YP CORP
Form 10KSB/A
December 01, 2005

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

FORM 10-KSB/A
(Amendment No. 1)

(Mark one)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 2004

¨ TRANSITION REPORT UNDER SECTION 13 OR 15 (d)
OF THE
SECURITIES EXCHANGE ACT OF 1934
For the Transition period from ____________ to ____________

Commission File Number: 0-24217

YP CORP.
(Name of Small Business Issuer in its Charter)

NEVADA (State or other jurisdiction of incorporation or organization)	85-0206668 (IRS Employer Identification No.)
4840 EAST JASMINE STREET, SUITE 105, MESA, ARIZONA (Address of principal executive offices)	85205 (Zip Code)

(480) 654-9646
(Issuer's telephone number)

Securities registered under Section 12(b) of the Exchange Act: NONE

Securities registered under Section 12(g) of the Exchange Act:

COMMON STOCK, $.001 PAR VALUE
(Title of Class)

YP.NET, INC.
(Former Name)

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB ¨.

Registrant's revenues for its most recent fiscal year were $57,168,105.

The aggregate market value of the common stock held by non-affiliates computed based on the closing price of such stock on December 1, 2004 was approximately $19,482,743

The number of shares outstanding of the registrant's classes of common stock, as of December 1, 2004 was 50,891,302.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Registrant's 2005 Annual Meeting of Shareholders to be held in March 2005 are incorporated by reference in Part III of this Form 10-KSB.

Transitional Small Business Disclosure Format: Yes ¨ No x

EXPLANATORY NOTE

This Amendment on Form 10-KSB/A (this "Amendment") amends the Annual Report on Form 10-KSB for the year ended September 30, 2004, as originally filed by YP Corp. on December 29, 2004 (the "Original Filing"), solely for the purpose of revising Part II, Items 6, 7 and 8A to amend and restate the disclosure with respect to our accounting for shares issued to, and subsequently recovered from, certain non-performing consultants during 1999 and 2000. The historical financial statements generated by predecessor management reflected an expense upon issuance of the shares and a reversal of this expense when it was deemed (through a settlement agreement or judgment) that these shares would be returned. However, after further analysis and consultation with the Securities and Exchange Commission, it was determined to be inappropriate to recognize the initial expense and its subsequent reversal as no services were rendered by these consultants. Instead, the issuance of these shares will be reflected as temporary equity, together with a related receivable, until the shares were returned. The net decrease to cumulative after-tax income of approximately $510,000 relates to shares issued in 1999 that were expected to be returned but, for various reasons, cannot be obtained. Such amounts will continue to be reflected as expense in the year granted and our revised statements will no longer reflect the reversal of this expense.

In addition, in connection with the filing of this Amendment and pursuant to the rules of the Securities and Exchange Commission, we are including with this Amendment certain currently dated consents and certifications.

Except as described above, no other changes have been made to the Original Filing. This Amendment continues to speak as of the date of the Original Filing, and, except a specifically stated herein, we have not updated the disclosures contained in this Amendment to reflect any events that occurred at a date subsequent to the filing of the Original Filing. The filing of this Form 10-KSB/A is not a representation that any statements contained in items of the Original Filing other than that information being amended are true or complete as of any date subsequent to the date of the Original Filing. The filing of this Form 10-KSB/A shall not be deemed an admission that the Original Filing or the amendments made thereto, when made, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement not misleading.

TABLE OF CONTENTS

Table of Contents

PART II

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS

For a description of our significant accounting policies and an understanding of the significant factors that influenced our performance during the fiscal year ended September 30, 2004, this "Management's Discussion and Analysis" should be read in conjunction with the Consolidated Financial Statements, including the related notes, appearing in Item 7 of this Annual Report.

Forward-Looking Statements

This portion of this Annual Report on Form 10-KSB, includes statements that constitute "forward-looking statements." These forward-looking statements are often characterized by the terms "may," "believes," "projects," "expects," or "anticipates and do not reflect historical facts. Specific forward-looking statements contained in this portion of the Annual Report include, but are not limited to the Company's (i) belief that any progress it has made in addressing the various challenges it faced during the past year will help preserve its financial and operational integrity; (ii) belief that Mr. Bergmann's background in the management of advertising and marketing companies will be helpful to the Company; (iii) expectation that the trend away from billing through LECs will continue in the future; (iv) belief that the fragmented online Yellow Pages market will experience some consolidation in the future; (v) expectation that it will keep its prices stable for the near future; (vi) plan to continue to take active measures to reconfirm its existing subscriber base and to convert customers from LEC billing to ACH billing; (vii) expectation that near-term revenues may continue to decline; and (viii) expectation that dilution may continue to decrease as the Company continues to convert more customers to ACH billing.

Forward-looking statements involve risks, uncertainties and other factors, which may cause our actual results, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. Factors and risks that could affect our results and achievements and cause them to materially differ from those contained in the forward-looking statements include those identified in the section titled "Risk Factors," as well as other factors that we are currently unable to identify or quantify, but that may exist in the future.

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

Challenges and Solutions

Overview

We confronted a number of significant challenges during fiscal 2004 and continue to face recent issues related to our billing methods, which is described in greater detail below under Recent Developments. However, we believe that the progress we have made in addressing these challenges and adopting enhanced corporate governance practices will help us to preserve the financial and operational integrity that we and our stockholders have experienced in the past. This progress is marked by the following examples:

- In keeping with our goal to end all related party transactions, we terminated the executive consulting agreements pursuant to which the offices of Chief Executive Officer, Chief Financial Officer and other executive positions were provided through consulting companies.

1

Table of Contents

- We revamped our management team and filled the positions of Chief Executive Officer and Chief Financial Officer, as described in greater detail below.

- We recomposed our Board of Directors to include more independent directors, as described in greater detail below.

- We formed an audit committee, adopted its charter and appointed its chairman.

- We identified and designated the Board of Directors' qualified financial expert.

- We adopted a comprehensive code of ethics.

- We revisited and updated our insider trading policies.

- We terminated our previous loan obligations to our two largest stockholders, Morris & Miller, Ltd. and Mathew and Markson, Ltd. Moreover, we negotiated the acceleration of three repayments, totaling an aggregate of $1,600,000, from these stockholders on their existing debt to us, which is well ahead of their April 2007 maturity dates.

- We obtained and publicly disclosed the beneficial ownership of Morris & Miller, Ltd. and Mathew and Markson, Ltd. as provided to us in sworn affidavits by their managing director, Ilse Cooper.

- We recently paid our third consecutive quarterly cash dividend to our stockholders.

- We established a new $1 million credit facility.

- We adopted a Stockholder Rights Plan to protect the Company and our stockholders from unsolicited offers and to provide our board of directors with the leverage and ample opportunity to negotiate the greatest value for the stockholders if another person wishes to acquire the Company.

Management and Board Changes

On May 28, 2004, our Chief Executive Officer, Angelo Tullo, resigned as an officer and director of our company. Our board of directors appointed Peter J. Bergmann to succeed Mr. Tullo as Chairman, President and Chief Executive Officer. Mr. Bergmann had previously been an independent director of our company since May 2002. Mr. Tullo's resignation was prompted by the fact that on May 27, 2004, federal indictments were handed down alleging that the former management of American Business Funding Corp., including Mr. Tullo, had engaged in fraud and conspiracy in connection with the factoring of receivables. American Business Funding Corp. is not and has never been affiliated with or related to our company.

Our board of directors believed that even though the indictments against Mr. Tullo were not related to our company or its business, so long as Mr. Tullo remained an officer and director of our company the indictments against him would adversely impact our business reputation and perception in the public markets and detract from our ability to expand our business. Accordingly, Mr. Tullo and the board of directors determined that it was in the best interests of our stockholders for Mr. Tullo to resign as an officer and director of our company. As described below under *Termination Agreements*, we also later terminated the executive consulting agreement with Mr. Tullo's company, Sunbelt Financial Concepts, Inc., or Sunbelt.

Table of Contents

Upon Mr. Tullo's resignation as Chairman and CEO, the board of directors determined that Mr. Bergmann was the most qualified candidate to replace him because of Mr. Bergmann's familiarity with our business, his business expertise, and his public company experience. We believe that Mr. Bergmann's background in the management of advertising and marketing companies will be helpful to our company, given our advertising focus.

Since January 1999, Mr. Bergmann has served as the President of Perfect Timing Media, Inc., a television development and production company that he founded. Mr. Bergmann received his PhD from New York University and has served as head of a number of companies and divisions, including:

- principal of Century Media Inc, a Santa Monica, California, based direct-response advertising agency and media buying company;
- head of the television division of Major Arts, Inc.;
- president of Coast Productions, where he engineered the merger of Coast Productions, Inc., with Odyssey Entertainment, Inc., which subsequently became Odyssey Filmmakers, Inc.;
- president of The Film Company, Inc.; and
- various capacities with the American Broadcasting Company (ABC), including Executive Vice President and Special Assistant to the Chairman of the Board.

On June 9, 2004, Gregory Crane, Vice President of Marketing, resigned as an officer and director in an effort to assist our company in recomposing management and the Board of Directors. As described below under *Termination Agreements*, we also later terminated the executive consulting agreement with Mr. Crane's company, Advertising Management & Consulting Services, Inc., or AMCS.

In November 2004, DeVal Johnson also resigned as an officer. As described below under *Termination Agreements*, we also later terminated the Executive Consulting Agreement with Mr. Johnson's company, Advanced Internet Marketing, Inc., or AIM. Mr. Johnson will continue to serve as a director.

We also concluded our relationship with MAR & Associates, Inc., or MAR, during fiscal 2004. MAR was the entity that provided us with services associated with the position of Chief Financial Officer through MAR's President, David Iannini. As described below under *Termination Agreements*, we also terminated the executive consulting agreement with MAR.

On August 3, 2004, we hired W. Chris Broquist as our new Chief Financial Officer. Mr. Broquist brings 23 years of business experience to our company, including 14 years in business banking. Most recently, he served as Vice President and Chief Financial Officer of Gold Graphics Manufacturing Co., a medium-sized Los Angeles-based manufacturer. Prior to Gold Graphics, Mr. Broquist held the senior financial position at Century Media Group, where he was a key member of the team that successfully negotiated its acquisition by a public entity. Mr. Broquist also was with The Summit Group for four years, where he led the Businesses Services Group, which was responsible for providing business and financial planning services as well as developing access to capital for small and medium sized businesses.

As part of our continuing effort to recompose our board of directors, John T. Kurtzweil and Paul Gottlieb became independent members of the board of directors during fiscal 2004. Messrs. Kurtzweil and Gottlieb also were appointed to our Audit and Compensation Committees. Mr. Kurtzweil has agreed to serve as the Chairman of the Audit Committee and as qualified financial expert.

3

Table of Contents

Mr. Kurtzweil brings more than 25 years of high-level corporate management background to our board of directors. Mr. Kurtzweil currently serves as the Senior Vice President and Chief Financial Officer of Cirrus Logic, Inc., a publicly-held corporation that is a premier supplier of high-performance analog, mixed-signal, and digital processing solutions for consumer entertainment electronics, automotive entertainment, and industrial product applications. He possesses a strong financial background, including public company experience with industry leaders such as ON Semiconductor and Honeywell, Inc. Mr. Kurtzweil maintains active CPA and CMA licenses.

Mr. Gottlieb is an attorney with Snow Becker Krauss, PC in New York City. His practice involves estate planning, tax, corporate and securities matters. Mr. Gottlieb received his undergraduate degree from Queens College of City University of New York, after which he served as a journalist in the United States Army. Upon completion of his military service, Mr. Gottlieb attended New York Law School, where he received his law degree. Mr. Gottlieb worked as a senior attorney with the Internal Revenue Service before entering private practice.

Termination Agreements

Following the personal resignations of Messrs. Tullo, Crane and Johnson, we entered into Termination Agreements with these individuals' respective entities concerning the termination of their Executive Consulting Agreements. The Termination Agreements with Messrs. Tullo and Crane provide for payments over two years and, in the case of Mr. Johnson, over 18 months. Had the Executive Consulting Agreements not been terminated, we would have been obligated to pay Sunbelt, AMCS and AIM, over the remaining life of the agreements, approximately $2.6 million, $1.9 million, and $1 million, respectively. However, under the Termination Agreements, these payouts were reduced to $960,000, $697,010, and $367,570, respectively, or approximately 36% of the full payouts. The Executive Consulting Agreements had allowed us to terminate those agreements and pay a one-time lump sum payment of 30% of the total payouts. However, we were able to negotiate extended payment periods and receive certain favorable consulting and non-compete covenants from these former officers, as described below in greater detail.

Specifically, the amounts owed under the Termination Agreement with Sunbelt are payable as follows:

a. $150,000 upon signing of the Termination Agreement;

b. $17,500 payable at the beginning of each month for 24 months commencing August 1, 2004;

c. $120,000 on October 1, 2004;

d. $150,000 on the one-year anniversary of the signing of the agreement; and

e. $120,000 no later than October 1, 2005. This payment must be made upon Sunbelt's written request at any time between the July 1, 2005 and the October 1, 2005 payment. We will be obligated to make such early payment so long as we retain 30 days' operating capital after making the payment, which is defined as a current ratio of 1-to-1.

The amounts owed under the Termination Agreement with AMCS are payable as follows:

a. $130,000 upon signing of the Termination Agreement;

b. $10,709 payable at the beginning of each month for 24 months commencing August 1, 2004;

c. $110,000 on October 1, 2004;

d. $110,000 on the one-year anniversary of the signing of the agreement; and

4

Table of Contents

e. $90,000 no later than October 1, 2005. This payment must be made upon AMCS' written request at any time between the July 1, 2005 and the October 1, 2005 payment. We will be obligated to make such early payment so long as we retain 30 days' operating capital after making said payment, which is defined as a current ratio of 1-to-1.

The amounts owed under the Termination Agreement with AIM are payable as follows:

a. $50,000 upon signing of the Termination Agreement;

b. $14,865 payable at the beginning of each month for 18 months commencing December 1, 2004; and

c. $50,000 on January 1, 2005.

Upon a change of control or the sale of all or substantially all of the assets of our Company, all the foregoing payments to Sunbelt, AMCS, and AIM will be immediately due and payable.

Additionally, pursuant to the Termination Agreements, each of Sunbelt, AMCS, and AIM, and their respective officers, directors, and affiliates have agreed not to compete with or solicit our customers or employees for a period of six years. Finally, the Termination Agreements require Messrs. Tullo, Crane, Johnson and other officers and employees of their respective entities to make themselves available to our company and our officers, directors, and employees for consultation as needed.

In connection with the conclusion of our relationship with MAR, we entered into a Separation and Settlement Agreement with MAR, whereby the Executive Consulting Agreement between our company and MAR was terminated. Under the arrangement, we will pay MAR $120,000 in equal monthly payments over the six months commencing August 1, 2004. This amount is well below the approximately $750,000 that would have been payable under the Executive Consulting Agreement with MAR over the remaining life of that agreement.

Recent Developments

Developments with LEC Billing and Resulting Impacts on the Business.

Historically, we have been highly dependent on our ability to bill our IAP advertisers directly through their monthly telephone bill. We refer to this method as LEC billing. Our ability to use this billing method has been severely curtailed as a result of new internal policies adopted by many of the LECs and changes in the telephony industry generally. This has forced us to explore alternative billing methods.

New Internal LEC Policies.

During the fourth quarter of fiscal 2004, several of the LECs changed their internal policies regarding the use of activation checks as an acceptable letter of authorization that allows us to bill our products and services directly on our advertisers' local telephone bill. These LECs are requiring additional confirmation procedures to allow new customers to be billed. Further, these LECs are requiring us to reconfirm our existing customer base before allowing such customers to be billed.

The LECs modified policies have impacted us by decreasing the effectiveness of the activation check. We are no longer able to use this check as the letter of authorization for LEC billing in certain regions. Instead, we must obtain written or verbal authorization, thereby reducing the effectiveness of the LECs as an efficient and cost-effective means of billing our customers.

5

Table of Contents

Developments with CLECs.

An additional contributing factor to the trend away from LEC billing is the increasing presence of Competitive Local Exchange Carriers, or CLECs, in local markets. Recently, the CLECs have been participating in providing local telephone services to IAP advertisers at an increasing rate. We are not permitted to bill our IAP advertisers through CLECs at the present time. If an advertiser changes their telephone carrier from a LEC to a CLEC, we must change our billing method from billing through the LEC to an alternative billing method.

Increasing Dependence on ACH Billing.

Prior to fiscal 2004, virtually all of the Company's revenues were billed via LECs. Our ACH billings were immaterial. During 2004, to address the billing problems posed by the CLECs, we began to convert our customers to ACH billing, as we believe this is an efficient and cost effective means of billing. With the decline in LEC billings and to address the LECs internal policy changes described above, we accelerated the conversion of a substantial amount of our customers to ACH billing by year-end. By September 2004, ACH billing accounted for 57% of total net billings and LEC billings dropped to approximately 43% of net billings.

The majority of our advertisers that switched billing channels during the fourth quarter of fiscal 2004 went from LEC billing to ACH billing. We believe ACH billing is less expensive, has a faster collection time than LEC billing and presents minimal dilution. Therefore, we believe it is a desirable means of billing. However, it is time-consuming and labor-intensive to convert customers from one billing channel to another and can result in missed billings or customer cancellations.

Because the announcement of the change in LEC billing practices came suddenly and unexpectedly in the fourth quarter of 2004, we were not able to transition all impacted customers to ACH billing in a timely fashion. Accordingly, we have not been able to bill all of our customers for services performed during the fourth quarter of 2004 and, with respect to certain customers, it is unlikely that this revenue will ever be effectively billed and collected. We estimate that this change has caused a decrease in revenue in the fourth quarter of 2004 of approximately $6 to $7 million as compared to our prior two quarters. We currently are in the process of determining an effective means of billing these customers for future service. We expect that this trend away from billing through LECs will continue in the future.

Revenue and Billing Concentration

We process our billings through two primary billing aggregators; PaymentOne, Inc. and Billing Concepts, Inc. PaymentOne provides the majority of our billings, collections, and related services. Total amounts due from PaymentOne (for both LEC and ACH billing) at September 30, 2004 were $8,565,408, net of an allowance for doubtful accounts of $2,230,279. The net receivable from PaymentOne for billing at September 30, 2004 represented approximately 80% of our total net accounts receivable.

Termination of M&M Credit Facility

As of April 9, 2004, we terminated certain loan obligations that we owed to Morris & Miller, Ltd. and Mathew and Markson, Ltd., our two largest stockholders. Under this termination agreement, we made final advances to these stockholders totaling an aggregate of $1,050,000 at an annual interest rate of 8%. The stockholders agreed to forego the final advance of $250,000. The aggregate of all advances made by our company to these stockholders is to be repaid by April 2007, along with accrued interest. To date, we have received $1,600,000 in negotiated accelerated repayments.

Table of Contents

Cash Dividends

In connection with our termination of the loan obligations to Morris & Miller and Mathew and Markson, we began paying a $0.01 per share dividend each quarter, subject to compliance with applicable laws. We have paid three consecutive quarterly dividends to date.

Disclosure of M&M Beneficial Ownership

On May 27, 2004, we issued a press release disclosing the beneficial ownership of Morris & Miller and Mathew and Markson, as provided to us in sworn affidavits by Ms. Ilse Cooper, the Managing Director of these entities. Specifically, it was disclosed that Ms. Cooper herself, as well as her sister, are the beneficial owners of these entities. It was further disclosed that any assets of Morris & Miller and Mathew and Markson remaining after their deaths will be bequeathed to the Swiss Institute for Experimental Cancer Research, a large not-profit-organization partially funded by the Swiss government.

New Credit Facility

On April 13, 2004, we entered into a one year, renewable revolving credit facility agreement with Merrill Lynch Business Financial Services, Inc. for a maximum principal amount of $1,000,000. We may request advances under the credit facility up to the full amount of the line. Interest on outstanding advances is payable monthly in arrears at the per annum rate of the one-month LIBOR as published in The Wall Street Journal, plus 3.0%. Outstanding advances are secured by all of our existing and -acquired tangible and intangible assets located in the United States.

We paid Merrill Lynch a $10,000 fee in connection with the initiation of the credit facility. A $10,000 line maintenance fee is payable to Merrill Lynch upon each annual renewal. As of September 30, 2004, we had no outstanding obligations. At this time, we do not have any current plans or need to draw down any funds under the credit facility.

The credit facility requires us to maintain a “Leverage Ratio” (total liabilities to tangible net worth) that does not exceed 1.5-to-1 and a “Fixed Charge Ratio” (earnings before interest, taxes, depreciation, amortization and other non-cash charges minus any internally financed capital expenditures divided by the sum of debt service, rent under capital leases, income taxes and dividends) that is not less that 1.5-to-1 as determined quarterly on a 12-month trailing basis. The credit facility includes additional covenants governing permitted indebtedness, liens, and protection of collateral.

Stockholder Rights Plan

In May 2004, our board of directors declared a dividend distribution of one right on each outstanding share of our common stock. Each right will entitle stockholders to buy one one-thousandth of a share of our newly created Series A Junior Participating Preferred Stock at an initial exercise price of $36.50 per one one-thousandth share.

The rights will enable our board of directors to control the terms and timing of its response if a third party makes an unsolicited bid to acquire control of the Company. The rights are designed to protect the interests of our stockholders, to ensure that all stockholders of the Company receive fair and equal treatment in the event of any proposed takeover of the Company, and to guard against partial tender offers, open market accumulations and other tactics designed to gain control of the Company without paying all stockholders a fair price. The rights accomplish these goals by creating the potential for an unacceptable level of dilution if an acquirer takes certain actions without the board of directors’ approval. The bidder will therefore be more likely to negotiate with the board of directors, which has the ability to redeem the rights or exempt the bidder from the rights’ dilutive effect if the bidder’s proposal is acceptable to the board. The rights were not distributed in response to any specific effort to acquire the Company.

7

Table of Contents

In general, the rights become exercisable if a person or group becomes an "Acquiring Person," or commences or announces a tender or exchange offer to acquire 15% or more of the outstanding Common Stock, at which time each right will entitle its holder to purchase, at the right's exercise price, a number of shares of common stock having a market value at that time of twice the right's exercise price. Rights held by an Acquiring Person will become void. In general, a person will become an Acquiring Person by acquiring 15% or more of the Company's outstanding Common Stock. Certain other shareholders that already own in excess of 15% will be come an Acquiring Person if they exceed higher thresholds.

Strategic Alternatives

We believe that the fragmented online Yellow Pages market will experience some consolidation in the future. Accordingly, we have engaged Jefferies & Company, Inc. as our financial advisor to assist us in exploring strategic alternatives to enhance shareholder value, including a possible sale or merger of our company. There can be no assurance that any transaction will result from this engagement.

Critical Accounting Estimates and Assumptions

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires our management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. As such, in accordance with the use of accounting principles generally accepted in the United States of America, our actual realized results may differ from management's initial estimates as reported. A summary of our significant accounting policies are detailed in the notes to the financial statements, which are an integral component of this filing.

The following summarizes critical estimates made by management in the preparation of the financial statements.

Revenue Recognition. We generate revenue from customer subscriptions for directory and advertising services. Our billing and collection procedures include significant involvement of outside parties, referred to as aggregators for LEC billing and service providers for ACH billing. Such processes are described below.

LEC Billing - When a customer subscribes to our service we create an electronic customer file, which is the basis for the billing. We submit gross billings electronically to third party billing aggregators. These billing aggregators compile and format our electronic customer files and forward the billing records to the appropriate LECs. The billing for our service flows through to monthly bills of the individual LEC customers. The LECs collect our billing and remit amounts to the billing aggregators, which in turn remit funds to us. The following are significant accounting estimates and assumptions used in the revenue recognition process with respect to these billings.

- Customer refunds. We have a customer refund policy that allows the customer to request a refund if they are not satisfied with the service within the first 120 days of the subscription. We accrue for refunds based on historical experience of refunds as a percentage of new billings in that 120-day period. Customer refunds are reserved and charged against gross revenue.

Table of Contents

- Non-paying customers. There are customers who may not pay the fee for our services even though we believe they are valid subscribers. Included in cost of services is an accrual for estimated non-paying customers that is recorded at the time of billing.

- Dilution. We recognize revenue during the month for which the service is provided based on net billings accepted by the billing aggregators. We recognize revenue only for accepted records. However, subsequent to this acceptance, there are instances in the LEC billing process where a customer cannot be billed due to changes in telephone numbers, telephone carriers, data synchronization issues, etc. These amounts that ultimately cannot be billed, as well as certain minor billing adjustments by the LECs are commonly referred to as "dilution." Dilution is estimated at the time of billing and charged to cost of services.

- Fees. Processing fees are charged by both the aggregator and the LEC. Additionally, the LEC charges fees for responding to billing inquiries by its customers, processing refunds, and other customer-related services. Such fees are estimated at the time of billing and charged to cost of services.

ACH Billing - For ACH billing, we submit electronic billing information to our service providers, who in turn use this information as a basis for processing direct bank withdrawals through an Automated Clearing House. We receive information regarding records that are rejected or cannot otherwise be processed on a timely basis, and we recognize revenue only for those items that are processed.

Direct bill customers - If we are unable to bill via any other means, we bill subscribers directly via paper invoices. Our collection rate on these billings is significantly lower than those processed through the LECs. We track collections on direct billed customers and recognize revenue from those customers based on the historical collection rates..

Allowance for Doubtful Accounts. We receive cash through the processes discussed above. Under our contractual arrangements with our third party aggregators and service providers, the LECs and aggregators/service providers deduct from our gross billings amounts for returns, nonpaying customers, dilution and fees to arrive at net proceeds remitted to us. We estimate an allowance for doubtful accounts on the basis of information provided by the billing aggregators and service providers. This information is an indicator of timely payments made by our subscribers. At September 30, 2004, the allowance for doubtful accounts was approximately 26% of gross accounts receivable.

Carrying Value of Intellectual Property. The carrying value of our intellectual property at September 30, 2004, relates primarily to the purchase of the Yellow-Page.Net Universal Resource Locator, or URL, from Telco. The URL is recorded at its $5,000,000 purchase price, less accumulated amortization of $2,137,205. We have estimated the useful life of this asset to be 20 years.

We evaluate the recoverability of the carrying amount of this intangible asset whenever events or changes in circumstances indicate that the carrying amount of this asset may not be fully recoverable. In 2004, there have been no events that indicate that this asset may be impaired and, accordingly, no such impairment tests are warranted. In the event of such changes, impairment would be assessed if the undiscounted expected cash flows derived for the asset are less than its carrying amount. The dynamic economic environment in which we operate and the resulting assumptions used to estimate future cash flows would impact the outcome of such impairment tests.

Table of Contents

Capitalization of Direct Response Advertising Costs and Amortization of those Costs. We purchase mailing lists and send advertising materials to prospective subscribers from those mailing lists. Customers subscribe to the services by affirmatively responding to those advertising materials, which serve as the contract for the subscription. We capitalize and amortize the costs of direct-response advertising on a straight-line basis over 18 months, which is the estimated average period of retention for new customers. We believe that when a customer is retained through the 120-day refund period, long term retention is longer than the 18 month amortization period. However, due to attrition in the first months of a new subscription, the amortization period has been determined to be 18 months. As of September 30, 2004, the carrying value of our direct response advertising costs was $4,482,173, which includes the gross cost of approximately $9,578,842, less amortization of $5,096,669.

Income Taxes. Management evaluates the probability of the utilization of the deferred income tax assets. We have estimated deferred income tax assets of $1,048,000 at September 30, 2004, which relates to various timing differences between book and tax expense recognition. We are required to make judgments and estimates related to the timing and utilization of deferred income tax assets, applicable tax rates, and feasible tax planning strategies.

Results of Operations

Net revenue increased 85.8%, or $26,400,661, to $57,168,105 for fiscal 2004 from $30,767,444 for fiscal 2003. This increase in net revenue is primarily the result of an increase in the average number of our IAP advertisers and an increase in our monthly pricing. These two factors are discussed further below.

Our net revenue decreased in the fourth quarter ended September 30, 2004 to $10,069,924 compared to $16,890,361 for the previous quarter ended June 30, 2004 and compared to $16,367,893 for the three-month period ended March 31, 2004. This decline in revenue resulted in a net loss of $311,721 for the quarter. The decrease in revenues for the fourth quarter was due, largely, to declines in our paying subscriber base, which is described in more detail below.

We differentiate between "paying" advertisers and "activated" advertisers. Paying advertisers, as the name implies, are those advertisers that are actually currently paying for the IAP product. The term activated advertiser is broader and more inclusive. Activated includes those advertisers that currently are paying for the IAP service, as well as those advertisers that either have signed-up for the IAP service but have not yet been billed or have been invoiced (via direct bill method) but have not yet remitted to us their fees.

We believe that our methodology of classifying advertisers as activated and paying is more accurate and can be more consistently applied to each period. We also believe that tracking and disclosing the numbers of our activated advertisers, in addition to our paying advertisers, provides greater clarity into our business by providing an indication of how many activated advertisers may eventually become paying advertisers.

Our activated IAP advertiser count increased to 327,512 at September 30, 2004 compared to 255,376 at September 30, 2003, an increase of approximately 28%. The increase in activated advertisers equates to average monthly growth of approximately 6,000 activated advertisers for the year ended September 30, 2004. This remains within our targeted net growth of 5,000 to 10,000 new activated advertisers per month.

Our average paying IAP advertiser count increased during fiscal 2004 as compared to fiscal 2003, accounting for a substantial portion of our revenue growth. However, we began to experience declines in our paying subscriber base in the second half of 2004. By year-end, our paying IAP advertiser count decreased by 11.7% to approximately 196,000 at September 30, 2004 compared to approximately 222,000 at September 30, 2003. Our paying subscriber base declined in the second half of 2004 due in large part to advertisers changing from LECs to CLECs for their local telephone service and changes in billing practices by LECs, both of which are described in greater detail above under Recent Developments.

10

Table of Contents

Within the last two years, the prices for our IAP product have fluctuated between $17.95 and $29.95 per month. Currently, the majority of our customers are charged $29.95 per month, though recently we dropped our price to $27.50 per month.

Looking forward, we continue to take active measures to reconfirm our existing subscriber base and to convert customers from LEC billing to ACH billing. However, because these are time-consuming projects and result in an increase in customer cancellations, we expect that near-term revenues may continue to decline.

Cost of services increased 192.2%, or $16,284,134, to $24,757,880 for fiscal 2004 from $8,473,768 for fiscal 2003. As a percentage of net revenue, our cost of services increased to 43.3% in fiscal 2004 from 27.5% in fiscal 2003. The increase in our cost of services is directly attributable to an increase in our dilution expense as a percentage of revenues. The following table sets forth our quarterly dilution expense for fiscal year 2004 as compared to fiscal year 2003:

	2004	**% of Net Revenues**	**2003**	**% of Net Revenues**
First Quarter	3,493,394	25.2%	1,336,091	23.3%
Second Quarter	5,329,811	32.6%	1,243,151	18.2%
Third Quarter	6,260,633	37.1%	1,120,826	14.0%
Fourth Quarter	3,384,676	33.6%	1,403,641	13.8%

The increase in dilution is primarily the result of the increasing trend towards advertisers switching from LECs to other telephone carriers for their local telephone service and the change in LEC billing practices with respect to customers whose activation check served as the letter of authorization. Each of these factors is described above in *Item 6: Management's Discussion and Analysis - Executive Overview*.

Our dilution peaked during the third quarter of 2004, both as a dollar amount and as a percentage of revenue and started to decline in the fourth quarter of 2004 as we converted many of our customers to ACH billing. We expect that this dilution may continue to decrease as we continue to convert more customers to ACH billing.

We are taking active measures to reduce our dilution. We have purchased new software that more quickly identifies the telephone numbers that are active with the LECs so that we are able to more efficiently bill our clients by omitting accounts that have switched to a CLEC. We have begun to acquire direct debit information from at least 40% of new accounts as we acquire them. We are contacting all of our direct invoice customers to obtain more direct billing information in an effort to switch them to ACH billing. While we expect this dilution and the costs to implement our new billing method to be reduced to more normal levels over the next few quarters as this process runs its course through the billing system, it has significantly increased our costs in the near term.

Gross profits increased 45.4%, or $10,116,527, to $32,410,225 for fiscal 2004 from $22,293,698 for fiscal 2003. The increase in our gross profits was due to increased revenues resulting from the previously mentioned increased average IAP advertiser counts and price increases, offset by increased dilution discussed above. Gross margins decreased to 56.7% of net revenues in fiscal 2004 compared to 72.5% of net revenues in fiscal 2003 due to increased dilution as a percentage of revenues in fiscal 2004. As previously discussed, we expect that this dilution will decrease in the first half of 2005.

Table of Contents

Our general and administrative expense increased 46.5%, or $4,028,646, to $12,686,336 for fiscal 2004 from $8,657,690 for fiscal 2003. General and administrative expenses increased due to an increase in personnel and other expenses relating to our growth in IAP advertisers, our Quality Assurance and outbound marketing initiatives, as well as an increase in certain officers' compensation relating to employment contracts with such officers and termination agreements with former officers.

As a percentage of net revenue, general and administrative expenses were approximately 22.2% and 28.1% for fiscal 2004 and 2003, respectively. The reduction in general and administrative expenses as a percentage of net revenue is the result of increasing revenue and the leveraging of our fixed cost infrastructure over a larger IAP advertiser base.

Sales and marketing expenses increased 57.4%, or $2,219,971, to $6,088,614 for fiscal 2004 from $3,868,643 for fiscal 2003. The main reasons for the increase in sales and marketing expenses is due to the increased effort in our marketing solicitation program, the implementation of new market strategies, and modifications to our direct mail marketing pieces. We expect these sales and marketing costs to continue to increase as our marketing efforts increase and as we continue to roll out our branding campaign. We capitalize certain direct marketing expenses and amortize those costs over an 18-month period based on the estimated IAP advertiser attrition rates. As a percentage of net revenues, sales and marketing expenses were approximately 10.7% and 12.6% for fiscal 2004 and fiscal 2003, respectively.

Depreciation and amortization, consisting of depreciation of property and equipment and amortization of intangible assets, increased 40.9%, or $269,918, to $930,393 for fiscal 2004 from $660,475 for fiscal 2003. This increase is attributable to increased depreciation due to additional purchases of equipment related to our upgrade in infrastructure in the information technology department and hardware purchased relating to our Quality Assurance and Outbound Marketing initiatives and increased amortization of intangible assets associated with website development costs that were capitalized during 2004.. Amortization relating to the capitalization of our direct mail marketing costs is included in marketing expenses, as discussed previously.

Operating income increased 39.5%, or $3,597,992, to $12,704,882 for fiscal 2004 from $9,106,890 for fiscal 2003. Operating margins decreased to 22.2% of net revenue in fiscal 2004 from 29.6% in fiscal 2003. The increase in operating income is the result of the increased revenue discussed above. Operating margins decreased due to the significant increase in our cost of services resulting from increased dilution expense, partially offset by increased revenues and the leveraging of certain fixed expenses over a larger IAP advertiser base.

Interest income increased $218,150 to $327,145 for fiscal 2004 from $108,995 for fiscal 2003. The increase in interest income primarily results from our increased average cash position that resulted from our increased profitability, as well as increased interest income that resulted from the increase in advances to affiliates.

Other income increased $497,173 to $788,175 for fiscal 2004 from $291,002 for fiscal year 2003 due to a nonrecurring reversal of previously accrued compensation costs for former executives for which payment is no longer expected.

Net income before taxes increased 45.5% or $4,313,920 to $13,801,079 for fiscal 2004 from $9,487,159 for fiscal year 2003. The increase in pre-tax income is a result of those factors that resulted in the increase in operating income in addition to the increased interest income and other income discussed above. Pre-tax margins decreased to 24.1% of net revenue in fiscal 2004 compared to approximately 30.8% of net revenue in fiscal 2003 primarily due to decreases in operating margins.

Table of Contents

The income tax provision was $4,840,096 for fiscal 2004 compared to $1,871,293 in the fiscal 2003. The increase in the income tax provision is the result of our increased profitability in 2004 compared to 2003, as well as the fact that we were able to recognize a net operating loss carry-forward in fiscal 2003 that was previously thought to be unavailable to us. As of September 30, 2004, we had fully utilized all of our net operating loss carry-forwards.

Net income increased 17.7% to $8,960,983, or $0.19 per diluted share for the fiscal year ended September 30, 2004, up from $7,615,866 or $0.17 per diluted share for fiscal year 2003. Net income as a percentage of net revenues for the fiscal year ended September 30, 2004 was 15.7%, compared to 24.8% for fiscal 2003.

Liquidity and Capital Resources

Net cash provided by operating activities increased $55,965, or 1%, to $4,818,203 for the fiscal year ended September 30, 2004 compared to $4,762,238 for fiscal 2003. The increase in cash generated from operations is due to a 13% increase in net income, offset by changes in working capital.

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

Our most significant cash outflows include payments for marketing expenses and general operating expenses. Cash outflows for direct response advertising, our primary marketing strategy, typically occur in advance of expense recognition as these costs are capitalized and amortized over 18 months, the average estimated retention period for new customers. General operating cash outflows consist of payroll costs, income taxes, and general and administrative expenses that typically occur within close proximity of expense recognition.

Net cash used for investing activities totaled $2,192,500 for the fiscal year ended September 30, 2004. The primary component of cash used for investing activities was net advances to affiliates of $1,450,000. We ceased making advances to affiliates as of April 9, 2004 and these affiliates have begun repayment of those advances. In the fiscal year ended September 30, 2003, cash used for investing activities was $2,798,500, of which the primary component was advances to affiliates of $1,800,000.

Net cash used for financing activities for the fiscal year ended September 30, 2004 was $1,428,022, consisting primarily of dividends paid, compared to net cash used for financing activities of $351,998 for fiscal 2003. The net cash used in financing activities in fiscal 2003 relates to proceeds and repayments on our two credit facilities and the repayment of $160,000 on a note payable.

Table of Contents

We had working capital of $12,484,833 as of September 30, 2004, compared to $6,615,537 as of September 30, 2003. The increase is due primarily to increases in cash and accounts receivable and reductions in accrued liabilities and income taxes payable.

In the past, we borrowed under two credit facilities. These credit facilities were maintained primarily for safety and security back-up purposes as our cash flow generally is more than sufficient to maintain and grow our business. We have terminated our previous credit facilities with the Bank of the Southwest and AcTrade Financial Technologies, Ltd. In April 2004, we established a $1,000,000 credit facility with Merrill Lynch Business Financial Services, Inc. This facility is for one year and is renewable. The applicable interest rate on borrowings, if any, will be a variable rate of the one-month LIBOR rate (as published in the *Wall Street Journal*), plus 3%. The facility requires an annual line fee of $10,000, payable whether or not we have drawn any funds on the line. We utilized our new credit facility with Merrill Lynch and repaid the balance during the quarter ended June 30, 2004 in order to test its functioning and reporting requirements. There was no balance outstanding on September 30, 2004.

We owe $115,868 to Mathew & Markson Ltd. on a note related to the original acquisition of the “Yellow Page.net” URL. This note is technically past due. We have not repaid the balance, however, as we have amounts owed to us from Mathew & Markson in excess of the amount due. As we have no legal right of offset, we have not netted this amount due with the amounts owed to us in our consolidated balance sheet filed as part of this Annual Report. We currently are negotiating the settlement of this balance.

Effective as of April 9, 2004, we terminated certain loan agreements whereby we were obligated to loan or advance money to Morris & Miller and Mathew and Markson, our two largest stockholders. These outstanding loans are secured by shares of our common stock held by these stockholders. Under the termination agreement, we made final advances to these stockholders totaling approximately $1,050,000 at 8% interest. We did not make an additional final advance of $250,000 as the stockholders decided to forego this payment. The aggregate of all advances made by the Company to these stockholders is to be repaid to the Company at the end of three years, along with accrued interest. As of September 30, 2004, however, these stockholders had made advance repayments totaling $1,600,000.

In connection with our termination of the loan obligations, we began paying a $0.01 per share dividend each quarter, subject to compliance with applicable laws. As of September 30, 2004, we had paid three consecutive quarterly dividends to all common stockholders, including those who hold unvested restricted stock.

Risk Factors

An investment in our common stock involves a substantial degree of risk. Before making an investment decision, you should give careful consideration to the following risk factors in addition to the other information contained in this report. The following risk factors, however, may not reflect all of the risks associated with our business or an investment in our common stock. Accordingly, you should only consider investing in our common stock if you can afford to lose your entire investment.

Risks Related to Our Business

The loss of our ability to bill IAP advertisers through Local Exchange Carriers on the IAP advertisers’ telephone bills will adversely impact our results of operations.

Table of Contents

Our business model historically has depended heavily upon our ability to bill advertisers on their telephone bills through their respective Local Exchange Carriers, or LECs. We have recently faced challenges and impediments to our ability to bill certain advertisers in this manner. This has forced us to convert these advertisers to alternative methods of billing, which has resulted in dilution and decreased revenues. We continue, however, to rely on our ability to use the LEC billing method for our other advertisers.

The existence of the LECs is the result of Federal legislation. In the same manner, Congress could pass future legislation that obviates the existence of or the need for the LECs. Additionally, regulatory agencies could limit or prevent our ability to use the LECs to bill our advertisers. The introduction of and advancement of new technologies, such as WiFi technology or other wireless-related technologies, could render unnecessary the existence of fixed telecommunication lines, which also could obviate the need for and access to the LECs. Finally, if the recent trend of certain LECs to change their policies concerning an ability to use an incentive check as a letter of authorization and to adopt more onerous reconfirmation requirements becomes more widespread, our ability to use the LECs to bill our advertisers could be jeopardized altogether. Our inability to use the LECs to bill our advertisers through their monthly telephone bills would result in increased dilution and decreased revenues and would have a material adverse impact on our financial condition and results of operations.

We may experience increased dilution and our revenue may decline over time due to the involvement of the CLECs.

We have experienced a decrease in revenue from the LECs from the effects of the Competitive Local Exchange Carriers, or CLECs, that are providing local telephone services to IAP advertisers. With the competition in the telephony industry, many business customers are finding alternative telephony suppliers, such as CLECs, that offer less expensive alternatives to the LECs. When the LECs effectuate a price increase this causes a rush of LEC customers looking for an alternative telephone company, which may be a CLEC. When our advertising customers switch service providers from the LECs to a CLEC, we are precluded from billing these customers on their monthly telephone bill and must instead convert them to alternative billing methods such as ACH billing or direct invoicing. This conversion process can be disruptive to our operations and result in lost revenue. These other billing methods may be cheaper or more expensive than our current LEC billing and we have not yet determined if they will be less or more effective. We cannot provide any assurances that our efforts will be successful. We may experience future increases in dilution of our customer base that we are able to bill on their monthly telephone bills, which, in turn, may result in decreases in our revenue.

Failure to achieve and maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our business and stock price.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, beginning with our Annual Report on Form 10-K for the fiscal year ending September 30, 2005, we will be required to furnish a report by our management on our internal control over financial reporting. The internal control report must contain (i) a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting, (ii) a statement identifying the framework used by management to conduct the required evaluation of the effectiveness of our internal control over financial reporting, (iii) management's assessment of the effectiveness of our internal control over financial reporting as of the end of our most recent fiscal year, including a statement as to whether or not internal control over financial reporting is effective, and (iv) a statement that the Company's independent auditors have issued an attestation report on management's assessment of internal control over financial reporting.

Table of Contents

In order to achieve compliance with Section 404 of the Act within the prescribed period, beginning in our next fiscal year, we will need to engage in a process to document and evaluate our internal control over financial reporting, which will be both costly and challenging. In this regard, management will need to dedicate internal resources, engage outside consultants and adopt a detailed work plan to (i) assess and document the adequacy of internal control over financial reporting, (ii) take steps to improve control processes where appropriate, (iii) validate through testing that controls are functioning as documented and (iv) implement a continuous reporting and improvement process for internal control over financial reporting. We can provide no assurance as to our, or our independent auditors', conclusions at September 30, 2005 with respect to the effectiveness of our internal control over financial reporting under Section 404 of the Act. There is a risk that neither we nor our independent auditors will be able to conclude at September 30, 2005 that our internal controls over financial reporting are effective as required by Section 404 of the Act.

During the course of our testing we may identify deficiencies which we may not be able to remediate in time to meet the deadline imposed by the Sarbanes-Oxley Act for compliance with the requirements of Section 404. In addition, if we fail to achieve and maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Moreover, effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly.

We face intense competition, including from companies with greater resources, which could adversely affect our growth and could lead to decreased revenues.

Several companies, including Verizon, Yahoo and Microsoft, currently market Internet Yellow Pages services that directly compete with our services and products. We may not compete effectively with existing and potential competitors for several reasons, including the following:

- some competitors have longer operating histories and greater financial and other resources than we have and are in better financial condition than we are;

- some competitors have better name recognition, as well as larger, more established, and more extensive marketing, IAP advertiser service, and IAP advertiser support capabilities than we have;

- some competitors may supply a broader range of services, enabling them to serve more or all of their IAP advertisers' needs. This could limit our sales and strengthen our competitors' existing relationships with their IAP advertisers, including our current and potential IAP advertisers;

- some competitors may be able to better adapt to changing market conditions and IAP advertiser demand; and

- barriers to entry are not significant. As a result, other companies that are not currently involved in the Internet-based Yellow Pages advertising business may enter the market or develop technology that reduces the need for our services.

Increased competitive pressure could lead to reduced market share, as well as lower prices and reduced margins for our services. If we experience reductions in our revenue for any reason, our margins may continue to decline, which would adversely affect our results of operations. We cannot assure you that we will be able to compete successfully in the future.

Table of Contents

Our success depends upon our ability to establish and maintain relationships with our advertisers.

Our ability to generate revenue depends upon our ability to maintain relationships with our existing advertisers, to attract new advertisers to sign up for revenue-generating services, and to generate traffic to our advertisers' websites. We primarily use direct marketing efforts to attract new advertisers. These direct marketing efforts may not produce satisfactory results in the future. We attempt to maintain relationships with our advertisers through IAP advertiser service and delivery of traffic to their businesses. An inability to either attract additional advertisers to use our service or to maintain relationships with our advertisers could have a material adverse effect on our business, prospects, financial condition, and results of operations.

If we do not introduce new or enhanced offerings to our advertisers and users, we may be unable to attract and retain those advertisers and users, which would significantly impede our ability to generate revenue.

We will need to introduce new or enhanced products and services in order to attract and retain advertisers and users and to remain competitive. Our industry has been characterized by rapid technological change, changes in advertiser and user requirements and preferences, and frequent new product and service introductions embodying new technologies. These changes could render our technology, systems, and website obsolete. We may experience difficulties that could delay or prevent us from introducing new products and services. If we do not periodically enhance our existing products and services, develop new technologies that address our advertisers' and users' needs and preferences, or respond to emerging technological advances and industry standards and practices on a timely and cost-effective basis, our products and services may not be attractive to advertisers and users, which would significantly impede our revenue growth. In addition, our reputation and our brand could be damaged if any new product or service introduction is not favorably received.

Our quarterly results of operations could fluctuate due to factors outside of our control.

Our net revenues may grow at a slower rate on a quarter-to-quarter basis than we have experienced in recent periods. Factors that could cause our results of operations to fluctuate in the future include the following:

- fluctuating demand for our services, which may depend on a number of factors including
  - changes in economic conditions and our IAP advertisers' profitability,
  - varying IAP advertiser response rates to our direct marketing efforts,
  - our ability to complete direct mailing solicitations on a timely basis each month,
  - changes in our direct marketing efforts,
  - IAP advertiser refunds or cancellations, and
  - our ability to continue to bill IAP advertisers on their monthly telephone bills, ACH or credit card rather than through direct invoicing;
- timing of new service or product introductions and market acceptance of new or enhanced versions of our services or products;
- our ability to develop and implement new services and technologies in a timely fashion in order to meet market demand;

- price competition or pricing changes by us or our competitors;

17

Table of Contents

- new product offerings or other actions by our competitors;
- month-to-month variations in the billing and receipt of amounts from LECs, such that billing and revenues may fall into the subsequent fiscal quarter;
- the ability of our check processing service providers to continue to process and provide billing information regarding our solicitation checks;
- the amount and timing of expenditures for expansion of our operations, including the hiring of new employees, capital expenditures, and related costs;
- technical difficulties or failures affecting our systems or the Internet in general;
- a decline in Internet traffic at our website;
- the cost of acquiring, and the availability of, information for our database of potential advertisers; and
- our expenses are only partially based on our expectations regarding future revenue and are largely fixed in nature, particularly in the short term.

Our ability to efficiently process new advertiser sign-ups and to bill our advertisers monthly depends upon our check processing service providers and billing aggregators, respectively.

We currently use check processing companies to provide us with advertiser information at the point of sign-up for our Internet Advertising Package. Our ability to gather information to bill our advertisers at the point of sign-up could be adversely affected if one or more of these providers experiences a disruption in its operations or ceases to do business with us.

We also depend upon our billing aggregators to efficiently bill and collect monies from the LECs relating to the LECs' billing and collection of our monthly charges from advertisers, as well as collecting from those advertisers on ACH billing. We currently have agreements with two billing aggregators and two ACH service providers. Any disruption in our billing aggregators' ability to perform these functions could adversely affect our financial condition and results of operations.

We depend upon third parties to provide certain services and software, and our business may suffer if the relationships upon which we depend fail to produce the expected benefits or are terminated.

We currently outsource to third parties certain of the services that we provide, including the work of producing usable templates for and hosting of the QuickSites, website templates known as Ezsites, and wholesale Internet access. These relationships may not provide us with benefits that outweigh the costs of the relationships. If any strategic supplier demands a greater portion of revenue derived from the services it provides or increases its charges for its services, we may decide to terminate or refuse to renew that relationship, even if it previously had been profitable or otherwise beneficial. If we lose a significant strategic supplier, we may be unable to replace that relationship with other strategic relationships with comparable revenue potential. The loss or termination of any strategic relationship with one of these third-party suppliers could significantly impair our ability to provide services to our advertisers and users.

Table of Contents

We depend upon third-party software to operate certain of our services. The failure of this software to perform as expected would have a material adverse effect on our business. Additionally, although we believe that several alternative sources for this software are available, any failure to obtain and maintain the rights to use such software would have a material adverse effect on our business, prospects, financial condition, and results of operations. We also depend upon third parties to provide services that allow us to connect to the Internet with sufficient capacity and bandwidth so that our business can function properly and our websites can handle current and anticipated traffic. Any restrictions or interruption in our connection to the Internet would have a material adverse effect on our business, prospects, financial condition, and results of operations.

The market for our services is uncertain and is still evolving.

Internet Yellow Pages services are evolving rapidly and are characterized by an increasing number of market entrants. Our future revenues and profits will depend substantially upon the widespread acceptance and the use of the Internet and other online services as an effective medium of commerce by merchants and consumers. Rapid growth in the use of and interest in the Internet may not continue on a lasting basis, which may negatively impact Internet-based businesses such as ours. In addition, advertisers and users may not adopt or continue to use Internet-base Yellow Pages services and other online services that we may offer in the future. The demand and market acceptance for recently introduced services generally is subject to a high level of uncertainty.

Most potential advertisers have only limited, if any, experience advertising on the Internet and have not devoted a significant portion of their advertising expenditures to Internet advertising. Advertisers may find Internet Yellow Pages advertising to be less effective for meeting their business needs than traditional methods of Yellow Pages or other advertising and marketing. Our business, prospects, financial condition or results of operations will be materially and adversely affected if potential advertisers do not adopt Internet Yellow Pages as an important component of their advertising expenditures.

We may not be able to secure additional capital to expand our operations.

Although we currently have no material long-term needs for capital expenditures, we will likely be required to make increased capital expenditures to fund our anticipated growth of operations, infrastructure, and personnel. We currently anticipate that our cash on hand as of September 30, 2004, together with cash flows from operations, will be sufficient to meet our anticipated liquidity needs for working capital and capital expenditures over the next 12 months. In the future, however, we may seek additional capital through the issuance of debt or equity depending upon our results of operations, market conditions or unforeseen needs or opportunities. Our future liquidity and capital requirements will depend on numerous factors, including the following:

- the pace of expansion of our operations;
- our need to respond to competitive pressures; and
- future acquisitions of complementary products, technologies or businesses.

Our forecast of the period of time through which our financial resources will be adequate to support our operations is a forward-looking statement that involves risks and uncertainties and actual results could vary materially as a result of the factors described above. As we require additional capital resources, we may seek to sell additional equity or debt securities or draw on our existing bank line of credit. Debt financing must be repaid at maturity, regardless of whether or not we have sufficient cash resources available at that time to repay the debt. The sale of additional equity or convertible debt securities could result in additional dilution to existing stockholders. We cannot provide assurance that any financing arrangements will be available in amounts or on terms acceptable to us, if at all.

We must manage our growth and maintain procedures and controls on our business.

Table of Contents

We have rapidly and significantly expanded our operations and we anticipate further significant expansion to accommodate the expected growth in our IAP advertiser base and market opportunities. We have increased the number of our personnel from the inception of our operations to the present. This expansion has placed, and is expected to continue to place, a significant strain on our management and operational resources. As a result, we may not be able to effectively manage our resources, coordinate our efforts, supervise our personnel or otherwise successfully manage our resources. We have added a number of key managerial, technical, and operations personnel and we may add additional key personnel in the future. These additional personnel may further strain our management resources.

The rapid growth of our business could in the future strain our ability to meet IAP advertiser demands and manage our IAP advertiser relationships. This could result in the loss of IAP advertisers and harm our business reputation.

In order to manage the expected growth of our operations and personnel, we must continue maintaining and improving or replacing existing operational, accounting, and information systems, procedures, and controls. Further, we must manage effectively our relationships with our IAP advertisers, as well as other third parties necessary to our business. Our business could be adversely affected if we are unable to manage our growth effectively.

We depend upon our executive officers and key personnel.

Our performance depends substantially on the performance of our executive officers and other key personnel. The success of our business in the future will depend on our ability to attract, train, retain and motivate high quality personnel, especially highly qualified technical and managerial personnel. The loss of services of any executive officers or key personnel could have a material adverse effect on our business, results of operations or financial condition. We do not maintain key person life insurance on the lives of any of our executive officers or key personnel.

Competition for talented personnel is intense, and there is no assurance that we will be able to continue to attract, train, retain or motivate other highly qualified technical and managerial personnel in the future. In addition, market conditions may require us to pay higher compensation to qualified management and technical personnel than we currently anticipate. Any inability to attract and retain qualified management and technical personnel in the future could have a material adverse effect on our business, prospects, financial condition, and results of operations.

Our business is subject to a strict regulatory environment.

Existing laws and regulations and any future regulation may have a material adverse effect on our business. For example, we believe that our direct marketing programs meet or exceed existing requirements of the United States Federal Trade Commission. Any changes to FTC requirements or changes in our direct or other marketing practices, however, could result in our marketing practices failing to comply with FTC regulations. Our increasing dependence on ACH billing has exposed us to greater scrutiny by the National Automated Clearing House Association, or NACHA. As a result, we could be subject to substantial liability in the future, including fines and criminal penalties, preclusion from offering certain products or services, and the prevention or limitation of certain marketing practices.

We may face risks as we expand our business into international markets.

Table of Contents

We currently are exploring opportunities to offer our services in other English-speaking countries. We have limited experience in developing and marketing our services internationally, and we may not be able to successfully execute our business model in markets outside the United States. We will face a number of risks inherent in doing business in international markets, including the following:

- international markets typically experience lower levels of Internet usage and Internet advertising than the United States, which could result in lower-than-expected demand for our services;
- unexpected changes in regulatory requirements;
- potentially adverse tax consequences;
- difficulties in staffing and managing foreign operations;
- changing economic conditions;
- exposure to different legal standards, particularly with respect to intellectual property and distribution of information over the Internet;
- burdens of complying with a variety of foreign laws; and
- fluctuations in currency exchange rates.

To the extent that international operations represent a significant portion of our business in the future, our business could suffer if any of these risks occur.

We may be unable to promote and maintain our brands.

We believe that establishing and maintaining the brand identities of our Internet Yellow Pages services is a critical aspect of attracting and expanding a base of advertisers and users. Promotion and enhancement of our brands will depend largely on our success in continuing to provide high quality service. If advertisers and users do not perceive our existing services to be of high quality, or if we introduce new services or enter into new business ventures that are not favorably received by advertisers and users, we will risk diluting our brand identities and decreasing their attractiveness to existing and potential IAP advertisers.

We may not be able to adequately protect our intellectual property rights.

Our success depends both on our internally developed technology and our third party technology. We rely on a variety of trademarks, service marks, and designs to promote our brand names and identity. We also rely on a combination of contractual provisions, confidentiality procedures, and trademark, copyright, trade secrecy, unfair competition, and other intellectual property laws to protect the proprietary aspects of our products and services. Legal standards relating to the validity, enforceability, and scope of the protection of certain intellectual property rights in Internet-related industries are uncertain and still evolving. The steps we take to protect our intellectual property rights may not be adequate to protect our intellectual property and may not prevent our competitors from gaining access to our intellectual property and proprietary information. In addition, we cannot provide assurance that courts will always uphold our intellectual property rights or enforce the contractual arrangements that we have entered into to protect our proprietary technology.

Third parties may infringe or misappropriate our copyrights, trademarks, service marks, trade dress, and other proprietary rights. Any such infringement or misappropriation could have a material adverse effect on our business, prospects, financial condition, and results of operations. In addition, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights is unclear. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our trademarks and other proprietary rights, which may result in the dilution of the brand identity of our services.

Table of Contents

We may decide to initiate litigation in order to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of our proprietary rights. Any such litigation could result in substantial expense, may reduce our profits, and may not adequately protect our intellectual property rights. In addition, we may be exposed to future litigation by third parties based on claims that our products or services infringe their intellectual property rights. Any such claim or litigation against us, whether or not successful, could result in substantial costs and harm our reputation. In addition, such claims or litigation could force us to do one or more of the following:

- cease selling or using any of our products that incorporate the challenged intellectual property, which would adversely affect our revenue;

- obtain a license from the holder of the intellectual property right alleged to have been infringed, which license may not be available on reasonable terms, if at all; and

- redesign or, in the case of trademark claims, rename our products or services to avoid infringing the intellectual property rights of third parties, which may not be possible and in any event could be costly and time-consuming.

Even if we were to prevail, such claims or litigation could be time-consuming and expensive to prosecute or defend, and could result in the diversion of our management's time and attention. These expenses and diversion of managerial resources could have a material adverse effect on our business, prospects, financial condition, and results of operations.

Current capacity constraints may require us to expand our infrastructure and IAP advertiser support capabilities.

Our ability to provide high-quality Internet Yellow Pages services largely depends upon the efficient and uninterrupted operation of our computer and communications systems. We may be required to expand our technology, infrastructure, and IAP advertiser support capabilities in order to accommodate any significant increases in the numbers of advertisers and users of our websites. We may not be able to project accurately the rate or timing of increases, if any, in the use of our services or expand and upgrade our systems and infrastructure to accommodate these increases in a timely manner. If we do not expand and upgrade our infrastructure in a timely manner, we could experience temporary capacity constraints that may cause unanticipated system disruptions, slower response times, and lower levels of IAP advertiser service. Our inability to upgrade and expand our infrastructure and IAP advertiser support capabilities as required could impair the reputation of our brand and our services, reduce the volume of users able to access our website, and diminish the attractiveness of our service offerings to our advertisers.

Any expansion of our infrastructure may require us to make significant upfront expenditures for servers, routers, computer equipment, and additional Internet and intranet equipment, as well as to increase bandwidth for Internet connectivity. Any such expansion or enhancement will need to be completed and integrated without system disruptions. An inability to expand our infrastructure or IAP advertiser service capabilities either internally or through third parties, if and when necessary, would materially and adversely affect our business, prospects, financial condition, and results of operations.

Risks Related to the Internet

Table of Contents

We may not be able to adapt as the Internet, Internet Yellow Pages services, and IAP advertiser demands continue to evolve.

Our failure to respond in a timely manner to changing market conditions or client requirements could have a material adverse effect on our business, prospects, financial condition, and results of operations. The Internet, e-commerce, and the Internet Yellow Pages industry are characterized by:

- rapid technological change;
- changes in advertiser and user requirements and preferences;
- frequent new product and service introductions embodying new technologies; and
- the emergence of new industry standards and practices that could render our existing service offerings, technology, and hardware and software infrastructure obsolete.

In order to compete successfully in the future, we must

- enhance our existing services and develop new services and technology that address the increasingly sophisticated and varied needs of our prospective or current IAP advertisers;
- license, develop or acquire technologies useful in our business on a timely basis; and
- respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

Our future success may depend on continued growth in the use of the Internet.

Because Internet Yellow Pages is a new and rapidly evolving industry, the ultimate demand and market acceptance for our services will be subject to a high level of uncertainty. Significant issues concerning the commercial use of the Internet and online service technologies, including security, reliability, cost, ease of use, and quality of service, remain unresolved and may inhibit the growth of Internet business solutions that use these technologies. In addition, the Internet or other online services could lose their viability due to delays in the development or adoption of new standards and protocols required to handle increased levels of Internet activity, or due to increased governmental regulation. Our business, prospects, financial condition, and results of operations would be materially and adversely affected if the use of Internet Yellow Pages and other online services does not continue to grow or grows more slowly than we expect.

We may be required to keep pace with rapid technological change in the Internet industry.

In order to remain competitive, we will be required continually to enhance and improve the functionality and features of our existing services, which could require us to invest significant capital. If our competitors introduce new products and services embodying new technologies, or if new industry standards and practices emerge, our existing services, technologies, and systems may become obsolete. We may not have the funds or technical know-how to upgrade our services, technology, and systems. If we face material delays in introducing new services, products, and enhancements, our advertisers and users, may forego the use of our services and select those of our competitors, in which event our business, prospects, financial condition and results of operations could be materially and adversely affected.

Regulation of the Internet may adversely affect our business.

Table of Contents

Due to the increasing popularity and use of the Internet and online services such as online Yellow Pages, federal, state, local, and foreign governments may adopt laws and regulations, or amend existing laws and regulations, with respect to the Internet and other online services. These laws and regulations may affect issues such as user privacy, pricing, content, taxation, copyrights, distribution, and quality of products and services. The laws governing the Internet remain largely unsettled, even in areas where legislation has been enacted. It may take years to determine whether and how existing laws, such as those governing intellectual property, privacy, libel, and taxation, apply to the Internet and Internet advertising and directory services. In addition, the growth and development of the market for electronic commerce may prompt calls for more stringent consumer protection laws, both in the United States and abroad, that may impose additional burdens on companies conducting business over the Internet. Any new legislation could hinder the growth in use of the Internet generally or in our industry and could impose additional burdens on companies conducting business online, which could, in turn, decrease the demand for our services, increase our cost of doing business, or otherwise have a material adverse effect on our business, prospects, financial condition, and results of operations.

We may not be able to obtain Internet domain names that we would like to have.

We believe that our existing Internet domain names are an extremely important part of our business. We may desire, or it may be necessary in the future, to use these or other domain names in the United States and abroad. Various Internet regulatory bodies regulate the acquisition and maintenance of domain names in the United States and other countries. These regulations are subject to change. Governing bodies may establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may be unable to acquire or maintain relevant domain names in all countries in which we plan to conduct business in the future.

The extent to which laws protecting trademarks and similar proprietary rights will be extended to protect domain names currently is not clear. We therefore may be unable to prevent competitors from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our domain names, trademarks, trade names, and other proprietary rights. We cannot provide assurance that potential users and advertisers will not confuse our domain names, trademarks, and trade names with other similar names and marks. If that confusion occurs, we may lose business to a competitor and some advertisers and users may have negative experiences with other companies that those advertisers and users erroneously associate with us. The inability to acquire and maintain domain names that we desire to use in our business, and the use of confusingly similar domain names by our competitors, could have a material adverse affect on our business, prospects, financial conditions, and results of operations in the future.

Our business could be negatively impacted if the security of the Internet becomes compromised.

To the extent that our activities involve the storage and transmission of proprietary information about our advertisers or users, security breaches could damage our reputation and expose us to a risk of loss or litigation and possible liability. We may be required to expend significant capital and other resources to protect against security breaches or to minimize problems caused by security breaches. Our security measures may not prevent security breaches. Our failure to prevent these security breaches or a misappropriation of proprietary information may have a material adverse effect on our business, prospects, financial condition, and results of operations.

Our technical systems could be vulnerable to online security risks, service interruptions or damage to our systems.

Table of Contents

Our systems and operations may be vulnerable to damage or interruption from fire, floods, power loss, telecommunications failures, break-ins, sabotage, computer viruses, penetration of our network by unauthorized computer users and "hackers," natural disaster, and similar events. Preventing, alleviating, or eliminating computer viruses and other service-related or security problems may require interruptions, delays or cessation of service. We may need to expend significant resources protecting against the threat of security breaches or alleviating potential or actual service interruptions. The occurrence of such unanticipated problems or security breaches could cause material interruptions or delays in our business, loss of data, or misappropriation of proprietary or IAP advertiser-related information or could render us unable to provide services to our IAP advertisers for an indeterminate length of time. The occurrence of any or all of these events could materially and adversely affect our business, prospects, financial condition, and results of operations.

If we are sued for content distributed through, or linked to by, our website or those of our advertisers, we may be required to spend substantial resources to defend ourselves and could be required to pay monetary damages.

We aggregate and distribute third-party data and other content over the Internet. In addition, third-party websites are accessible through our website or those of our advertisers. As a result, we could be subject to legal claims for defamation, negligence, intellectual property infringement, and product or service liability. Other claims may be based on errors or false or misleading information provided on or through our website or websites of our directory licensees. Other claims may be based on links to sexually explicit websites and sexually explicit advertisements. We may need to expend substantial resources to investigate and defend these claims, regardless of whether we successfully defend against them. While we carry general business insurance, the amount of coverage we maintain may not be adequate. In addition, implementing measures to reduce our exposure to this liability may require us to spend substantial resources and limit the attractiveness of our content to users.

Risks Related to Our Securities

Stock prices of technology companies have declined precipitously at times in the past and the trading price of our common stock is likely to be volatile, which could result in substantial losses to investors.

The trading price of our common stock has risen and fallen significantly over the past twelve months and could continue to be volatile in response to factors including the following, many of which are beyond our control:

- decreased demand in the Internet services sector;
- variations in our operating results;
- announcements of technological innovations or new services by us or our competitors;
- changes in expectations of our future financial performance, including financial estimates by securities analysts and investors;
- our failure to meet analysts' expectations;
- changes in operating and stock price performance of other technology companies similar to us;
- conditions or trends in the technology industry;

- additions or departures of key personnel; and
- future sales of our common stock.

Table of Contents

Domestic and international stock markets often experience significant price and volume fluctuations that are unrelated to the operating performance of companies with securities trading in those markets. These fluctuations, as well as political events, terrorist attacks, threatened or actual war, and general economic conditions unrelated to our performance, may adversely affect the price of our common stock. In the past, securities holders of other companies often have initiated securities class action litigation against those companies following periods of volatility in the market price of those companies' securities. If the market price of our stock fluctuates and our stockholders initiate this type of litigation, we could incur substantial costs and experience a diversion of our management's attention and resources, regardless of the outcome. This could materially and adversely affect our business, prospects, financial condition, and results of operations.

Certain provisions of Nevada law and in our charter, as well as our Shareholder Rights Plan, may prevent or delay a change of control of our company.

We are subject to the Nevada anti-takeover laws regulating corporate takeovers. These anti-takeover laws prevent Nevada corporations from engaging in a merger, consolidation, sales of its stock or assets, and certain other transactions with any stockholder, including all affiliates and associates of the stockholder, who owns 10% or more of the corporation's outstanding voting stock, for three years following the date that the stockholder acquired 10% or more of the corporation's voting stock except in certain situations. In addition, our amended and restated articles of incorporation and bylaws include a number of provisions that may deter or impede hostile takeovers or changes of control or management. These provisions include the following:

- our board is classified into three classes of directors as nearly equal in size as possible, with staggered three year-terms;

- the authority of our board to issue up to 5,000,000 shares of serial preferred stock and to determine the price, rights, preferences, and privileges of these shares, without stockholder approval;

- all stockholder actions must be effected at a duly called meeting of stockholders and not by written consent unless such action or proposal is first approved by our board of directors;

- special meetings of the stockholders may be called only by the Chairman of the Board, the Chief Executive Officer, or the President of our company; and

- cumulative voting is not allowed in the election of our directors.

We also recently adopted a Shareholder Rights Plan, commonly referred to as a poison pill. This Plan serves as a strong deterrent to any unsolicited or hostile takeover attempts and, effectively, requires an interested acquirer to negotiate with our board of directors.

These provisions of Nevada law and our articles and bylaws, as well as our poison pill, could prohibit or delay mergers or other takeover or change of control of our company and may discourage attempts by other companies to acquire us, even if such a transaction would be beneficial to our stockholders.

Our common stock may be subject to the "penny stock" rules as promulgated under the Exchange Act.

In the event that no exclusion from the definition of "penny stock" under the Exchange Act is available, then any broker engaging in a transaction in our common stock will be required to provide its customers with a risk disclosure document, disclosure of market quotations, if any, disclosure of the compensation of the broker-dealer and its sales person in the transaction, and monthly account statements showing the market values of our securities held in the customer’s accounts. The bid and offer quotation and compensation information must be provided prior to effecting the transaction and must be contained on the customer’s confirmation of sale. Certain brokers are less willing to engage in transactions involving “penny stocks” as a result of the additional disclosure requirements described above, which may make it more difficult for holders of our common stock to dispose of their shares.

Table of Contents

ITEM 7. FINANCIAL STATEMENTS

YP CORP.

TABLE OF CONTENTS **Page**

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board
of Directors of YP Corp.:

We have audited the accompanying consolidated balance sheet of YP Corp. and subsidiaries as of September 30, 2004 and the related statements of operations, stockholders' equity and cash flows for the each of the two years in the period then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the auditing standards generally accepted in the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of YP Corp. and subsidiaries as of September 30, 2004, and the consolidated results of its operations and cash flows for each of the two years in the period ended September 30, 2004, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, the Company restated its financial statements for the years ended September 30, 2004 and 2003.

/s/ Epstein, Weber & Conover, PLC
Scottsdale, Arizona
December 9, 2004
(except for the restatement of financial statements
described in Note 1, for which the date is November 18, 2005)

Table of Contents

YP CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
SEPTEMBER 30, 2004

Assets		
Cash and equivalents	$	3,576,529
Accounts receivable, net of allowance for doubtful accounts of $3,400,575		8,362,283
Prepaid expenses and other current assets		822,919
Income tax refund receivable		1,239,436
Deferred tax asset		352,379
Total current assets		14,353,546
Accounts receivable, long term portion, net of allowance for doubtful accounts of $269,662		2,075,334
Customer acquisition costs, net of accumulated amortization of $5,096,669		4,482,173
Property and equipment, net		725,936
Deposits and other assets		239,060
Intangible assets, net of accumulated amortization of $2,446,403		3,326,274
Advances to affiliates		3,894,862
Total assets	$	29,097,185
Liabilities and Stockholders' Equity		
Accounts payable	$	1,210,364
Accrued liabilities		542,481
Notes payable- current portion		115,868
Total current liabilities		1,868,713
Deferred income taxes		848,498
Total liabilities		2,717,211
Commitments and contingencies		-
Series E convertible preferred stock, $.001 par value, 200,000 shares authorized, 128,340 issued and outstanding, liquidation preference $38,502		10,909
Common stock, $.001 par value, 100,000,000 shares authorized, 50,071,302 issued and outstanding		50,858
Paid in capital		12,151,947
Deferred stock compensation		(5,742,814)
Retained earnings		19,909,074
Total stockholders' equity		26,379,974
Total liabilities and stockholders' equity	$	29,097,185

See accompanying notes to consolidated financial statements.

Table of Contents

YP CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS

	Year ended September 30,	
	2004	2003
Net revenues	$ 57,168,105	