The following table sets forth certain financial data as a percentage of net revenues for the periods indicated:

	For the three months ended March 31,	
	2003	2002
	----	----
Net revenues	100.00%	100.00%
Cost of services	93.20	92.51
	-----	-----
Gross margin	6.80	7.49
Selling expenses	4.32	2.56
General and administrative expenses	3.92	4.22
Depreciation and amortization	0.15	0.13
Provision for bad debts	-	0.09
Interest expense, net	-	0.02
	-----	-----
Earnings (loss) before income taxes	(1.59)%	0.47%
	-----	-----

### THREE MONTHS ENDED MARCH 31, 2003 COMPARED TO THREE MONTHS ENDED MARCH 31, 2002

**NET REVENUES.** Net revenues for the three months ended March 31, 2003 increased \$15.5 million, or 27.2%, to \$72.9 million from \$57.4 million for the same period in 2002. Except for the Queens and Connecticut offices, same location sales in each other location increased during the three months ended March 31, 2003 as compared to the same period in 2002. Sales for our California office increased 54.8% over previous year as we opened an additional office in Orange County and hired additional salespersons to promote the sales. Internet sales recorded a 39.6% increase over its previous year levels. In 2002 and during the quarter ended March 31, 2003, we added additional websites selling our cards to the consumers. Our office in Chicago, IL, recorded 70.2% increase in sales over

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previous year sales as it expanded its operations by opening a sales office in Dearborn, Michigan. The Maryland office recorded a 29.1% increase in sales over the same period in 2002 as it expanded its operations by opening a sales office in Richmond, Virginia. The Company opened new offices in Miami, Florida and Charlotte, North Carolina in October 2002, which accounted for 7.0% and 1.3% respectively of the total sales for the three months ended March 31, 2003. In February 2003, the Company opened its new sales office in Columbus, Ohio. The same store revenues increased primarily as a result of extensive marketing efforts and continued expansion of market share for our private label cards. However, sales in some of the NY Metro area offices and Connecticut have declined by as much as 47.6% over the same period in 2002. The Company has primarily been focusing its sales efforts outside the NY Metro area during the past year. Intense competition and slowing economy in the region have also contributed to this decline.

**GROSS MARGIN.** Gross margin increased by \$0.67 million, or 15.5%, to \$4.96 million from \$4.30 million, for the three months ended March 31, 2003. As a percentage of sales, the gross margin dropped to 6.8% of net revenues for the three months ended March 31, 2003, as compared to 7.5% of net revenues for the same period in 2002. The Company's continued efforts to gain market share by giving up gross margins is attributable to this decline.

**SELLING EXPENSES.** Selling expenses for the three months ended March 31, 2003 increased \$1.68 million or 115% to \$3.15 million from \$1.47 million for the three months ended March 31, 2002. Of this, \$0.71 million was attributable to increase in advertising and promotion costs incurred to promote our new private label cards in new markets and to promote sales over the Internet. Commission expense increased by \$1.06 million as we hired commissioned salespersons to promote sales, starting in 2001.

Selling expenses as a percentage of net revenues increased to 4.3% for the three months ended March 31, 2003, from 2.56%, for the same period in 2002.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses for the three months ended March 31, 2003, increased by \$0.44 million or 18.2% to \$2.86 million from \$2.42 million for the same period in 2002. This increase was primarily due to the increase in costs of salaries and related taxes by \$286,000 in 2003 as compared to 2002 as we hired additional staff in our new locations. Included in the general and administrative expenses is the cost of rent expense increased by \$31,000, telephone expense increased by \$71,000 and travel expense by \$64,000 in 2003 as compared to 2002 as the Company continued to add new locations and expand existing facilities.

**DEPRECIATION AND AMORTIZATION.** Depreciation and amortization for the three months ended March 31, 2003 totaled \$111,732, an increase of \$39,000 as compared to the same period in 2002. Increase is due to acquisition of fixed assets for our new locations.

**NET INCOME (LOSS) FROM OPERATIONS.** We had a net loss of \$1.16 million for the three months ended March 31, 2003 as compared to a net profit of \$0.26 million for the three months ended March 31, 2002. The decrease in net income was due to the increase in selling expenses and operating expenses. Our geographical expansion by opening up new offices nationwide has led to increase in selling, general and administrative costs. We also adopted an aggressive pricing policy by discounting our cards and giving away promotional cards in these new locations to gain market share. We believe that our loss from operations is a temporary phenomenon and that there should be a turnaround once these new offices are established.

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### LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2003, we had total current assets of \$47.1 million. This included \$6.97 million in cash, \$19.93 million in inventories and \$20.06 million in accounts receivable. Our cash balances vary significantly from day-to-day due to the large volume of purchases made by us from the various prepaid phone cards companies and sales to numerous distributors to whom we sell cards. Although we had accounts payable of \$62.0 million at March 31, 2003, we believe that continued support from our trade creditors will provide us with adequate liquidity to fund our continued growth.

We provided \$1.97 million in cash from operating activities during the three months ended March 31, 2003 as compared to using \$1.2 million during the same period in 2002. Increase in cash flows during

the three months ended March 31, 2003 are related to increase in accounts payable by \$4.5 million and release of restricted cash by the bank in the amount of \$1.0 million, offset by increase in inventories and accounts receivables of \$1.9 million and \$0.4 million respectively and a net loss of \$1.16 million incurred during the three months ended March 31, 2003. Our working capital decreased by \$3.6 million during the three months ended March 31, 2003. The decrease in working capital is attributable to our net loss from operations and to a lesser extent to our opening of new offices, which involve carrying of additional inventories and accounts receivable. We believe our working capital shortfalls will decline once these offices are established and profitable.

Investing activities used \$2.5 million during the three months ended March 31, 2003 to acquire additional fixed assets and amounts paid to finance a strategic partner in setting up a switching platform, which is expected to benefit the Company in the future. Financing activities used \$43,000 during the three months ended March 31, 2003 to pay down principal on debt obligations.

We believe that existing cash and cash equivalents, cash flow from operations and available vendor credit will be sufficient to meet our planned working capital and capital expenditure budget through the next twelve months. However, circumstances could arise which would require the payment to our vendors sooner than we currently expect. We are largely dependent upon the credit granted to us by our vendors. In the event sufficient vendor credit is not available to us we would require other sources of financing. If we are required to seek other financing, there can be no assurance that we will be able to obtain such financing on commercially reasonable terms, or otherwise, or that we will be able to otherwise satisfy our short-term cash flow needs from other sources in the future which would have a material adverse effect on our operations. These factors raise substantial doubt about the Company's ability to continue as a going concern.

We are continuously renegotiating credit terms with our telephone card suppliers. The favorable changes in terms from our vendors has eliminated the temporary cash crunches that have occurred in the past, due to the restrictive credit terms previously made available to us from the telecommunications companies we buy branded cards from, as compared to the credit terms we make available to our customers. The Company believes its relationships with its vendors are satisfactory; however, the Company's creditors currently have the right to modify credit terms.

### OBLIGATIONS AND COMMITMENTS

As of March 31, 2003, the Company had the following obligations and commitments to make future payments under contracts, contractual obligations, and commercial commitments:

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	Total	Less than 1 year	1-3 years	4-7 years
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Operating leases	\$2,056,000	\$522,000	\$1,088,000	\$446,000
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CRITICAL ACCOUNTING POLICIES

Financial Reporting Release No. 60, published by the SEC, recommends that all companies include a discussion of critical accounting policies used in the preparation of their financial statements. The Company's significant accounting policies are summarized in Note 3 of its financial statements. While all

these significant accounting policies impact its financial condition and results of operations, the Company views certain of these policies as critical. Policies determined to be critical are those policies that have the most significant impact on the Company's financial statements and require management to use a greater degree of judgment and/or estimates. Actual results may differ from those estimates.

The Company believes that given current facts and circumstances, it is unlikely that applying any other reasonable judgments or estimate methodologies would cause a material effect on the Company's consolidated results of operations, financial position or liquidity for the periods presented in this report.

The accounting policies identified as critical are as follows:

REVENUE RECOGNITION. The Company recognizes revenues in accordance with generally accepted accounting principles as outlined in SAB No. 101 which requires that four basic criteria be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists, (2) product delivery, including customer acceptance, has occurred or services have been rendered, (3) the price is fixed or determinable and (4) collectibility is reasonably assured. The Company believes that its revenue recognition policy is critical because revenue is a very significant component of its results of operations. Decisions relative to criteria (4) regarding collectibility are based upon management judgments and should conditions change in the future and cause management to determine these criteria are not met, the Company's recognized results may be affected.

INCOME TAXES. In preparing the Company's consolidated financial statements, income tax expense is calculated for each of the jurisdictions in which the Company operates. This process involves estimating actual current taxes due plus assessing temporary differences arising from differing treatment for tax and accounting purposes which are recorded as deferred tax assets and liabilities. Deferred tax assets are periodically evaluated to determine their recoverability and where their recovery is not likely, a valuation allowance is established and a corresponding additional tax expense is recorded in the Company's statement of operations. In the event that actual results differ from the Company's estimates given changes in assumptions, the provision for income taxes could be materially impacted. As of March 31, 2003, the company had a deferred tax asset of approximately \$5,600,000 and a full valuation allowance due to uncertainty surrounding the company's ability to realize its deferred tax asset.

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INVENTORIES. Inventories, which are composed of prepaid calling cards, are valued at the lower of cost (first in, first out) or market. On a periodic basis, we compare the amount of inventory on hand and under commitment with our latest forecasted requirements to determine whether write-downs for excess or obsolete inventory are required. Although we consider the amounts on hand at quarter-end to be realizable, there can be no assurance that these amounts will prove to be realizable over time.

GOODWILL AND OTHER INTANGIBLES. Purchase accounting requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair market value of the assets and liabilities purchased, with the excess value, if any, being classified as goodwill. In addition, as described in Notes 3 of the Company's financial statements, as a result of the Company's acquisitions, values were assigned to intangible assets for customer lists and related relationships. Finite useful lives were assigned to these intangibles and they will be amortized over their remaining life. As with any intangible asset, future write-downs may be required if the value of these assets become impaired.

ALLOWANCE FOR DOUBTFUL ACCOUNTS. The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current credit

worthiness, as determined by a review of their current credit information. The Company continuously monitors collections and payments from customers and a provision for estimated credit losses is maintained based upon its historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been within the Company's expectations and the provisions established, the Company cannot guarantee that the same credit loss rates will be experienced in the future. Concentration risk exists relative to the Company's accounts receivable, as 24.8% of the Company's total accounts receivable balance at March 31, 2003 is concentrated in one affiliated customer. While the accounts receivable related to this customer may be significant, the Company does not believe the credit loss risk to be significant given the consistent payment history by this customer.

### RECENT ACCOUNTING PRONOUNCEMENTS.

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities", which addresses accounting for restructuring and similar costs. SFAS 146 supersedes previous accounting guidance, principally Emerging Issues Task Force Issue No. 94-3. The Company will adopt the provisions of SFAS 146 for restructuring activities initiated after December 31, 2002. SFAS 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost was recognized at the date of the Company's commitment to an exit plan. SFAS 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS 146 may affect the timing of recognizing future restructuring costs as well as the amounts to be recognized.

In December 2002, the FASB issued SFAS No.148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No.123." SFAS No.148 amends SFAS No.123,"Accounting for Stock-Based Compensation," to provide alternative methods of transition for an entity that voluntarily changes to the fair value-based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in APB

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Opinion No.25 and related interpretations as provided for under SFAS No.148. Accordingly, compensation expense is only recognized when the market value of the Company's stock at the date of the grant exceeds the amount an employee must pay to acquire the stock. The adoption of SFAS No.148 did not have material impact on the Company's financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation No.45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No.45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN No. 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN No.45 are effective for any guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim or annual period ending December 15, 2002. The adoption of the disclosure requirements of FIN No. 45 did not have a material impact on the Company's financial position or results of operations. The Company is currently evaluating the effects of the recognition provision of FIN No. 45, but does not expect the adoption to have a material impact on the Company's financial position or results of operations.

In January 2003, the FASB issued FASB Interpretation No.46 "Consolidation of Variable Interest Entities." In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for

business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. A variable interest entity often holds financial assets, including loans or receivables, real estate or other property. A variable interest entity may be essentially passive or it may engage in activities on behalf of another company. Until now, a company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN No.46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN No.46's consolidation requirements apply immediately to variable interest entities created or acquired after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year on interim period beginning after June 15, 2003. Certain of the disclosure requirements apply to all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Company has not adopted FIN No.46 for the quarter ended March 31, 2003, however the Company has provided for the required disclosures required by FIN No. 46. The Company has not completed its analysis of the effects of adopting FIN No. 46.

On April 30, 2003, FASB issued Statement No. 149 ("SFAS No. 149"), "Amendment of Statement 133, on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under Statement No. 133. In particular, this statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in Statement No. 133, and it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003 and is to be applied prospectively. The Company has not yet completed its analysis of SFAS No. 149 and therefore, the effect on the Company's combined financial statements of the implementation of SFAS No. 149, when effective, has

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not yet been determined.

On May 15, 2003, FASB issued Statement No. 150 ("SFAS No. 150"), Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that pursuant to its terms can be a liability or an asset depending on certain circumstances. SFAS No 150 affects the issuer's accounting for three types of free-standing financial instruments:

- mandatorily redeemable shares, which the issuing company is obligated to buy back in exchange for cash or other assets;
- instruments that do or may require the issuer to buy back some of its shares in exchange for cash or other assets; includes put options and forward purchase contracts; and
- obligations that can be settled with shares, the monetary value of which is fixed, tied solely or predominantly to a variable such as a market index, or varies inversely with the value of the issuers' shares.

SFAS No. 150 does not apply to features embedded in a financial instrument that is not a derivative in its entirety. Most of the guidance in SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has not yet completed its analysis of SFAS No. 150 and therefore, the effect on the Company's combined financial statements of the implementation of SFAS 150, when effective,

has not yet been determined.

### ITEM 3. CONTROLS AND PROCEDURES

**EVALUATION OF DISCLOSURES.** The Company maintains disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in the reports filed with the SEC is recorded, processed, summarized and reported within the time periods specified in the rules of the SEC. Within 90 days prior to the filing of this Quarterly Report on Form 10-Q, an evaluation, was completed under the supervision and participation of management, including the Chief Executive Officer and Principal Accounting Officer, of the design and operation of this disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Principal Accounting Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to the company (including the Company's consolidated subsidiaries) required to be included in the periodic SEC filings.

**CHANGES IN INTERNAL CONTROLS.** There were no significant changes in internal controls or other factors that could significantly affect the Company's internal controls subsequent to the date of our evaluation.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are subject to certain legal proceedings and claims which have arisen in the ordinary course of our business. These actions when ultimately concluded will not, in the opinion of management, have a material adverse effect on our financial position, results of operations or liquidity. We are also subject to other legal proceedings which we have previously disclosed.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

None.

ITEM 5. OTHER INFORMATION.

None.

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

(a) Exhibits.

EXHIBIT

NUMBER	DESCRIPTION OF EXHIBIT
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99.1	Certification of 9278 Communications, Inc. Chief Executive Officer and Principal Accounting Officer pursuant to Sec 906 of the Sarbanes-Oxley Act of 2002.
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(b) Reports on Form 8-K

None



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SIGNATURES

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

9278 COMMUNICATIONS, INC.

Date: June 20, 2002

By /s/ Sajid Kapadia

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Sajid Kapadia  
Chief Executive Officer/  
Principal Accounting Officer

CERTIFICATIONS

I, Sajid B. Kapadia, certify that:

1. I have reviewed this quarterly report on Form 10-Q of 9278 Communications, Inc. (the "registrant");
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.
4. I am responsible for establishing and maintaining disclosure controls and

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procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

- a) designed such disclosure controls and procedures to ensure that material information relating to the a registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect a the registrant's ability to record, process, summarize, and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluations, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 20, 2003

/s/ SAJID B. KAPADIA

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SAJID B. KAPADIA  
CHIEF EXECUTIVE OFFICER AND PRINCIPAL  
ACCOUNTING OFFICER