

Edgar Filing: YP NET INC - Form 10QSB/A

YP NET INC  
Form 10QSB/A  
July 08, 2003

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U.S. Securities and Exchange Commission  
Washington, D.C. 20549

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Amendment No. 2  
to  
FORM 10-QSB/A  
-----

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

For the quarterly period ended December 31, 2002

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

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

-----  
Commission File Number 0-24217  
-----

YP.NET, INC.  
(Exact name of small business issuer as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

85-0206668  
(IRS Employer Identification No.)

4840 East Jasmine St. Suite 105  
Mesa, Arizona 85205  
(Address of principal executive offices)

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

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  
-----            -----

The number of shares of the issuer's common equity outstanding as of  
February 7, 2003 was 43,463,222 shares of common stock, par value \$.001.

Transitional Small Business Disclosure Format (check one):

Yes                    No    X  
-----                    -----

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YP.NET, INC.  
INDEX TO FORM 10-QSB FILING  
FOR THE QUARTER ENDED DECEMBER 31, 2002

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

UNAUDITED CONSOLIDATED BALANCE SHEET  
AS OF DECEMBER 31, 2002

ASSETS:

CURRENT ASSETS

Cash and equivalents	\$ 889,532
Accounts receivable, net of allowance for doubtful accounts of \$2,160,694	4,529,946

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Prepaid expenses and other current assets	99,822
	-----
Total current assets	5,519,300
ACCOUNTS RECEIVABLE, long term portion, net of allowance for doubtful accounts of \$213,701	488,853
CUSTOMER ACQUISITION COSTS, net of accumulated amortization of \$483,054	1,918,983
PROPERTY AND EQUIPMENT, net	392,477
DEPOSITS AND OTHER ASSETS	88,631
INTELLECTUAL PROPERTY- URL, net of accumulated amortization of \$1,481,148	3,492,271
ADVANCES TO AFFILIATES	342,720
	-----
TOTAL ASSETS	\$12,243,235
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY:	
CURRENT LIABILITIES:	
Accounts payable	\$ 171,412
Accrued liabilities	81,976
Deferred income taxes	127,527
Income taxes payable	1,173,587
	-----
Total current liabilities	1,554,502
NOTES PAYABLE - long term portion	115,868
DEFERRED INCOME TAXES	6,866
	-----
Total liabilities	1,677,236
	-----
STOCKHOLDERS' EQUITY:	
Series E convertible preferred stock, \$.001 par value, 200,000 shares authorized, 131,840 issued and outstanding, liquidation preference \$39,552	11,206
Common stock, \$.001 par value, 50,000,000 shares authorized, 49,499,340 issued and outstanding	49,582
Paid in capital	4,734,907
Treasury stock at cost	(287,401)
Retained earnings	6,057,705
	-----
Total stockholders' equity	10,565,999
	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$12,243,235
	=====

See the accompanying notes to these unaudited financial statements

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YP.NET, INC.  
 UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
 FOR THE THREE-MONTH PERIODS ENDED DECEMBER 31, 2002 AND DECEMBER 31, 2001

NET REVENUES	\$ 5,741,455	\$ 2,992,993
	-----	-----

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OPERATING EXPENSES:		
Cost of services	1,822,150	1,184,277
General and administrative expenses	1,376,078	865,801
Sales and marketing expenses	632,435	43,879
Depreciation and amortization	138,932	148,379
	-----	-----
Total operating expenses	3,969,595	2,242,336
	-----	-----
OPERATING INCOME	1,771,860	750,657
	-----	-----
OTHER (INCOME) AND EXPENSES		
Interest (income) expense	(720)	28,414
Other (income) expense	(48,906)	(4,291)
	-----	-----
Total other (income) expense	(49,626)	24,123
	-----	-----
INCOME BEFORE INCOME TAXES	1,821,486	726,534
INCOME TAX PROVISION (BENEFIT)	728,594	420,185
	-----	-----
NET INCOME	\$ 1,092,892	\$ 306,349
	=====	=====
NET INCOME PER SHARE:		
Basic	\$ 0.02	\$ 0.01
	=====	=====
Diluted	\$ 0.02	\$ 0.01
	=====	=====
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic	46,515,590	43,813,680
	=====	=====
Diluted	46,515,590	43,813,680
	=====	=====

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YP.NET, INC.  
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 FOR THE THREE -MONTH PERIODS ENDED DECEMBER 31, 2002 AND DECEMBER 31, 2001

	THREE MONTHS ENDED DECEMBER 31, 2002	THREE MONTHS ENDED DECEMBER 2001
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 1,092,892	\$ 306,349
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	138,933	148,379

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Income recognized on forgiveness of debt	(45,362)	
Deferred income taxes	41,251	
Officers & consultants paid common stock	453,750	
Common stock surrendered	(115,979)	
Changes in assets and liabilities:		
Trade and other accounts receivable	(953,153)	(
Customer acquisition costs	(500,756)	(1
Prepaid and other current assets	(35,611)	(1
Other assets	62,094	(
Accounts payable	(23,982)	
Accrued liabilities	(101,317)	(
Income taxes payable	687,344	4
Deferred revenue	-	
	-----	-----
Net cash provided by operating activities	700,104	4
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Advances made to affiliates and related parties	(100,000)	
Purchases of intellectual property	(6,761)	
Purchases of equipment	(163,919)	(
	-----	-----
Net cash (used in) investing activities	(270,680)	(
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from debt	147,000	
Purchase of Treasury Stock	-	(
Principal repayments on notes payable	(454,000)	(7
	-----	-----
Net cash (used)/provided by financing activities	(307,000)	(7
	-----	-----
INCREASE (DECREASE) IN CASH	122,424	(3
CASH, BEGINNING OF PERIOD	767,108	6
	-----	-----
CASH, END OF PERIOD	\$ 889,532	\$ 3
	=====	=====

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YP.NET, INC.  
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 FOR THE THREE-MONTH PERIODS ENDED DECEMBER 31, 2002 AND DECEMBER 31, 2001,  
 continued

SUPPLEMENTAL CASH FLOW INFORMATION:

	Three month period ended December 31, 2002	Three month period ended December 31, 2001
	-----	-----
Interest Paid	\$ 6,000	\$ 28,414

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE-MONTH PERIODS ENDED

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DECEMBER 31, 2002 AND DECEMBER 31, 2001

### 1. Basis of Presentation

The accompanying unaudited financial statements represent the consolidated financial position of YP.Net, Inc. ("the Company" or "YP.Net") for the three month periods ended December 31, 2002, and December 31, 2001, which includes results of operations of the Company and Telco Billing, Inc. ("Telco"), its wholly owned subsidiary, and statement of cash flows for the three periods ended December 31, 2002 and December 31, 2001. These statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments to these unaudited financial statements necessary for a fair presentation of the results for the interim period presented have been made.

### 2. Company Organization and Operations

YP.Net, Inc., a Nevada corporation (the "Company," "we," "us," or "our"), is in the business of providing Internet-based yellow page advertising space on or through [www.Yellow-Page.Net](http://www.Yellow-Page.Net) and [www.YP.Net](http://www.YP.Net) .

The Company's "yellow page" database lists approximately 18 million businesses throughout the United States. Our website enables internet users to search through these "yellow page" listings and is used by businesses and consumers attempting to locate a business and/or service provider in response to a user's specific search criteria.

As our primary source of revenue, we offer "preferred" listings to businesses for a monthly fee (currently \$17.95). The "preferred" listing provides a business with a priority placement listing over non-paying listings and is displayed in a bigger and bolder font at the beginning of, or in the first section of the user's search results, thus featuring our paying customers more prominently to user's of our website. In addition, our paying customers get a Mini-Webpage(TM) which includes a 40-word description of their business, their hours of operation and other useful information, a direct link to the paying customers website, (if they have one and it is provided by the advertiser), map, driving directions to the paying customers location and more. We market for advertisers of our "preferred" listing service under the name "Yellow-Page.Net", exclusively to businesses through a direct mail solicitation program. The solicitation includes a promotional incentive (i.e. generally a \$3.50 check) which, if cashed by the business, automatically signs the business up for the Preferred Listing service for an initial twelve month period with automatic renewals thereafter. This easy subscription process provides a written confirmation (i.e. the check) of the subscription by the newly subscribing business, which is verified by an independent third party (i.e. the paying customers depositing bank). To additionally insure the intention of sign-up, the Company then mails a written confirmation card to the newly subscribing business generally within 30 days from activation. The Company also provides a 120-day cancellation period whereby the subscribing business may cancel and receive a full refund of any amounts paid to the Company.

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Each paying customer is billed monthly for that month's service, the vast majority of such monthly billings appear on the subscribing business's local phone bill. Management believes this ability to bill the paying customer through the paying customers phone bill is a significant competitive advantage for the

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Company as few independent (not owned by a telephone company) yellow page companies are authorized to bill directly on the phone bill for services rendered.

The Company uses Simple.Net, Inc. ("SN"), an internet service provider beneficially owned by a director (Deval Johnson) of the Company, to provide internet dial-up and other services to its customers (See Footnote 9 to the financial statements). SN charges the Company's customers \$2.50 per month for such internet access.

We were originally incorporated as a New Mexico company in 1969 and the Company was re-incorporated in Nevada in 1996 as Renaissance Center, Inc. Our Articles of Incorporation were restated in July 1997 and our name was changed to Renaissance International Group, Ltd. Effective July 1998, we changed our name to RIGL Corporation. In June 1999, we acquired Telco Billing, Inc. ("Telco") and commenced our current operations through this entity which is a wholly-owned subsidiary. In October 1999, we amended our Articles of Incorporation to change our corporate name to YP.Net, Inc. to better identify our company with our business focus.

From August through December 1999, we abandoned all subsidiaries previously involved in the multi-media software and medical billing and practice management areas. With the acquisition of Telco, our business focus shifted to the Internet yellow page services business and this business is currently our main source of revenue. Telco is operated as our wholly owned subsidiary.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents: This includes all short-term highly liquid

investments that are readily convertible to known amounts of cash and have original maturities of three months or less. At times cash deposits may exceed government insured limits. At December 31, 2002, cash deposits exceeded those insured limits by \$650,268.

Principles of Consolidation: The consolidated financial statements include

the accounts of the Company and its wholly owned subsidiary, Telco Billing, Inc. All significant intercompany accounts and transactions are eliminated.

Customer Acquisition Costs: These costs represent the direct response

marketing costs that are incurred as the primary method by which customers subscribe to the Company's services. The Company purchases mailing lists and sends advertising materials to prospective subscribers from those lists. Customers subscribe to the services by positively responding to those advertising materials which serve as the contract for the subscription. The Company capitalizes and amortizes the costs of direct-response advertising on a straight-line basis over eighteen months, the estimated average period of retention for new customers. The Company capitalized costs of \$983,000 and \$219,000 during the three months ended December 31, 2002 and 2001 respectively. The Company amortized \$483,000 and \$59,000, respectively, of total capitalized costs during the three months ended December 31, 2002 and 2001.

The Company also incurs sales and marketing costs that are not considered direct-response advertising. These other costs are expensed when incurred. These sales and marketing expenses were \$149,381 and \$37,612 for the three months ended December 31, 2002 and 2001 respectively.

Revenue Recognition: The Company's revenue is generated by customer

subscriptions of directory and advertising services. Revenue is billed and recognized monthly for services subscribed in that specific month. The Company utilizes outside billing companies to transmit billing data, much of which is forwarded to Local Exchange Carriers ("LEC's") that provide local telephone service. Monthly subscription fees are generally included on the telephone bills of the customers. The Company recognizes revenue based on net billings accepted by the LEC's. Due to the periods of time for which adjustments may be reported by the LEC's and the billing companies, the Company estimates and accrues for dilution and fees reported subsequent to year-end for initial billings related to services provided for periods within the fiscal year.

Revenue for billings to certain customers whom are billed directly by the Company and not through the LEC's, is recognized based on estimated future collections. The Company continuously reviews this estimate for reasonableness based on its collection experience.

Income Taxes: The Company provides for income taxes based on the provisions

of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, which, among other things, requires that recognition of deferred income taxes be measured by the provisions of enacted tax laws in effect at the date of financial statements.

Financial Instruments: Financial instruments consist primarily of cash,

accounts receivable, and obligations under accounts payable, accrued expenses and notes payable. The carrying amounts of cash, accounts receivable, accounts payable, accrued expenses and notes payable approximate fair value because of the short maturity of those instruments. The Company has applied certain assumptions in estimating these fair values. The use of different assumptions or methodologies may have a material effect on the estimates of fair values.

Net Income Per Share: Net income per share is calculated using the weighted

average number of shares of common stock outstanding during the year. The Company has adopted the provisions of SFAS No. 128, Earnings Per Share.

Use of Estimates: The preparation of financial statements in conformity

with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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. Actual results could differ from those estimates.

Significant estimates made in connection with the accompanying financial statements include the estimate of dilution and fees associated with LEC billings and the estimated reserve for doubtful accounts receivable.

Stock-Based Compensation: Statements of Financial Accounting Standards No.

123, Accounting for Stock-Based Compensation, ("SFAS 123") established accounting and disclosure requirements using a fair-value based method of



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accounting for stock-based employee compensation. In accordance with SFAS 123, the Company has elected to continue

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accounting for stock based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees."

### 4. ACCOUNTS RECEIVABLE

The Company provides billing information to third party billing companies for the majority of its monthly billings. Billings submitted are "filtered" (ie. Delete invalid phone numbers etc.) by these billing companies and the LEC's. Net accepted billings are recognized as revenue and accounts receivable. The billing companies remit payments to the Company on the basis of cash ultimately received from the LEC's by those billing companies. The billing companies and LEC's charge fees for their services which are netted against the gross accounts receivable balance. The billing companies also apply holdbacks to the remittances for potentially uncollectible accounts. These dilution amounts will vary due to numerous factors and the Company may not be certain as to the actual amounts of dilution on any specific billing submittal until several months after that submittal. The Company estimates the amount of these charges and holdbacks based on historical experience and subsequent information received from the billing companies. The Company also estimates uncollectible account balances and provides an allowance for such estimates. The billing companies retain certain holdbacks that may not be collected by the Company for a period extending beyond one year. These balances have been classified as long-term assets in the accompanying balance sheet.

The Company experiences significant dilution of its gross billings by the billing companies. The Company negotiates collections with the billing companies on the basis of the contracted terms and historical experience. The Company's cash flow may be affected by holdbacks, fees, and other matters which are determined by the LEC's and the billing companies.

### 5. INTELLECTUAL PROPERTY

The URL is recorded at its cost net of accumulated amortization. Management believes that the Company's business is dependent on its ability to utilize this URL given the recognition of the Yellow page term. Also, its current

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customer base relies on the recognition of this term and URL as a basis for maintaining the subscriptions to the Company's service. Management believes that the current revenue and cash flow generated through use of Yellow-page.net supports the carrying of the asset. The Company

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periodically analyzes the carrying value of this asset to determine if impairment has occurred. No such impairments were identified during the year ended September 30, 2002 or the three months ended December 31, 2002. The URL is amortized on an accelerated basis over the twenty-year term of the licensing agreement. Amortization expense on the URL was \$93,031 and \$107,500 for the three months ended December 31, 2002 and 2001 respectively.

### 6. PROVISION FOR INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences

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between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

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During the year ended September 30, 2002, the Company structured certain transactions related to its merger with Telco that allowed the Company to utilize net operating losses that were previously believed to be unavailable or limited under the change of control rules of Internal Revenue Code 382. The deferred income tax asset of \$1,471,000 related to these net-operating losses recorded at September 30, 2001, was fully offset by a valuation allowance. That valuation allowance was eliminated and recognized as a benefit in the year ended September 30, 2002. Due to these changes, the Company recognized an income tax benefit of \$1,614,716 for the year ended September 30, 2002. At September 30, 2002 the Company has utilized all of its federal and state net operating losses.

Income taxes for three months ended December 31, is summarized as follows:

	2002 ----	2001 ----
Current Provision	\$ 687,344	\$ 291,738
Deferred (Benefit) Provision	41,250	128,447
	-----	-----
Net income tax provision	\$ 728,594	\$ 420,185
	=====	=====

At December 31, 2002, deferred income tax assets related to differences in book and tax bases of accounts receivable, direct marketing costs and intangible assets.

At December 31, 2002 deferred tax liabilities were comprised of differences in book and tax bases of customer acquisition costs and property and equipment respectively.

7. STOCKHOLDERS' EQUITY

Series E Convertible Preferred Stock  
-----

During the year ended September 30, 2002, the Company created a new series of equity, the Series E Convertible Preferred Stock. The Company authorized 200,000, \$0.001 par value shares. The shares carry a \$0.30 per share liquidation preference and accrue dividends at the rate of 5% per annum on the liquidation preference per share, payable quarterly from legally available funds. If such funds are not available, dividends shall continue to accumulate until they can be paid from legally available funds. Holders of the preferred shares shall be entitled, after two years from issuance, to convert them into common shares on a one-to-one basis together with payment of \$0.45 per converted share.

During the year ended September 30, 2002, pursuant to an existing tender offer, holders of 131,840 shares of the Company's common stock exchanged said shares for an equal number of the Series E Convertible Preferred shares, at the then \$0.085 market value of the

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common stock. As of December 31, 2002, the liquidation preference value of the outstanding Series E Convertible Preferred Stock was \$39,552, and dividends totaling \$395 had been accrued associated with said shares.

### Common Shares Received and Retired Under Legal Settlements-Treasury Stock

-----

During the three months ended December 31, 2002, the Company acquired 82,500 shares of its common stock in connection with a settlement with a former consultant to the Company. The shares were issued as consideration under the consulting agreement. The return of the shares was recorded as a gain in the three-month period ended December 31, 2002. The gain was determined at the value at which the shares were originally issued of \$115,979. At December 31, 2002, there were 3,941,000 shares of stock held in treasury.

During January 2003, the Company acquired 582,500 shares of its common stock in connection with a settlement with two former consultants to the Company. The shares were issued as consideration under the consulting agreements. In consideration for the settlement agreements, the Company paid the former associates an aggregate of \$135,000 and the parties granted mutual releases.

### 8. NET INCOME PER SHARE

Net income per share is calculated using the weighted average number of shares of common stock outstanding during the three months ended December 31, 2002 and 2001, respectively. Preferred stock dividends are subtracted from the net income to determine the amount available to common shareholders. There were \$395 and \$-0- preferred stock dividends in the three months ended December 31, 2002 and 2001, respectively. Warrants to purchase 500,000 shares of common stock were excluded from the calculation for the three months ended December 31, 2002. The exercise price of those warrants was greater than the trading value of the common stock and therefore inclusion of such would be anti-dilutive. Also excluded from the calculation were 131,840 shares of Series E Convertible Preferred Stock issued during the year ended September 30, 2002, which are considered anti-dilutive due to the cash payment required by the holders of the securities at the time of conversion. Neither the preferred stock or the warrants were outstanding during the three month period ended December 31, 2001.

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The following presents the computation of basic and diluted loss per share from continuing operations for the three months ended December 31:

	2002		2001		
Income	Shares	Per Share	Income	Shares	Per share
Net Income	\$1,092,892		\$306,349		
Preferred stock dividends	(395)		-0-		
Income available to common Stockholders	\$1,092,497		\$306,349		

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	=====	=====	=====	=====	=====	=====
BASIC EARNINGS PER SHARE:						
Income available to common stockholders	\$1,092,497	46,515,590	\$ 0.02	\$306,349	43,813,680	\$ 0.01
	=====		=====	=====		=====
Effect of dilutive securities						
DILUTED EARNINGS PER SHARE	\$1,092,497	46,515,590	\$ 0.02	\$306,349	43,816,680	\$ 0.01
	=====		=====	=====		=====

### 9. RELATED PARTY TRANSACTIONS

During the three months ended December 31, 2002, the Company conducted transactions with entities affiliated with the Company because of commonality in members in management or direct or indirect control of the affiliate by a member or members of the Company's management. The following summarizes those transactions:

Entity	Amount
-----	-----
Dial-Up Services, Inc. DBA Simple.Net ("SN")	\$ 56,102
Advertising Management Specialists, Inc.	96,398
Advanced Internet Marketing, Inc.	90,431
DLC Consulting	30,000
Sunbelt Financial Concepts, Inc.	164,250
	-----
	\$437,181
	=====

The above amounts represent payments made to these entities during the period.

In addition to these transactions the Company advanced an additional \$100,000 to an entity that is a significant shareholder of the Company. The total balance due from this entity was \$300,000 at December 31, 2002. See Liquidity and Capital Resources.

All of the amounts explained above, except for Simple.Net, Inc., represent compensation to certain officers and directors of the Company and their related staff in exchange for the services they provide to the Company. These officers and directors are compensated by the Company only through these entities.

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

YP.Net, Inc., a Nevada corporation (the "Company," "we," "us," or "our"), is in the business of providing Internet-based yellow page advertising space on or through [www.Yellow-Page.Net](http://www.Yellow-Page.Net) and [www.YP.Net](http://www.YP.Net).

The Company's "yellow page" database lists approximately 18 million businesses throughout the United States. Our website enables internet users to search through these "yellow page" listings and is used by businesses and consumers

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attempting to locate a business and/or service provider in response to a user's specific search criteria.

As our primary source of revenue, we offer "Preferred" listings to businesses for a monthly fee (currently \$17.95). The "preferred" listing provides a business with a priority placement listing over non-paying listings and is displayed in a bigger and bolder font at the beginning of, or in the first section of the user's search results - thus featuring our paying customers more prominently to user's of our website. In addition, our paying customers get a Mini-Webpage(TM) which includes a 40-word description of their business, their hours of operation and other useful information, a direct link to the paying customers website, (if they have one and it is provided by the advertiser), map, driving directions to the paying customers location and more. As of December 31, 2002 we have approximately 180,111 "preferred" listing advertisers who have subscribed for this enhanced advertising service. This represents less than six tenths of 1% of the estimated available market for preferred listings. We market for advertisers of our "preferred" listing service, under the name "Yellow-Page.Net, exclusively to businesses through a direct mail solicitation program. The solicitation includes a promotional incentive (i.e. generally a \$3.50 check) which, if cashed by the business, automatically signs the business up for the Preferred Listing service for an initial twelve month period with automatic renewals thereafter. This easy subscription process provides a written confirmation (i.e. the check)

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of the subscription by the newly subscribing business, which is verified by an independent third party (i.e the paying customers depositing bank). To additionally insure the intention of sign-up, the Company then mails a written confirmation card to the newly subscribing business generally within 30 days from activation. The Company also provides a 120-day cancellation period whereby the subscribing business may cancel and receive a full refund of any amounts paid to the Company.

Recently, the Company has created an outbound calling department whose function is to proactively obtain the 40-word description to be used in the Mini-Webpage(TM), as well as other information from each newly subscribing customer. This effort is expected to provide more information for potential customers searching our website to help them choose to do business with one of our Preferred Listing advertisers.

Each paying customer is billed monthly for that month's service, the vast majority of such monthly billings appear on the subscribing business's local phone bill. Management believes this ability to bill the paying customer through the paying customers phone bill is a significant competitive advantage for the Company as few independent (not owned by a telephone company) yellow page companies are authorized to bill directly on the phone bill for services rendered.

The Company uses Simple.Net, Inc. ("SN"), an internet service provider beneficially owned by a director (Deval Johnson) of the Company, to provide internet dial-up and other services to its customers (See Footnote 9 to the financial statements). SN charges the Company's customers \$2.50 per month for such internet access.

We were originally incorporated as a New Mexico company in 1969 and the Company was re-incorporated in Nevada in 1996 as Renaissance Center, Inc. Our Articles of Incorporation were restated in July 1997 and our name was changed to

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Renaissance International Group, Ltd. Effective July 1998, we changed our name to RIGL Corporation. In June 1999, we acquired Telco Billing, Inc. ("Telco") and commenced our current operations through this entity which is a wholly-owned subsidiary. In October 1999, we amended our Articles of Incorporation to change our corporate name to YP.Net, Inc. to better identify our company with our business focus.

From August through December 1999, we abandoned all subsidiaries previously involved in the multi-media software and medical billing and practice management areas. With the acquisition of Telco, our business focus shifted to the Internet yellow page services business and this business is currently our main source of revenue. Telco is operated as our wholly owned subsidiary.

### GROWTH INITIATIVES

#### PRIMARY GROWTH STRATEGIES

PREFERRED LISTINGS-We currently derive almost all of our revenue from selling Preferred Listings for the search results on our website. A Preferred Listing is displayed at the beginning of search results in response to a user's specific questions. A Preferred Listing is enhanced on the display of search results and includes a "Mini-Webpage(TM)" listing where the paying customer can use up to 40 words to advertise; among other features. Our primary growth strategy is to obtain a significantly greater number of Preferred Listings given the large, estimated potential available market for such listings. As part of this strategy, the Company has re-instituted its marketing program and plans to regularly solicit its potential customer base of approximately 18 million businesses through its direct mail solicitation program. As a result of such program, the Company has increased its customer count from 88,799 at December 31, 2001 to 180,111 at December 31, 2002, an increase of over 100%

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BRANDING-The Company also plans to further embark upon a substantial campaign to brand its product using the YP.Net and Yellow-Page.Net names. The Company seeks to become the "internet yellow pages of choice" to businesses and consumers performing searches.

In addition to its cross marketing and cross placement agreement(s) with other websites, the Company has signed a contract for advertising relating to Baca Racing and National Hot Rod Association ("NHRA") events which provides us with advertising on the Baca Racing vehicles as well as public relations and advertising as a sponsor of NHRA. In addition, we are members of both the Yellow Pages Integrated Media Association (YPIMA) and the Association of Directory Publishers (ADP). These organizations are trade associations for yellow page publishers that promote quality of published content and advertising methods. The Company plans to take an even more active role in the year ahead.

In the future, the Company also plans to substantially increase its advertising through print, media and fixed placement advertising in select markets.

#### RESULTS OF OPERATIONS

Net Revenue for the three-month period ended December 31, 2002, was \$5,741,455 compared to \$2,992,993 for the three-month period ended December 31, 2001, an increase of over 90%. The increase in net revenue is primarily the result of an increase in preferred listing customers. Preferred listing customers increased to 180,111 at December 31, 2002 compared to 88,799 preferred listing customers at December 31, 2001. The increase in preferred listing customers is the result of our direct mail solicitation marketing efforts.

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Cost of services for the three-month periods ended December 31, 2002 and December 31, 2001 were \$1,822,150 and \$1,184,277, respectively. Cost of services is comprised of billing aggregator dilution expenses, certain direct mailer marketing costs and the amortization of such costs, allowances for bad debt and our billing costs including billing fees charged by our billing aggregators. Dilution expenses include customer credits and any other receivable write-downs. The primary reason our cost of services has continued to increase is due to the previously mentioned increase in preferred listing customers. Cost of services as a percent of net revenue fell to approximately 31% for the three months ended December 31, 2002 compared to approximately 39% for the same period in the prior fiscal year as a result of the leveraging of our fixed overhead due to the increased preferred listing customers. Also, previously implemented filtering procedures (ie. Delete wrong phone numbers, etc.) continue to assure the proper filtering of our customer base to the correct LEC for billing purposes to reduce dilution. Further, our customer contact program has allowed the Company to obtain current information on its customers who have moved or changed the names of their businesses further reducing dilution.

General and administrative expense for the three-month periods ended December 31, 2002 and December 31, 2001 were \$1,376,078 and \$865,801, respectively. General and Administrative expenses increased due to an increase in costs and employees relating to our growth in preferred listing customers, our Quality Assurance and Outbound marketing initiatives, as well as an increase in certain officers compensation relating to executive services contracts which provide the Company with the services of such officers. As a percent of net revenues, such expenses declined to approximately 24% from approximately 29% in the comparable prior year period.

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Sales and marketing expenses are primarily the costs associated with our marketing relating to our direct mail solicitations. Sales and marketing expenses for the three-month periods ended December 31, 2002 and December 31, 2001 were \$632,435 and \$43,879, respectively. The primary reason for the increase in sales and marketing is due to the Company re-instituting its marketing solicitation program and the implementation of new market strategies and modification of direct mail marketing pieces. We capitalize certain direct marketing expenses and amortize those costs over an 18-month period based on the customer attrition rates analyzed by the Company.

The cost of our Yellow-Page.Net URL license was capitalized at \$5,000,000.

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The URL is amortized on an accelerated basis over the twenty-year term of the licensing agreement. Amortization expense on the URL was \$91,125 and \$148,379 for the three-month periods ended December 31, 2002 and December 31, 2001, respectively. Annual amortization expense in future years related to the URL is anticipated to be approximately \$200,000 - 300,000.

Interest income, net of interest expense, for the three-month periods ended December 31, 2002 was \$720 and interest expense, net of interest income for the three months ended December 31, 2001 was \$28,414. The decrease in the interest expense portion was a result of the payment of a substantial portion of our debt.

We recorded other income of \$48,906 and other expense of \$4,291, respectively, for the three-month periods ended December 31, 2002 and December 31, 2001. The primary component of other income in the 2002 period was a gain of \$115,979 resulting from a settlement with a former consultant to the Company.

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Net income before taxes for the three-month periods ended December 31, 2002 and December 31, 2001 were \$1,821,486 and \$726,534, respectively. Net income for the three-month periods ended December 31, 2002 and December 31, 2001 were \$1,092,892, or \$0.02 per diluted share, and \$306,349, or \$0.01 per diluted share, respectively. Net income increased due to the increase in preferred listing customers cited above with a less than corresponding increase in the expenses to service such customers due to nature of certain fixed infrastructure expenses which do not necessarily increase as revenues increase.

### LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities for the three-month period ended December 31, 2002, was \$700,104 compared to \$452,099 for the three-month period ended December 31, 2001. The increase in cash generated from operations is primarily due to a significant increase in net income resulting from an increase in preferred listing customers offset by an increase in the accounts receivable balance from such growth, funds expended for mailings related to the Company's marketing efforts as well as payments to officers and consultants with common stock.

We had working capital of \$3,964,798 as of December 31, 2002 compared to \$1,740,083 as of December 31, 2001. The increase is due to increases in accounts receivable of \$1,612,142 and net capitalized direct marketing costs of \$1,534,988 resulting from our growth in preferred listing customers.

Cash used in investing activities was \$270,680 for the three-month period ended December 31, 2002. The primary components of cash used, represents purchase of computer equipment and intellectual property of \$170,680 and net advances to affiliates of \$100,000. Compared to the three-month period ended December 31, 2001, cash used of \$29,800 represented the purchase of computer equipment.

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Cash used by financing activities was \$307,000 for the three-month period ended December 31, 2002, compared to \$771,781 for the three -month period ended December 31, 2001. The cash used represents total payments made to reduce the principal balances of our outstanding debt reduced by financing of \$147,000 under the Company's trade acceptance draft program with AcTrade Financial Technologies, Ltd.

We have repaid almost all of our debt. We believe that we will continue to generate adequate cash flow from our operations to service our remaining debt. As part of our "Puts" settlement agreement, we have a commitment to provide up to \$10,000,000 in loans to each of the M&M's (Morris & Miller, Ltd. and Matthew & Markson, Ltd.). Those funding commitments are contingent upon the Company having sufficient cash flow for its operations. Any amounts advanced to the M&M's are to be repaid to the Company and can be offset against amounts owed to the M&M's. We do not believe that the M&M's will make significant requests for funding under this commitment since the M&M's are our largest shareholders and any such advances would adversely affect our liquidity

On September 20, 2002, the Company entered into Executive Consulting Agreements with Sunbelt Financial Concepts Inc. ("Sunbelt"), Advertising Management and Consulting Services, Inc. ("AMCS") and Advanced Interent Marketing Inc. ("AIM") relating to the employment of three executive managers and their respective staffs. As part of these agreements a Flex Compensation



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program was instituted. Under these agreements, each of Sunbelt, AMCS and AIM may annually draw up to \$220,000, \$50,000 and \$50,000 respectively subject to sufficient cash on hand at the Company. The amounts are increased by 10% annually and also contain a Due on Sale Clause, whereby if there is a change of control of the Company, as defined, then the respective agreements allows each to receive the greater of 30% of the amounts due under the respective agreements or 12 months worth of fees. As of March 31, 2003, Sunbelt, AMCS and AIM had drawn approximately \$200,000, \$50,000 and \$50,000 respectively under these Flex agreements.

### CERTAIN RISK FACTORS

There are numerous factors that affect our business and the results of our operations. Sources of these factors include general economic and business conditions, federal and state regulation of our business activities, the level of demand for our services, the level and intensity of competition in the electronic yellow page industry and the pricing pressures that may result, our ability to develop new services based on new or evolving technology and the market's acceptance of those new services, our ability to timely and effectively manage periodic product transitions, the services, customer and geographic sales mix of any particular period, and our ability to continue to improve our infrastructure (including personnel and technology systems) to keep pace with the growth in our overall business activities. Our operations can be adversely affected if we are unable to increase our customer base and revenue through our direct marketing efforts. We are also subject to intense competition from other providers of Internet "yellow page" type services, Yahoo and Microsoft, as well as competition from large telephone companies. Set forth below and elsewhere in this Form 10-QSB are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained herein.

**GROSS MARGINS MAY DECLINE OVER TIME:** We expect that gross margins may be adversely affected because we have determined that profit margins from the electronic yellow pages offerings that we have profited from in the past have fluctuated. We have experienced a decrease in revenue from the LEC from the effects of the Competitive Local Exchange Carriers (CLEC) that are participating in providing local telephone services to customers. We have begun to address this problem and we are implementing data filters to reduce the effects of the CLEC's. We have also sought other billing methods to reduce the adverse effects of the CLEC billings. 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 continue to look for profitable Internet opportunities; however there are no assurances that we will be successful, and presently we have no acquisitions in progress.

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**DEPENDENCE ON KEY PERSONNEL:** Our performance is substantially dependant on the performance of our executive officers and other key employees and 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 employees could have a material adverse effect on our business, results of operations or financial condition. 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. Our Chief Executive Officer is involved in personal litigation, which may divert his attention from the management of the Company.

Operating results for a particular quarter are difficult to predict: We expect

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that in the future, our net sales may grow at a slower rate on a quarter-to-quarter basis than experienced in previous periods.

REGULATORY ENVIRONMENT. Existing laws and regulations and any future regulation may have a material adverse effect on our business. These effects could include substantial liability including fines and criminal penalties, preclusion from offering certain products or services and the prevention or limitation of certain marketing practices. As a result of such changes, our ability to increase our business through Internet usage could also be substantially limited.

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### ITEM 3 - CONTROLS AND PROCEDURES

As required by Rule 13a-14 under the Exchange Act, within 90 days prior to the filing date of this report, the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures. This evaluation was carried on under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Principal Accounting Officer. Based upon that evaluation, our Chief Executive Officer and Principal Accounting Officer concluded that our controls and procedures are effective. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date the Company carried out this evaluation.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in Company reports filed under the Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Principal Accounting Officer as appropriate, to allow timely decisions regarding disclosures.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We are party to ordinary routine litigation in the course of our operations. See Footnote 7 to the Company's financial statements included herein.

Previously, we have also been subject to certain state and federal regulatory proceedings which have been settled.

### ITEM 2. CHANGES IN SECURITIES

During the three-months ended December 31, 2002, the Company issued an aggregate of approximately 6,050,000 shares in consideration of executive service agreements and compensation to an employee.

The Company issued the following shares:

- 4,000,000 shares (value of \$300,000) to Sunbelt Financial Concepts, Inc. ("Sunbelt"), for services provided to the Company. Angelo Tullo,

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- the Company's CEO and Chairman, is President of Sunbelt; 1,000,000 shares (value of \$75,000) to Advertising Management and Consulting Services, Inc. ("AMCS") for services rendered to the Company. Greg Crane, Company's Vice President of Marketing and a Director, is President of AMCS;
- 1,000,000 shares (value of \$75,000) to Advanced Internet Marketing, Inc. ("AIM") for services rendered to the Company. DeVal Johnson, the Company's Secretary and Director is President of AIM; and
- 50,000 shares (value of \$3,750) to David J. Iannini, the Company's CFO, for services rendered as such.

The restricted shares were issued based upon the average bid and ask prices at the time of issuance (\$0.075) and were issued in reliance on the exemption from registration provided by Section 4 (2) of the Securities Act.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

EXHIBITS

REPORTS ON FORM 8-K

None.

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SIGNATURES

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

YP.NET, INC.

Dated: February 12th, 2003

s/s Angelo Tullo  
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Chairman, President, Chief Executive Officer  
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(Principal Executive Officer)  
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s/s David J. Iannini  
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Chief Financial Officer  
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(Principal Accounting Officer)  
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CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002

I, Angelo Tullo, certify that:

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1. I have reviewed this quarterly report on Form 10-QSB of YP.Net, Inc.;

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

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

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

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

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

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

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

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

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

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

Dated: February 12, 2003  
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By: /s/ ANGELO TULLO  
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Angelo Tullo  
Chairman, President and Chief Executive  
Officer

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### CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, David Iannini, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of YP.Net, Inc.;

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

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

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

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

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

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

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

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

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

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

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Dated: February 12, 2003  
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By: /s/ DAVID IANNINI  
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David Iannini  
Chief Financial Officer

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