OMNI ENERGY SERVICES CORP
Form S-1/A
April 25, 2006


**As filed with the Securities and Exchange Commission on April 25, 2006**

**Registration No. 333-131696**

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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# AMENDMENT NO. 1 TO

# FORM S-1

# REGISTRATION STATEMENT

***UNDER***

***THE SECURITIES ACT OF 1933***

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# OMNI ENERGY SERVICES CORP.

**(Exact Name of Registrant as Specified in its Charter)**

| | | |
|---|---|---|
| **Louisiana** | **1382** | **72-1395273** |
| **(State of other jurisdiction of incorporation or organization)** | **(Primary Standard Industrial Classification Code Number)** | **(I.R.S. Employer Identification No.)** |

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**4500 N.E. Evangeline Thruway**

**Carencro, Louisiana 70520**

**(337) 896-6664**

**(Address, including zip code and telephone number, including area code, of**

**Registrant s principal executive offices)**

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***With a copy to:***


| | |
|---|---|
| **G. Darcy Klug** | **David Taylor**<br>**Locke Liddell & Sapp LLP** |
| **OMNI Energy Services Corp.** | **3400 JPMorgan Chase Tower** |
| **4500 N.E. Evangeline Thruway** | **600 Travis Street** |
| **Carencro, Louisiana 70520** | **Houston, Texas 77002** |
| **Telephone: (337) 896-6664** | **Telephone: (713) 226-1200** |
| **Fax: (337) 896-9067** | **Fax: (713) 223-3717** |


**(Name, address, including zip code and telephone number, including area code, of agent for service)**

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**Approximate date of commencement of proposed sale to the public:** From time to time after this Registration Statement becomes effective.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. x

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

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**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any state where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED APRIL 25, 2006.**

**PROSPECTUS**

# OMNI ENERGY SERVICES CORP.

## 3,000,000 Shares of Common Stock

This prospectus relates to the sale of up to 3.0 million shares of our common stock by Fusion Capital Fund II, LLC (  Fusion Capital  ). Fusion Capital is sometimes referred to in this prospectus as the selling shareholder.

The selling shareholder may from time to time offer all or a portion of these shares of common stock through public or private transaction on the Nasdaq National Market or such other securities exchange on which our common stock is traded at the time of the sale. The selling shareholder may sell these shares of common stock at prevailing market prices or at privately negotiated prices either directly or through agents, broker dealers or otherwise.

The selling shareholder is an  underwriter  as such term is defined in the Securities Act of 1933, as amended (the  Securities Act ), and any commissions paid or discounts or concessions allowed to any such person and any profits received on resale of the securities offered hereby may be deemed to be underwriting compensation under the Securities Act.

The selling shareholder will receive all of the net proceeds from the sale of the shares of common stock offered by this prospectus. We are paying all of the expenses of registration incurred in connection with this offering, but the selling shareholder will pay all selling and other expenses. You may find more information concerning how the selling shareholder may sell these securities under the caption  Plan of Distribution.

Our common stock is quoted on the Nasdaq National Market under the symbol  OMNI.  On April 20, 2006, the last reported sale price for our common stock as reported on the Nasdaq National Market was $6.04 per share. We have applied to have the shares of common stock offered pursuant to this prospectus approved for trading on the Nasdaq National Market.

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**Investing in our common stock involves certain risks. See "Risk Factors" beginning on page 3 for a discussion of these risks.**

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**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

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**The date of this Prospectus is ______, 2006.**

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## SUMMARY

*This summary highlights selected information contained elsewhere in this prospectus. This summary does not contain all of the information you should consider before investing in shares of our common stock. You should read this entire prospectus carefully, including Risk factors beginning on page 4 and our consolidated financial statements and the related notes thereto beginning on page F-1, before making an investment decision. Except as otherwise noted, we present all financial and operational data on a fiscal year and fiscal quarter basis. Our fiscal year ends on December 31 of each year. Our fiscal quarters end March 31, June 30, September 30 and December 31 of each year.*

**OMNI Energy Services Corp.**

OMNI Energy Services Corp. is an integrated oilfield service company specializing in providing a range of (i) onshore seismic drilling, operational support, permitting, and survey services; and (ii) dock-side and offshore hazardous and non-hazardous oilfield waste management and environmental cleaning services, including tank and vessel cleaning and safe vessel entry, for oil and gas companies operating in the Gulf of Mexico. At December 31, 2005 we operated in two business divisions Seismic Drilling and Environmental Services. As more fully described herein, we sold our Aviation Transportation Services segment effective June 30, 2005. This division provided helicopter transportation services to oil and gas companies operating in the shallow waters of the Gulf of Mexico as well as helicopter support services to our Seismic Drilling Division. Subsequent to December 31, 2005, we acquired Preheat, Inc. ( Preheat ), a premier provider of rental equipment and specialized environmental services principally to drilling contractors operating in the Gulf of Mexico.

We were founded in 1987, as OMNI Drilling Corporation, to provide drilling services to the geophysical industry. In July 1996, OMNI Geophysical, L.L.C. acquired substantially all of the assets of OMNI Geophysical Corporation, the successor to the business of OMNI Drilling Corporation. OMNI Energy Services Corp. was formed as a Louisiana corporation on September 11, 1997 to acquire all of the outstanding common units of OMNI Geophysical, L.L.C.

**Seismic Drilling**. The principal market of our Seismic Drilling division is the marsh, swamp, shallow water and contiguous dry land areas along the Gulf of Mexico (the Transition Zone ), primarily in Louisiana and Texas, where we are the leading provider of seismic drilling support services. In 1997, we commenced operations in the mountainous regions of the western United States, and in 2003 we initiated seismic drilling activities in various Transition Zone regions of Mexico.

We own and operate a fleet of specialized seismic drilling and transportation equipment for use in the Transition Zone. We believe we are the only company that currently can provide both an integrated range of seismic drilling, permitting and survey services in all of the varied terrain of the Transition Zone and simultaneously support operations for multiple, large-scale seismic projects. In 2002, we acquired all of the assets of AirJac Drilling, a division of Veritas Land DGC. With this acquisition, we became the largest domestic provider of seismic drilling support services to geophysical companies.

**Environmental Services**. We provide dock-side and offshore, hazardous and non-hazardous oilfield waste management and environmental cleaning services, including drilling rig, tank and vessel cleaning, safe vessel entry, naturally occurring radioactive material decontamination, platform abandonment services, pipeline flushing, gas dehydration, and hydro blasting. Demand for our dock-side vessel and tank cleaning and non-hazardous waste treatment businesses are primarily driven by drilling and well-site abandonment activity in the shallow waters of the Gulf of Mexico, as reflected by the drilling rig count. Much of the cleaning and waste treatment is from residual waste created in the drilling process.

**Equipment Leasing**. We completed the acquisition of Preheat, Inc. effective February 10, 2006. Preheat is a premier provider of rental equipment and specialized environmental services principally to drilling contractors operating in the Gulf of Mexico. Preheat has a vast fleet of rental equipment including pressure washers, reverse osmosis machines and steam cleaners. In addition to the oilfield rental equipment, Preheat offers wellhead installation, stress relieving services and environmental pit cleaning services to drilling contractors. Preheat operates from locations in Belle Chasse and Broussard, Louisiana and Freer, Texas.

Our principal executive offices are located at 4500 N.E. Evangeline Thruway, Carencro, Louisiana 70520, and our telephone number at that address is (337) 896-6664. The address of our website is www.omnienergy.com. The information on our website is not part of this prospectus. Our common stock is quoted on the Nasdaq National Market under the symbol OMNI. Unless otherwise indicated, references in this prospectus to OMNI , Company , we , us , or our refer to OMNI Energy Services Corp.

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**Recent Events**

On January 17, 2006, we announced the appointment of Gregory B. Milton as our Chief Accounting Officer.

On February 14, 2006, we completed the acquisition of Preheat, Inc. ( Preheat ) pursuant to a Stock Purchase and Sale Agreement dated December 29, 2005 between us and the shareholders of Preheat. We purchased 100% of the outstanding common stock of Preheat for a purchase price of $22.5 million consisting of $16 million in cash plus the issuance of 900,000 shares of our common stock and $4 million in buyer promissory notes. In addition, we assumed $1.6 million of certain long-term debt of Preheat. As a condition of closing, Preheat was required to have on hand excess working capital of at least $4.5 million.

**The Offering**

On November 11, 2005, we entered into a Common Stock Purchase Agreement (the Purchase Agreement ) with Fusion Capital pursuant to which Fusion Capital agreed, under certain conditions, to purchase on each trading day $25,000 of our common stock up to an aggregate of $12.5 million over a 25 month period, subject to earlier termination at our discretion. In our discretion, we may elect to sell more of our common stock to Fusion Capital than the minimum daily amount. The purchase price of the shares of common stock will be equal to a price based upon the future market price of the common stock. Fusion Capital does not have the right or the obligation to purchase shares of our common stock in the event that the price of our common stock is less than $1.50. In addition, if we elect to sell our shares to Fusion Capital at a price per share below $2.39, we first would be required to obtain shareholder approval in order to be in compliance with the Nasdaq National Market rules.

At any time from November 11, 2005 until 30 days after we have sold $12.5 million of our stock to Fusion Capital, we have the right in our sole discretion to enter into a new purchase agreement with Fusion Capital for the purchase of up to $12.5 million of our common stock. If we exercise such option we cannot enter into such a new agreement until all $12.5 million of our common stock is purchased by Fusion Capital under the November 11, 2005 agreement.

Fusion Capital, the selling shareholder under this prospectus, is offering for sale up to 3,000,000 shares of our common stock. In connection with entering into the Purchase Agreement, we authorized the purchase by Fusion Capital of up to $12.5 million of our common stock and agreed to register up to 3,000,000 shares of our common stock (which includes the 177,000 shares issued and 73,000 shares issuable to Fusion Capital as the commitment fee). We have the right but not the obligation to issue more than 3,000,000 shares to Fusion Capital. In the event we elect to issue more than 3,000,000 shares offered hereby, we will be required to file a new registration statement and have it declared effective by the Securities and Exchange Commission to cover such additional shares. The number of shares ultimately offered for sale by Fusion Capital is dependent upon the number of shares purchased by Fusion Capital under the Purchase Agreement.

As of April 20, 2006, there were 16,181,570 shares of our common stock outstanding, including the 177,000 shares that we have issued to Fusion Capital as compensation for its purchase commitment, but excluding the 2,750,000 shares offered by Fusion Capital pursuant to this prospectus which it has not yet purchased from us and 73,000 shares that may be issued as a commitment fee. If all of shares offered by this prospectus were issued and outstanding as of the date hereof, the number of shares offered by this prospectus would represent 15.8% of the total common stock outstanding as of April 20, 2006.

**FORWARD-LOOKING STATEMENTS**

This prospectus contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements include statements regarding, among other things,

- our business plans or strategies, and projected or anticipated benefits or other consequences of such plans or strategies;
- our objectives;
- projected and anticipated benefits from future or past acquisitions; and
- projections involving capital expenditure or revenues, earnings or other aspects of capital projects or operating results.

Forward-looking statements, which involve assumptions and describe our future plans, strategies, and expectations, are generally identifiable by use of the words may , will , should , expect , anticipate , estimate , believe , intend or project or the negative of these words or other these words or comparable terminology. This information may involve known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from the future results, performance, or achievements expressed or implied by any forward-looking statements. These statements may be found under Management s Discussion and Analysis of Financial Condition and Results of Operations and Business, as well as in this prospectus generally. You are cautioned that all forward-looking statements involve risk associated with our dependence on activity in the oil and gas industry, labor shortages, international expansion, dependence on significant customers, seasonality and weather risks, competition, technological evolution and other risks detailed in our filings with the Securities and Exchange Commission. Additional important factors could cause actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements are discussed under the caption Risk Factors below. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date that they are made. We undertake no obligation to publicly update our forward-looking statements.

**You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. Offers to sell and offers to buy shares of our common stock are being made only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock.**

**No action is being taken in any jurisdiction outside the United States to permit a public offering of common stock or possession or distribution of this prospectus in that jurisdiction. Persons who come into possession of this prospectus in jurisdictions outside the United States are required to inform themselves about and to observe any restrictions as to this offering and the distribution of this prospectus applicable to that jurisdiction.**

## RISK FACTORS

You should carefully consider the following risk factors, in addition to the other information set forth or incorporated in this prospectus, before purchasing shares of our common stock. Each of these risk factors could adversely affect our business, operating results and financial condition, and also adversely affect the value of an investment in our common stock.

*We have incurred net losses in previous years.*

For 2005, we had net income from our continuing operations. However, our recent financial history, including the year ended December 31, 2005, reflects annual net losses, of which our current net loss is attributable mainly to discontinued operations. We hope to continue generating increased revenues and profits from our continuing operations; however, any such increase may not be sustainable or indicative of future results of operations. We do intend to continue investing in internal expansion, infrastructure, integration of acquired companies and into our operations and our marketing and sales efforts.

*We may require additional financing to sustain our operations.*

The extent to which we may rely on Fusion Capital as a source of funding will depend on a number of factors including, without limitation, the prevailing market price of our common stock, that no event of default exists under the Purchase Agreement, and the extent to which we are able to secure working capital from other sources. Fusion Capital does not have the right or the obligation to purchase shares of our common stock in the event that the price of our common stock is less than $1.50. In addition, we are not required or permitted to issue any shares of common stock under the Purchase Agreement if such issuance would breach our obligations under the rules or regulations of the Nasdaq National Market. If obtaining financing from Fusion Capital becomes unavailable or prohibitively dilutive, we will need to secure another source of funding in order to satisfy our working capital needs. Even if we are able to access the full $12.5 million under the Purchase Agreement with Fusion Capital, we may still need additional capital to implement our business, operating and development plans. Should the financing we require to sustain our working capital needs be unavailable or prohibitively expensive when we require it, the consequences would have a material adverse effect on our business, operating results, financial condition and prospects.

*The sale of our common stock to Fusion Capital may cause dilution and the sale of the shares of common stock acquired by Fusion Capital could cause the price of our common stock to decline*

The purchase price for the common stock to be sold to Fusion Capital pursuant to the Purchase Agreement will fluctuate based on the future market price of our common stock. Fusion Capital does not have the right or the obligation to purchase shares of our common stock in the event that the price of our common stock is less than $1.50. In addition, we are not required or permitted to issue any shares of common stock under the Purchase Agreement if such issuance would breach our obligations under the rules or regulations of the Nasdaq National Market. All shares in this offering are freely tradable. Fusion Capital may sell none, some or all of the shares of common stock purchased from us at any time. Depending upon market liquidity at the time, a sale of shares under this offering at any given time could cause the trading price of our common stock to decline. The sale of a substantial number of shares of our common stock under this offering, or anticipation of such sales, could make

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it more difficult for us to sell equity or equity-related securities in the future at a time and at a price that we might otherwise wish to effect sales.

*Industry volatility may adversely affect our results of operations.*

The demand for our services depends on the level of capital expenditures by oil and gas companies for developmental construction and these expenditures are critical to our operations. The levels of such capital expenditures are influenced by:

- oil and gas prices and industry perceptions of future price levels;
- the cost of exploring for, producing and delivering oil and gas;
- the ability of oil and gas companies to generate capital;
- the sale and expiration dates of leases in the United States;
- the availability of current geophysical data;
- the discovery rate of new oil and gas reserves; and
- local and international political and economic conditions.

The cyclical nature of the oil and gas industry has a significant effect on our revenues and profitability. Historically, prices of oil and gas, as well as the level of exploration and developmental activity, have fluctuated substantially. This has, in the past, and may, in the future, adversely affect our business. We are unable to predict future oil and gas prices or the level of oil and gas industry activity. A prolonged low level of activity in the oil and gas industry will likely depress development activity, adversely affecting the demand for our products and services and our financial condition and results of operations.

*Our growth and growth strategy involves risks.*

We have grown over the last several years through internal growth and acquisitions of other companies. It will be important for our future success to manage our rapid growth and this will demand increased responsibility for management personnel. The following factors could present difficulties to us:

- the lack of sufficient executive-level personnel;

- the successful integration of the operations of Preheat, Inc. including the integration of a management team with no history of working together;
- increased levels of debt and administrative burdens; and
- increased logistical problems of large, expansive operations.

If we do not manage these potential difficulties successfully, they could have a material adverse effect on our financial condition and results of operations.

*The dangers inherent in our operations and the potential limits on insurance coverage for certain risks could expose us to potentially significant liability costs.*

Our operations, and to a significant degree our seismic operations, are subject to risks or injury to personnel and loss of equipment. Our crews often conduct operations in extreme weather, in difficult terrain that is not easily accessible, and under other hazardous conditions. We maintain what we believe is prudent insurance protection. However, we cannot assure that our insurance will be sufficient or effective under all circumstances. A successful claim for which we are not fully insured may have a material adverse effect on our revenues and profitability. Moreover, we do not carry business interruption insurance with respect to our operations.

*We operate in a highly competitive industry.*

We compete with several other providers of seismic drilling, permitting, survey and environmental services. Competition among seismic contractors historically has been, and will continue to be, intense. Competitive factors have in recent years included price, crew experience, equipment availability, technological expertise and reputation for quality and dependability. Our revenues and earnings may be affected by the following factors:

- changes in competitive prices and availability of trained personnel;

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- fluctuations in the level of activity and major markets;
- general economic conditions; and
- governmental regulation.

Additionally, in certain geographical areas, some of our competitors may operate more crews than we do and may have substantially greater financial and other resources. These operators could enjoy an advantage over us if the competitive environment for contract awards shifts to one characterized principally by intense price competition.

*Seasonality and adverse weather conditions in the regions in which we operate may adversely affect our operations.*

Our operations are directly affected by the weather conditions in the Gulf of Mexico. Due to seasonal differences in weather patterns, we may operate more days in the spring, summer and fall periods and less in the winter months. The seasonality of oil and gas industry activity in the Gulf Coast region also affects our operations. Due to exposure to weather, we generally experience higher drilling activity in the spring, summer and fall months with the lowest activity in winter months, especially with respect to our operations in the mountainous regions of the western United States. The rainy weather, hurricanes and other storms prevalent in the Gulf of Mexico and along the Gulf Coast throughout the year may also affect our operations. As a result, full-year results are not likely to be a direct multiple of any particular quarter or combination of quarters.

*We are dependent on key personnel.*

Our success depends on, among other things, the continued active participation of our executive officers and certain of our other key operating personnel. Our officers and personnel have extensive experience in the domestic and international oilfield services industry. The loss of the services of any one of these persons could impact adversely our ability to implement our expansion strategy.

*We may incur additional expenditures to comply with governmental regulations.*

Our seismic operations are subject to extensive governmental regulation, violations of which may result in civil and criminal penalties, injunctions and cease and desist orders. These laws and regulations govern, among other things, operations in wetlands, the handling of explosives and hazardous and non-hazardous waste. Although our cost of compliance with such laws has to date been immaterial, such laws are changed frequently. Accordingly, it is impossible to predict the cost or impact of such laws on our future operations. We are also required by various governmental agencies to obtain certain permits, licenses and certificates. To date, we believe that we possess all permits, licenses and certificates material to the operation of our business. The loss by us of any of the licenses required for our operation could have a material adverse effect on our operations.

We depend on demand for our services from the oil and gas industry, and this demand may be affected by changing tax laws and oil and gas regulations. As a result, the adoption of laws that curtail oil and gas production in our areas of operation may adversely affect us. We cannot determine to what extent our operations may be affected by any new regulations or changes in existing regulations.

*One stockholder has substantial control over our affairs.*

Dennis R. Sciotto beneficially owns approximately 34.1% of our outstanding common stock. Mr. Sciotto represents and controls The Dennis R. Sciotto Family Trust and was appointed to the Board of Directors by the holders of the Series C Preferred Stock on June 13, 2005 pursuant to the Securities Purchase Agreement dated May 17, 2005. As a result, Mr. Sciotto has the ability to substantially influence our management and affairs and all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger, consolidation or sale of substantially all of our assets. This may have the effect of delaying, deferring or preventing a change in control, or impeding a merger or consolidation.

*Future technological advances could impair operating assets or require substantial unbudgeted capital expenditures.*

We compete in providing services in a capital intensive business. The development of seismic data acquisition and processing equipment has been characterized by rapid technological advancements in recent years, and this trend may continue. Manufacturers of seismic equipment may develop new systems that have competitive advantages over systems now in use that could render our current equipment obsolete or require us to make significant unplanned capital expenditures to maintain our competitive position. Under such circumstances, there can be no assurance that we would be able to obtain necessary financing on favorable terms.

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*Our seismic drilling operations depend on a few significant customers.*

We derive a significant amount of our seismic drilling revenue from a small number of geophysical companies. Our inability to continue to perform services for a number of our large existing customers, if not offset by sales to new or other existing customers, could have a material adverse effect on our business and operations. For example, our largest customers (those which individually accounted for more than 10% of revenue in a given year, listed alphabetically) collectively accounted for 71% (Quantum Geophysical, Seismic Exchange, and Veritas DGC), 50% (PGS, Quantum Geophysical, Seismic Exchange, and Veritas DGC), and 38% (Quantum Geophysical and Veritas DGC) of revenue for fiscal 2003, 2004, and 2005, respectively.

*Unfavorable results of litigation could have a material adverse impact on our financial statements.*

We are subject to a variety of claims and lawsuits. Adverse outcomes in some or all of the pending cases may result in significant monetary damages or injunctive relief against us. We are also subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on our financial position or results of operations. The litigation and other claims are subject to inherent uncertainties and management s view of these matters may change in the future. There exists the possibility of a material adverse impact on our financial position and the results of operations for the period in which the effect of an unfavorable final outcome becomes probable and reasonably estimable.

*We are not able to guarantee that our backlog will be timely converted into revenue in any particular fiscal period.*

Our backlog represents those seismic drilling and survey projects for which a customer has hired us and has scheduled a start date for the project. Backlog levels vary during the year depending on the timing of the completion of certain contracts and when we are awarded new contracts. Projects currently included in our backlog are subject to termination or delay without penalty at the option of the customer, which could substantially reduce the amount of backlog currently reported, and consequently, the conversion of that backlog into revenue.

the extent of his pecuniary interest therein.

*If we breach any of the material financial covenants under our various indebtedness, or if an event of default is declared with respect to any such indebtedness, our debt service obligations could be accelerated.*

If we breach any of the material financial covenants under our various indebtedness, or if an event of default is declared with respect to any such indebtedness, our substantial debt service obligations could be accelerated. In the event of any such simultaneous acceleration, we would not be able to repay all of the indebtedness.

*The market price of our common stock is highly volatile.*

The market price of our common stock has been and is expected to continue to be highly volatile. Factors, including announcements of technological innovations by us or other companies, regulatory matters, new or existing products or procedures, concerns about our financial position, operating results, litigation, government regulation, developments or disputes relating to agreements, patents or proprietary rights, may have a significant impact on the market price of our common stock. In addition, potential dilutive effects of future sales of shares of common stock by our shareholders, including Fusion Capital, and by us, pursuant to this prospectus or otherwise could have an adverse effect on the market price of our common stock.

## USE OF PROCEEDS

All of the shares of common stock offered hereby are being offered by the selling shareholder, who will receive all proceeds from such sales. We will not receive any proceeds from the sale of shares of common stock in this offering. However, we may receive up to $12.5 million in proceeds from the sale of our common stock to Fusion Capital under the Purchase Agreement. Any proceeds from Fusion Capital we receive under the Purchase Agreement will be used to reduce long-term debt and for working capital and general corporate purposes. Pending such uses, we will invest any proceeds in short term, investment grade, interest bearing securities.

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## MARKET PRICE AND DIVIDEND INFORMATION

### Market information and price range of common stock

Our common stock is traded on the Nasdaq National Market under the symbol OMNI. The following table sets forth the range of high and low sales prices of our common stock as reported by the Nasdaq National Market for the periods indicated.

| | HIGH | LOW |
|---|---|---|
| **2006** | | |
| First quarter | $ 4.94 | $ 3.23 |
| Second quarter (through April 20, 2006) | $ 6.25 | $ 4.29 |
| **2005** | | |
| First quarter | $ 2.84 | $ 1.21 |
| Second quarter | $ 2.66 | $ 1.43 |
| Third quarter | $ 5.35 | $ 2.01 |
| Fourth quarter | $ 4.22 | $ 2.30 |
| **2004** | | |
| First quarter | $ 9.00 | $ 4.76 |
| Second quarter | $ 7.80 | $ 4.22 |
| Third quarter | $ 5.35 | $ 2.95 |
| Fourth quarter | $ 4.94 | $ 1.65 |

On April 20, 2006, the reported last sale price of our common stock was $6.04. As of April 20, 2006 there were approximately 6,100 holders of record of our common stock.

### Dividend policy

We have never paid cash dividends on our common stock. We intend to retain future earnings, if any, to meet our working capital requirements and to finance future operations of our business. Therefore, we do not plan to declare or pay cash dividends to holders of our common stock in the foreseeable future. In addition, certain of our credit arrangements contain provisions that limit our ability to pay cash dividends on our common stock.

## SELECTED CONSOLIDATED FINANCIAL DATA

The selected financial data as of and for the five years ended December 31, 2005 is derived from our audited consolidated financial statements. The following information should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto included elsewhere in this prospectus. Our selected historical results are not necessarily indicative of results expected in future periods. The per share data gives retroactive effect to the one for three reverse stock split effective July 3, 2002.

We sold our Aviation Transportation Services segment effective June 30, 2005. In order to enhance the comparability of the amounts from year to year, the financial information related to the results of operations for the years ended December 31, 2001 through December 31, 2004 have been adjusted to present the operations of the Aviation Transportation Services segment as discontinued operations.

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## SELECTED FINANCIAL DATA

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 2001 | 2002 | 2003 | 2004 | 2005 |
| | (In thousands, except per share data) | | | | |
| INCOME STATEMENT DATA: | | | | | |
| Operating revenue | $ 19,839 | $ 24,592 | $ 31,555 | $ 39,064 | $ 43,350 |
| Operating expenses | | | | | |
| Direct costs | 15,005 | 17,178 | 21,586 | 28,510 | 27,515 |
| Depreciation and amortization | 3,328 | 3,270 | 3,355 | 4,282 | 4,627 |
| General and administrative expense | 2,436 | 3,186 | 3,718 | 9,464 | 8,497 |
| Total operating expenses | 20,769 | 23,634 | 28,659 | 42,256 | 40,639 |
| Asset impairment and other charges | 632 | | | | |
| Operating income (loss) | (1,562) | 958 | 2,896 | (3,192) | 2,711 |
| Interest expense | 1,223 | 799 | 943 | 3,288 | 2,836 |
| (Gain) loss on debenture conversion inducement and debt extinguishment | | | | 729 | (758) |
| Other expense (income), net | (7,929) | (115) | (114) | 290 | (835) |
| Income (loss) before income taxes | 5,144 | 274 | 2,067 | (7,499) | 1,468 |
| Income tax benefit | | 400 | 1,092 | | 508 |
| Net income (loss) from continuing operations | 5,144 | 674 | 3,159 | (7,499) | 1,976 |
| Income (loss) from discontinued operations, net of taxes | 520 | 534 | 324 | (6,756) | (3,978) |
| Loss on disposal of discontinued operations assets, net of taxes | | | | | (2,271) |
| Net income (loss) | 5,664 | 1,208 | 3,483 | (14,255) | (4,273) |
| Dividends and accretion of preferred stock | (726) | (484) | (484) | (490) | (249) |
| Non-cash charge attributable to beneficial conversion features of preferred stock | | | | | (745) |
| Net income (loss) available to common stockholders | $ 4,938 | $ 724 | $ 2,999 | $ (14,745) | $ (5,267) |
| Basic Income (loss) per common share: | | | | | |
| Income (loss) from continuing operations | $ 0.49 | $ 0.02 | $ 0.30 | $ (0.73) | $ 0.07 |
| Income (loss) from discontinued operations | 0.06 | 0.06 | 0.04 | (0.62) | (0.30) |
| Loss on disposal of discontinued operations assets | | | | | (0.17) |
| Net Income (loss) available to common stockholders | $ 0.55 | $ 0.08 | $ 0.34 | $ (1.35) | $ (0.40) |
| Diluted Income (loss) per common share: | | | | | |
| Income (loss) from continuing operations | $ 0.45 | $ 0.02 | $ 0.28 | $ (0.73) | $ 0.07 |
| Income (loss) from discontinued operations | 0.05 | 0.06 | 0.03 | (0.62) | (0.29) |
| Loss on disposal of discontinued operations assets | | | | | (0.16) |
| Net income (loss) available to common stockholders | $ 0.50 | $ 0.08 | $ 0.31 | $ (1.35) | $ (0.38) |
| Number of Weighted Average Shares: | | | | | |
| Basic | 9,015 | 8,739 | 8,772 | 10,884 | 13,251 |

| | | | | | |
|---|---|---|---|---|---|
| Diluted | 9,844 | 8,745 | 11,362 | 10,884 | 13,683 |

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| | DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 2001 | 2002 | 2003 | 2004 | 2005 |
| BALANCE SHEET DATA: | | | | | |
| Total assets | $ 38,448 | $ 41,325 | $ 50,289 | $ 65,913 | $ 43,758 |
| Long-term debt, less current maturities | 9,289 | 8,340 | 9,624 | 12,952 | 15,801 |
| Preferred Stock | 11,616 | 12,100 | 12,100 | 29 | 806 |
| Total Equity | 18,560 | 19,781 | 24,386 | 4,864 | 11,135 |

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 2001 | 2002 | 2003 | 2004 | 2005 |
| STATEMENT OF CASH FLOW DATA:<br>(for continuing and discontinued operations) | | | | | |
| Net cash provided by (used in) operating activities | $ 6,355 | $ 5,015 | $ 5,664 | $ 5,550 | $ 2,894 |
| Net cash provided by (used in) investing activities | (155) | (1,901) | (4,158) | (12,647) | 11,474 |
| Net cash provided by (used in) financing activities | (5,284) | (3,643) | (1,638) | 7,568 | (15,237) |

## MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management s discussion and analysis of financial condition and results of operations contains certain forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ), which reflect management s best judgment based on factors currently known. Actual results could differ materially from those anticipated in these forward looking statements as a result of a number of factors, including but not limited to those discussed under the headings Risk factors, and Forward-looking statements provided by us pursuant to the safe harbor established by the federal securities laws should be evaluated in the context of these factors.

This discussion and analysis should be read in conjunction with our consolidated financial statements and accompanying notes contained herein.

**Recent Events**

On January 17, 2006, we announced the appointment of Gregory B. Milton as our Chief Accounting Officer.

On February 14, 2006, we completed the acquisition of Preheat, Inc. ( Preheat ) pursuant to a Stock Purchase and Sale Agreement dated December 29, 2005 between us and the shareholders of Preheat. We purchased 100% of the outstanding common stock of Preheat for a purchase price of $22.5 million consisting of $16 million in cash plus the issuance of 900,000 shares of our common stock and $4 million in buyer promissory notes. In addition, we assumed $1.6 million of certain long-term debt of Preheat. As a condition of closing, Preheat was required to have on hand excess working capital of at least $4.5 million.

**Reclassification of financial statements**

Effective June 30, 2005, we sold our Aviation Transportation Services segment. The income statements for the years ended December 31, 2001, 2002, 2003, 2004 and 2005 have been revised to properly present the comparative information related to the Aviation Transportation Services segment. For these periods, the activities of the Aviation Transportation Services segment has been presented as discontinued operations.

**General**

**Demand For Our Services**. We receive our revenues from customers in the energy industry. Demand for our services is principally impacted by conditions affecting geophysical companies engaged in the acquisition of 3-D seismic data and oil and gas companies operating primarily in the shallow waters of the Gulf of Mexico. The level of activity for our services is primarily influenced by the level of capital expenditures by oil and gas companies.

A number of factors affect the decision of oil and gas companies to pursue the acquisition of seismic data and the exploration for oil and gas, including (i) prevailing and expected oil and gas demand and prices; (ii) the cost of exploring for, producing and developing oil and gas reserves; (iii) the discovery rate of new oil and gas reserves; (iv) the availability and cost of

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permits and consents from landowners to conduct seismic activity; (v) local and international political and economic conditions; (vi) governmental regulations; and (vii) the availability and cost of capital. The ability to finance the acquisition of seismic data in the absence of oil and gas companies interest in obtaining the information is also a factor, as some geophysical companies will acquire seismic data on a speculative basis.

**Seasonality And Weather Risks**. Our operations are subject to seasonal variations in weather conditions and daylight hours as our activities take place outdoors. On average, fewer hours are worked per day and fewer holes are generally drilled or surveyed per day in winter months than in summer months due to an increase in rainy, foggy, and cold conditions and a decrease in daylight hours.

**Results Of Operations**

The following discussion provides information related to the results of our operations.

As discussed below in Discontinued Operations, we sold our Aviation Transportation Services segment effective June 30, 2005. In order to enhance the comparability of the amounts reflected for the periods below, the financial information related to the results of operations for the years ended December 31, 2004 and 2005 has been revised to present the activities of the Aviation Transportation Services segment as discontinued operations. For more information regarding the discontinued operations of the Aviation Transportation Services segment refer to Note 13 of Consolidated Financial Statements, included herein.

**Year Ended December 31, 2004 Compared To The Year Ended December 31, 2005:**

| | YEAR ENDED DECEMBER 31, | |
|---|---|---|
| | **2004** | **2005** |
| | **(In thousands)** | |
| Operating revenue | $ 39,064 | $ 43,350 |
| Operating expenses | | |
| Direct costs | 28,510 | 27,515 |
| Depreciation and amortization | 4,282 | 4,627 |
| General and administrative expenses | 9,464 | 8,497 |
| Total operating expenses | 42,256 | 40,639 |
| Operating income (loss) | (3,192) | 2,711 |
| Interest expense | 3,288 | 2,836 |
| (Gain) loss on debenture conversion inducement and debt extinguishment | 729 | (758) |
| Other (income) expense | 290 | (835) |
| Income (loss) before taxes | (7,499) | 1,468 |
| Income tax benefit | | 508 |

| | | |
|---|---|---|
| Net income (loss) from continuing operations | (7,499) | 1,976 |
| Loss from discontinued operations | (6,756) | (3,978) |
| Loss on disposal of discontinued operations assets | | (2,271) |
| Net loss | (14,255) | (4,273) |
| Preferred stock dividends | (490) | (249) |
| Non-cash charge attributable to beneficial conversion features of preferred stock | | (745) |
| Net loss available to common stockholders | $ (14,745) | $ (5,267) |

Operating revenues increased 11%, or $4.3 million, from $39.1 million to $43.4 million for the years ended December 31, 2004 and 2005, respectively, of which $8.8 million of this increase was due to the June 30, 2004 acquisition of Trussco. Drilling revenues decreased from $30.4 million for the year ended December 31, 2004 to $25.9 million for the year ended December 31, 2005 due to permitting and weather-related delays. Operating revenues are expected to increase in 2006, as the demand for, and range of, our services continue to improve.

Direct costs decreased 4%, or $1.0 million, from $28.5 million in 2004 to $27.5 million in 2005. Operating payroll costs increased $0.9 million from $12.8 million to $13.7 million for the years ended December 31, 2004 and 2005, respectively. Payroll costs from the Trussco acquisition accounted for a $2.9 million increase while the drilling division accounted for a $2.0 million decrease. Repairs and maintenance expenses decreased $0.7 million from 2004 to 2005, with $0.8 million of the decrease related to the drilling division offset by $0.1 million related to Trussco. Explosives expense decreased $0.4 million primarily as a result of the decreased drilling activity in 2005. Contract services decreased $1.9 million company-wide, of

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which our drilling division accounted for $2.0 million of the decrease with an offsetting increase of $0.1 million related to Trussco. In 2004, we contracted third parties exclusively to provide services for heliportable drilling in the Rocky Mountains where we no longer provide these specialized drilling services. In 2004, we also contracted third parties to provide airboat drilling services during a period when most of our available employees were working on other projects. Rental and lease expenses increased $0.6 million from 2004 to 2005, with a $0.2 million decrease related to the drilling division offset by a $0.8 million increase related to Trussco. Field office expenses and insurance expenses increased $0.5 million collectively, due to the Trussco acquisition. While operating expenses are expected to continue to increase in 2006 as operating revenues increase, we expect these expenses to remain consistent as a percentage of revenues.

Depreciation and amortization costs increased $0.3 million, from $4.3 million in 2004 to $4.6 million in 2005. Depreciation expense increased $0.2 million due to the increase in revenue-producing assets, primarily from the acquisition of Trussco in June 2004. Additionally, amortization expense increased by $0.1 million resulting primarily from amortization of intangible assets related to the Trussco acquisition.

General and administrative expenses decreased $1.0 million from $9.5 million for 2004 to $8.5 million for 2005. Of this decrease, $2.8 million relates to professional services, offset by a $1.6 million increase attributable to the Trussco acquisition. Other general and administrative expense increased by $0.2 million. General and administrative expenses are expected to increase slightly in 2006.

During 2004, we recorded asset impairment charges of $4.2 million related to the revaluation of certain aviation equipment, prepaid repairs and assets held for sale resulting in a charge to expense of $0.6 million, $3.0 million and $0.6 million, respectively. There was no impairment charge required to be recorded in 2005. This 2004 impairment charge, which relates entirely to the Aviation Transportation Services Segment, is included in the loss from discontinued operations.

Interest expense was $2.8 million for the year ended December 31, 2005 compared to $3.3 million for the year ended December 31, 2004. The decrease was partially attributable to decreased levels of debt including the convertible debentures. Interest expense allocated to loss from discontinued operations amounted to $0.9 million and $1.9 million for the year ended December 31, 2005 and 2004, respectively. We expect to manage our senior debt facility as we explore strategic business opportunities.

In 2005, we recorded a $0.8 million accounting gain in connection with the early extinguishment of a portion of our debt compared to a $0.7 million loss during 2004. An additional loss of $0.7 million is included in loss from discontinued operations for 2005 compared to $0.3 million for 2004.

Other (income) expense increased from an expense of $0.3 million to income of $0.8 million. This increase in income was partially attributable to costs incurred as a result of financing transactions that did not close in 2004 coupled with a $0.8 million gain on sale of assets in 2005.

During 2004, the entire amount of the net operating loss carryforward generated was fully reserved as it was determined that more likely than not this increase in deferred tax asset would not be realized in the near future. In 2005, an income tax benefit was recognized in the amount of $0.5 million to establish the deferred tax asset balance to its estimated realizable amount.

As previously discussed, we sold our Aviation Transportation Services segment effective June 30, 2005. Accordingly, we recorded a loss from discontinued operations of $4.0 million net of tax benefit, for the year ended December 31, 2005 compared to $6.8 million for the year ended December 31, 2004. Included in the 2004 loss from discontinued operations is the asset impairment charge of $4.2 million mentioned above.

Additionally, we recorded a loss of $2.3 million on the sale of our Aviation Transportation Services segment.

Preferred stock dividends were $0.5 million and $0.2 million, respectively, for the years ended December 31, 2004 and 2005. Furthermore, we recorded a non-cash charge (deemed dividend) attributable to the beneficial conversion feature associated with the Series C 9% Convertible Preferred Stock issued during 2005.

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**Year Ended December 31, 2003 Compared To The Year Ended December 31, 2004:**

| | YEAR ENDED DECEMBER 31, | |
|---|---|---|
| | 2003 | 2004 |
| | (In thousands) | |
| Operating revenue | $ 31,555 | $ 39,064 |
| Operating expenses | | |
| Direct costs | 21,586 | 28,510 |
| Depreciation and amortization | 3,355 | 4,282 |
| General and administrative expenses | 3,718 | 9,464 |
| Total operating expenses | 28,659 | 42,256 |
| Operating income (loss) | 2,896 | (3,192) |
| Interest expense | 943 | 3,288 |
| Loss on debenture conversion inducement and debt extinguishment | | 729 |
| Other (income) expense | (114) | 290 |
| Income (loss) before taxes | 2,067 | (7,499) |
| Income tax benefit | 1,092 | |
| Net income (loss) from continuing operations | 3,159 | (7,499) |
| Income (loss) from discontinued operations | 324 | (6,756) |
| Net income (loss) | 3,483 | (14,255) |
| Preferred stock dividends | (484) | (490) |
| Net income (loss) available to common stockholders | $ 2,999 | $ (14,745) |

Operating revenues increased 24%, or $7.5 million, from $31.6 million to $39.1 million for the years ended December 31, 2003 and 2004, respectively, of which $8.7 million of this increase was due to the June 30, 2004 acquisition of Trussco. Drilling revenues decreased slightly from $31.6 million for the year ended December 31, 2003 to $30.6 million for the year ended December 31, 2004 due to permitting and weather-related delays.

Direct costs increased 32%, or $6.9 million, from $21.6 million in 2003 to $28.5 million in 2004. Operating payroll expenses increased $2.3 million from $6.2 million to $8.5 million for the years ended December 31, 2003 and 2004, respectively. Payroll costs from the Trussco acquisition accounted for $2.3 million of the increase while the drilling division accounted for a $0.6 million decrease. Repairs and maintenance expenses decreased $0.3 million from 2003 to 2004, with $0.5 million of the decrease related to the drilling division offset by $0.3 million related to Trussco. Explosives expense increased $1.7 million due to an increase in the cost of explosives and downhole costs on jobs performed in 2004. Contract services increased $0.8 million company-wide, of which our drilling division accounted for $1.3 million of the increase with an offsetting decrease of $0.6 million form our permitting division. In 2004, we contracted third parties exclusively to provide services for heliportable drilling in the Rocky Mountains where we no longer provide these specialized drilling services. In 2004, we also contracted third parties to provide airboat drilling services during a period when most of our available employees were working on other projects. Shop expenses increased $0.4 million from 2003 to 2004 as a result of the Trussco acquisition. Other direct costs increased $2.3 million, of which Trussco accounted for $1.0 million.

Depreciation and amortization costs increased 26%, or $0.9 million, from $3.4 million in 2003 to $4.3 million in 2004. Depreciation expense increased $0.4 million due to the increase in revenue-producing assets, primarily from the acquisitions of Trussco in June 2004. Additionally, amortization expense increased by $0.5 million resulting primarily from amortization of intangible assets related to the Trussco acquisition.

General and administrative expenses increased $5.8 million from $3.7 million for 2003 to $9.5 million for 2004. Of this increase, $2.2 million is attributable to the Trussco acquisition, $2.4 million is related to professional services and $0.4 million is related to payroll increases. Other general and administrative expense increased by $0.8 million.

During 2004, we recorded asset impairment charges of $4.2 million related to the revaluation of certain aviation equipment, prepaid repairs and assets held for sale resulting in a charge to expense of $0.6 million, $3.0 million and $0.6 million, respectively. There was no impairment charge required to be recorded in 2003. This 2004 impairment charge, which relates entirely to the Aviation Transportation Services Segment, is included in the loss from discontinued operations.

Interest expense was $3.3 million for the year ended December 31, 2004 compared to $0.9 million for the year ended December 31, 2003. The increase was partially attributable to increased levels of debt including the convertible debentures coupled with increased interest rates between the periods. Also, $1.3 million of the increase related to amortization of deferred loan costs and $0.7 million related to the amortization of debt discounts originally recorded in conjunction with the

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convertible debentures in early 2004. Interest expense allocated to loss from discontinued operations amounted to $1.9 million and $0.5 million for the year ended December 31, 2004 and 2003, respectively.

We recorded a $1.0 million accounting loss in connection with the inducement for early extinguishment of a portion of our convertible debentures during 2004. Of that loss, $0.3 million is included in loss from discontinued operations. There was no such charge in 2003.

Other expense (income) decreased from income of $0.1 million to expense of $0.3 million. This increase in expense was due to costs incurred as a result of financing transactions that did not close.

In 2003, we reversed $1.6 million of the allowance for deferred taxes previously reserved of which $0.5 million was allocated to discontinued operations. There were no taxes recorded in 2004 due to the significant net operating loss incurred. During 2004, the entire amount of the net operating loss carryforward generated was fully reserved as it was determined that more likely than not this increase in deferred tax asset would not be realized in the future.

As previously discussed, we sold our Aviation Transportation Services segment on June 30, 2005. In order to enhance the comparability of the amounts from year to year, the financial information related to the results of operations for the years ended December 31, 2003 and 2004 has been adjusted to present the activities of the Aviation Transportation Services segment as discontinued operations. The income, net of tax benefit, related to those discontinued operations was $0.3 million for the year ended December 31, 2003 and the loss related to the discontinued operations was $6.8 million for the year ended December 31, 2004. Included in the 2004 loss from discontinued operations is the asset impairment charge of $4.2 million mentioned above.

Accretion of preferred stock and preferred stock dividends remained constant at $0.5 million for the years ended December 31, 2003 and 2004.

**Liquidity And Capital Resources**

At December 31, 2005, we had approximately $0.2 million in cash on hand and approximately $2.4 million available on our revolving line of credit. This compares to approximately $1.0 million in cash on hand and no availability on our revolving line of credit at December 31, 2004. At December 31, 2005, we had a working capital deficit of approximately $0.02 million as compared to a working capital deficit of approximately $22.1 million at December 31, 2004. Our increase in working capital is the result of restructuring and settlement of certain debt obligations during 2005.

Cash provided by continuing operating activities was $3.2 million, $6.0 million and $6.0 million in the years ended December 31, 2005, 2004 and 2003, respectively. The largest contributing factors in 2003 were a result of non-cash transactions and a decrease in prepaid expenses and other current assets. In 2004, the largest contributing factors were a result of non-cash transactions, an increase in accounts payable and accrued expenses and a decrease in prepaid expenses and other current assets. In 2005, the largest contributing factors were a result of non-cash transactions, an increase in receivables and a decrease in prepaid expenses and other current assets and accounts payable and accrued expenses.

Historically, our capital requirements have primarily related to the purchase or fabrication of new seismic drilling equipment and related support equipment, additions to our aviation fleet and new business acquisitions. In 2004, we acquired Trussco, Inc., purchased approximately $6.4 million of aircraft accounted for as capital leases, and purchased approximately $0.8 million of new vehicles accounted for as capital leases. For the year ended December 31, 2005, we acquired $0.1 million of new vehicles and approximately $0.1 million in aviation support equipment as well as $0.2 million in equipment and approximately $0.3 million in facility improvements. In 2005, we sold the assets of our Aviation Transportation Services segment. Proceeds from the sale were used to repay capital lease obligations related to that division. In 2006, we plan to continue to explore strategic business opportunities, renew our rolling stock and expand and upgrade our facilities and equipment to improve efficiency of our operations.

During the quarter ended March 31, 2005, we repaid approximately $3.3 million of our debt primarily related to our equipment notes, capital leases and real estate loans. Furthermore, we extinguished three capital leases totaling $2.9 million as a result of our disposition of three helicopters.

During the quarter ended June 30, 2005, we finalized a new $50.0 million senior credit facility, which we also refer to as the Term A Loan. The proceeds from the Term A Loan were used to re-finance certain long-term debt, provide working capital and establish funding necessary to complete various strategic transactions which are under consideration. During the year ended December 31, 2005, a portion ($9.35 million) of the $11.0 million proceeds from the sale of the Aviation Transportation Services segment were used to repay a portion of the Term A Loan as well as a $3.4 million repayment from proceeds of the Term B Loan discussed below. At December 31, 2005, the balance owed on the facility was $4.5 million.

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During the quarter ended September 30, 2005, we completed a new $25 million multiple draw term credit facility, which we also refer to as our Term B Loan. The proceeds from the Term B Loan were used to (i) reduce indebtedness under our Term A Loan; (ii) retire certain Subordinated Notes; (iii) retire certain Subordinated Debt; and, (iv) provide working capital and funds necessary for potential strategic transactions. At December 31, 2005, the balance owed on the Term B Loan was $9.0 million.

Loan closing costs of $3.6 million were incurred during the year ended December 31, 2005 related to the Term A and Term B Loans and a total of $0.5 million was incurred during the year ended December 31, 2005 related to our various credit facilities.

**Long-Term Debt**

At December 31, 2004 and 2005, long-term debt consists of the following:

| | DECEMBER 31, | |
|---|---|---|
| | 2004 | 2005 |
| | (In thousands) | |
| Notes payable to a finance company, variable interest rate at LIBOR plus 5.0% (7.42% at December 31, 2004) maturing July 31, 2006, secured by various property and equipment, repaid in full | $ 867 | $ |
| Notes payable to a bank with interest payable at Prime plus 1.75% (8.25% at December 31, 2005 and 6.75% at December 31, 2004) maturing July 31, 2023, secured by real estate | 1,392 | 1,354 |
| Notes payable to a finance company with interest at 10.24%, maturing May 18, 2008, secured by an aircraft, repaid in full | 168 | |
| Notes payable to a finance company with interest at 6.26%, maturing March 17, 2006, secured by various aircraft, repaid in full | 1,697 | |
| Notes payable to a bank with interest at 8.13%, maturing June 20, 2009, secured by aircraft, repaid in full | 238 | |
| Notes payable to a finance company with interest at 8%, maturing February 10, 2013, secured by real estate | 214 | 195 |
| Notes payable to a bank with interest at 12% at December 31, 2004, maturing May 31, 2005, secured by various property and equipment, repaid in full | 6,500 | |
| Convertible promissory notes payable to certain former stockholders of Trussco, Inc. with interest at 5%, maturing in June 2007 | 3,000 | 1,000 |
| Capital lease payable to leasing companies secured by vehicles | 1,198 | 729 |
| Capital lease payable to finance companies | 9,100 | 941 |
| Subordinated promissory note to a former debenture holder with a fixed interest rate of 8%, maturing May 13, 2008, unsecured | | 913 |
| Term B notes payable to a finance company, variable interest rate at LIBOR plus 8.0% (12.41% at December 31, 2005) maturing August 29, 2010, secured by various property and equipment | | 9,000 |
| Term A notes payable to a finance company, variable interest rate at LIBOR plus 6.5% (10.80% at December 31, 2005), maturing May 18, 2010, secured by various equipment | | 4,540 |
| Other debt | 86 | 52 |
| Total | 24,460 | 18,724 |
| Less: current maturities | (6,095) | (2,926) |
| Less: long-term debt of discontinued operations | (11,228) | |
| Long-term debt, less current maturities continuing operations | $ 7,137 | $ 15,798 |

**Line Of Credit**

We have a working capital revolving line of credit agreement (the Line ). Availability under the Line is the lower of: (i) $15.0 million or (ii) the eligible accounts receivable, as defined under the agreement. The Line accrues interest at the prime interest rate plus 1.5% (9.25% at December 31, 2005) and matures in May 2010. The Line is collateralized by accounts receivable and is subject to certain customer concentration limitations. As of December 31, 2005, we had $4.8 million outstanding under the Line. The weighted-average interest rate on borrowings under our revolving lines of credit was 6.0% and 7.7% for the years ended December 31, 2004 and 2005, respectively. Due to the lock-box arrangement and the subjective acceleration clause of the Line agreement, the debt under the Line has been classified as a current liability as of December 31, 2004 and 2005, as required by Emerging Issues Task Force ( EITF ) No. 95-22, *Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that include both a Subjective Acceleration Clause and a Lock-Box Arrangement.*

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**Senior Secured**

On October 21, 2004, we completed a $6.5 million senior secured loan ( Bridge Loan ) with Beal Bank, SSB. The Bridge Loan accrued interest at the rate of 12% per annum, matured January 15, 2005, and was collateralized by specific seismic assets, certain Trussco equipment and three Bell helicopters. The proceeds were used to repay debt, pay the October Put Option on the Convertible Debentures discussed below and for working capital purposes.

On January 21, 2005, we entered into a forbearance agreement with Beal Bank, SSB, which increased the interest rate from 12% to 17% and extended the maturity of the Bridge Loan to March 15, 2005. On May 2, 2005, we entered into a second agreement to extend the maturity date to May 31, 2005. The Bridge Loan restricted the payment of dividends and contained customary financial covenants requiring, among other things, minimum levels of tangible net worth, debt to earnings before interest, taxes, depreciation and amortization ( EBITDA ) ratios, and limitations on annual capital expenditures and certain customer concentrations. This loan was repaid in full with proceeds from the Senior Credit Facility (see below) on May 18, 2005.

**Capital Leases**

During the year ended December 31, 2005, we had several capital leases for aircraft which generally had lease terms of 60 months at inception of the lease. Aircraft leases either contain a bargain purchase option at the end of the lease or a balloon amount due that can be refinanced over 36 months. From time to time, we acquired an aircraft through cash flows from operations or through the Line which was then sold to a financing company and leased back to us. These sales and lease back transactions were recorded as a capital lease and gains and losses incurred on the sale are deferred and amortized over the life of the lease term or the asset, whichever is shorter. These leases were paid in full from proceeds of our Term A Loan in the third quarter of 2005.

We also lease several vehicles used in our seismic drilling operations under 40-month capital leases.

**Convertible Debentures**

Pursuant to a Securities Purchase Agreement dated February 12, 2004, we issued (i) $10,000,000 in principal amount of 3-year, 6.5% fixed rate, Convertible Debentures (the Initial Debentures ) that were convertible into shares of common stock at an initial conversion price of $7.15 per share, (ii) 1-year common stock Series A Warrants to purchase an aggregate of 700,000 shares of Common Stock at an initial exercise price of $7.15 per share and (iii) 5-year Common Stock Series B Warrants to purchase an aggregate of 390,000 shares of Common Stock at an initial exercise price of $8.50 per share. The warrants were not exercisable for a period of six months and one day after the issue date of such warrants and in no event would the exercise prices of such warrants be less than $6.15 per share. In accordance with APB Opinion No. 14, the warrants were valued at a fair market value of $0.9 million using the Black Scholes model. The value of these warrants was recorded as debt discount with a corresponding amount recorded to paid in capital at the date of issuance. The 1-year Series A warrants expired during 2005.

On April 15, 2004, in accordance with the Securities Purchase Agreement, we issued (i) $5,050,000 in principal amount of 3-year, 6.5% fixed rate, Convertible Debentures (collectively with the Initial Debentures, hereinafter referred to as the Debentures ) that were convertible into shares of common stock at an initial conversion price of $7.20 per share, and (ii) 5-year Common Stock Series A Warrants to purchase an aggregate of 151,500 shares of common stock at an initial exercise price of $9.00 per share. The warrants were not exercisable for a period of six months and one day after the issue date of such warrants and in no event would the exercise prices of such warrants be less than $7.11 per share. In accordance with APB Opinion No. 14, the warrants were valued at a fair market value of $0.2 million using the Black Scholes model. The value of the warrants and beneficial conversion feature were recorded as a debt discount with a corresponding amount recorded to paid in capital at the date of issuance.

Total proceeds of $14.2 million were received from the issue of these Debentures, after expenses. Of the total proceeds received, $8.2 million was used to redeem the Series A Preferred Stock and dividends in February 2004, $4.9 million was used to redeem the Series B Preferred Stock and dividends in March and April 2004 and the balance used for working capital purposes (See Note 9 to the Consolidated Financial Statements).

The debt discounts for the February 12, 2004 and April 15, 2004 debentures were $0.9 million and $0.2 million, respectively. The debt discounts are being amortized to interest expense using the effective interest method over the period in which the debentures can be put to us. A total of $0.9 million is included in interest expense and $0.2 million loss on extinguished related to the amortization of the debt discounts for the year ended December 31, 2004. Since the Debentures were in default at December 31, 2004, the entire amount of the debt discount was charged to expense during 2004.

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Prior to maturity of the Debentures, the holders of the Debentures had the right to require the repayment or conversion of up to an aggregate of $13.17 million of the Debentures (the Put Option ). We registered 5,012,237 shares effective June 30, 2004 covering the common stock that may have been issuable pursuant to the conversion of the Debentures and the exercise of the Put Option and all associated warrants, including additional shares that may be issuable due to adjustments for conversion price upon the Debenture conversion, payment of interest with shares and/or the exercise of warrants due to subdivision or combination of our common stock. Pursuant to the Debenture agreement, the registration of the related common stock triggered the ability of the Debentures holders to exercise the Put Option in ten consecutive non-cumulative and equal monthly installments equal to 8.75% of the face value of the Debentures ($1,316,875) beginning August 1, 2004. Accordingly the Debentures, net of debt discount, were classified as a current liability in the Consolidated Balance Sheet at December 31, 2004. We received, and redeemed for cash, notices from the holders of the Debentures exercising their Put Option for August, September and October 2004. Upon receipt of the Debenture Holders intent to exercise a Put Option, we had the irrevocable option to deliver cash or, if certain conditions set forth in the Debentures were satisfied, shares of our common stock. If we elected to pay the Put Option with common stock, the underlying shares would have been valued at a 12.5% discount to the average trading price of our common stock for the applicable pricing period, as defined in the Debenture agreement. The number of shares we would have delivered was equal to the value of the Put Option installment due divided by the fair market value of our common stock for the applicable pricing period discounted at 12.5%. We did not redeem for cash or stock notices received from the Debenture Holders exercising their Put Option for the months of November and December 2004 and January, February, March and April 2005.

As provided for in the terms of the applicable Securities Purchase Agreements, the Debenture holders received Put Option payments of $1.3 million in principal, plus accrued interest, each on August 5, 2004, on September 9, 2004 and on October 25, 2004. In accordance with APB Opinion No. 26 *Early Extinguishment of Debt,* we recorded $0.2 million as a loss on extinguishment of debt in 2004 as a result of the early extinguishment of these portions of the Debentures. (See Note 4 to the Consolidated Financial Statements).

On October 8, 2004, we entered into an Amendment and Conditional Waiver Agreement (the Amendment ) with the holders of the Debentures. Under the terms of the Amendment, the Debenture holders granted us, among other things, the right to pre-pay in cash all, but not less than all, of the outstanding Debentures held by each holder on or prior to November 15, 2004. In exchange for such right, we agreed to allow the holders of the Debentures to convert $2,000 of the principal amount of the April 15, 2004 Debentures into 200,000 shares of common stock at a revised conversion price of $0.01 per share. As a result of this conversion and in accordance with the requirements of Statement of Financial Accounting Standards ( SFAS ) No. 84, *Induced Conversions of Convertible Debt, an amendment to APB Opinion No. 26,* we recorded $0.9 million in debt conversion expense in 2004.

On January 25, 2005, we filed suit in United States District Court, Western District of Louisiana against the holders of the Debentures and other third parties (collectively, the Debenture Holders ). In the suit, we alleged that the Debenture Holders violated Section 16(b) of the Securities Exchange Act of 1934, and we sought the disgorgement of profits realized by the Debenture Holders from their purchases and sales of our common stock.

On May 18, 2005, we entered into settlement agreements ( Debenture Settlement Agreements ) with each of the Debenture Holders in exchange for our dismissal of the lawsuit filed against the Debenture Holders (see Note 4 to the Consolidated Financial Statements). Under the terms of the Debenture Settlement Agreements, we agreed to (i) pay the Debenture Holders approximately $4.0 million cash; (ii) immediately issue the Debenture Holders 2.0 million shares of our common stock at an agreed upon value of $3.4 million; and, (iii) issue the Debenture Holders approximately $4.3 million of unsecured, subordinated promissory notes ( Subordinated Debenture Notes ). The Company recorded a gain of $0.2 million at the close of these transactions. The Subordinated Debenture Notes were scheduled to be paid quarterly, with interest in arrears, over 36 months in level payments with interest accruing at the rate of 8% per annum. Execution of the Debenture Settlement Agreements extinguished the terms of the original Debentures and released all parties from any future claims.

On August 26, 2005, we entered into a settlement agreement and mutual release ( Agreement and Release ) with two of the three holders of the Subordinated Debenture Notes. Under terms of the Agreement and Release, we paid $1.5 million in cash from the proceeds of a new $25.0 million multiple draw term credit facility, and issued 750,000 shares of our common stock in full satisfaction of the applicable Subordinated

Debenture Notes. At December 31, 2005, the remaining Subordinated Debenture Note had a balance of approximately $0.9 million.

**Senior Credit Facility**

On May 18, 2005, we completed a $50 million equipment term financing facility, and increased our Line to $15 million from its previous level of $12 million. Under the terms of the Term A Loan, funding will be limited to the lesser of $50 million and the sum of (i) 85% of the orderly liquidation value of our aviation fleet; (ii) 75% of the orderly liquidation value of our seismic drilling and environmental equipment; and (iii) 50% of the fair market value of certain real estate. Proceeds from the

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Term A Loan were used to refinance certain long-term debt, provide working capital and establish funding necessary to complete various strategic transactions under consideration. The Term A Loan restricts the payment of cash dividends and contains customary financial covenants requiring, among other things, minimum levels of tangible net worth, debt to EBITDA ratios and limitations on annual capital expenditures. The Term A Loan matures in May 2010 and will be repaid in equal payments of up to a 50% balloon at maturity date, with interest, paid in arrears and accruing at the initial annual interest rate of 30-day LIBOR plus 6.5% (10.80% at December 31, 2005). Upon the completion of the sale of the aviation transportation services segment, the total borrowing base under the Term A Loan was reduced to $30.0 million. Proceeds from the sale of the Aviation Transportation Services segment were used to pay approximated $9.35 million on the Term A Loan during July 2005, leaving an outstanding balance of approximately $8.6 million. Additionally, a portion of the proceeds from the Term B Loan (discussed below) were used to reduce the balance of the Term A Loan to approximately $5.0 million in August 2005.

**Junior Credit Facility**

On August 29, 2005, we completed a $25 million multiple draw term credit facility. Under the terms of the Term B Loan, borrowings will be done through advances at our request in minimum amounts of $2 million. Quarterly payments in the amount of $0.175 million, plus interest, will begin on April 1, 2008 and the Loan matures in August 2010 and accrues interest at the rate of LIBOR plus 8% (12.41% at December 31, 2005). The Term B Loan restricts the payment of cash dividends and contains customary financial covenants requiring, among other things, minimum levels of tangible net worth, debt to EBITDA ratios and limitations on annual capital expenditures. The proceeds from the Term B Loan were used to (i) reduce the current outstanding balance under our Term A Loan by $3.4 million; (ii) retire approximately $3.3 million of 8% Subordinated Debenture Notes with a payment of $1.5 million cash and the issuance of 750,000 shares of our common stock; (iii) retire $2 million of certain Subordinated Notes with a payment of $1 million cash and the issuance of 200,000 shares of common stock; and (iv) provide working capital and funds necessary for potential strategic transactions.

**Trussco Notes**

On June 30, 2004, we purchased Trussco for an aggregate acquisition price of $11.9 million, including $7.3 million in cash, $3.0 million in 5% convertible promissory notes payable to certain stockholders ( Stockholder Notes ) maturing in June 2007, and the assumption of approximately $1.6 million in debt and other liabilities. The Stockholder Notes can be prepaid at any time and are convertible into shares of our common stock at a price of $9.40 per share.

On May 18, 2005, we entered into early debt extinguishment agreements ( Debt Extinguishment Agreements ) with respect to $2.0 million of the Stockholder Notes and $1.0 million of the Earnout Note more fully described in Note 8 to the Consolidated Financial Statements contained herein. Under the terms of the Debt Extinguishment Agreements, we (i) immediately issued 0.2 million shares of our common stock; and (ii) paid certain holders of the Stockholder Notes $1.0 million on or before August 16, 2005, in full and complete satisfaction of $2.0 million of the Stockholder Notes and $1.0 million of the contingent Earnout Note. We recognized a gain on debt extinguishment of $0.3 million upon closing the transaction.

At December 31, 2005, we had $1.0 million of Stockholder Notes outstanding bearing interest at 5% and maturing in June 2007. At December 31, 2005, we also had outstanding a $2.0 million contingent Earnout Note payable, none of which had been earned. Based upon current estimates, the amounts due and payable by the end of the term of the Earnout Notes, if any, will be immaterial. See Trussco Earnout in Commitments and Contingencies below.

**Series C 9% Convertible Preferred Stock**

On May 17, 2005, we entered into a Securities Purchase Agreement with certain of our affiliates and executive officers to issue up to $5.0 million of Series C 9% Convertible Preferred Stock (the Series C Preferred ) in conjunction with the completion of the Term A Loan more fully described above. Our Series C Preferred is convertible into our common stock at a conversion price of $1.95 per share and includes detachable warrants to purchase up to 6,550,000 additional shares of our common stock at exercise prices ranging between $1.95 and $3.50 per share. The transactions contemplated by the Securities Purchase Agreement closed in two tranches. On May 17, 2005, the closing date of the first tranche, we issued an aggregate of 3,500 shares of Series C Preferred and warrants to acquire 4,585,000 shares of our common stock, in exchange for $3,500,000. The second tranche closed on August 29, 2005, at which time the remainder of the Series C Preferred and warrants were issued generating proceeds of $1.5 million and we granted the remaining 1,965,000 warrants.

As mentioned above, the Term A Loan and the Term B Loan restrict the payment of cash dividends. Consequently, a portion of the 9% dividend obligation related to the Series C Preferred has been satisfied through the issuance of payment-in-kind ( PIK ) dividends. The PIK dividends are paid through the issuance of additional shares of Series C Preferred. These additional shares of preferred stock do not have warrants attached to them. During the year ended December 31, 2005, 128 shares of Series C Preferred were issued as PIK dividends at par.

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**Related Party Transactions**

During the three year period ended December 31, 2001, we privately placed with an affiliate subordinated debentures totaling $7.5 million, $3.4 million and $1.5 million, respectively. The debentures matured five years from their date of issue and accrued interest at various rates ranging from a fixed rate of 12% per annum to a variable rate of interest starting at 12% per annum and escalating to 20% per annum. In October 2000, we agreed to convert $4.6 million of the subordinated debentures into our Series A Preferred. In May 2001, we agreed to pay the affiliate $3.0 million cash plus issue to the affiliate $4.6 million of the Company s Series B Preferred in satisfaction of all of the remaining outstanding subordinated debentures including accrued interest of $1.8 million. This transaction resulted in the affiliate agreeing to forgive $1.0 million of indebtedness, which was reflected as a capital contribution from the affiliate (See Note 9 to the Consolidated Financial Statement for the accounting for preferred stock). In February 2004 and April 2004, we issued $10 million and $5.05 million, respectively, of 6.5% Subordinated Convertible Debentures (See Note 4 to the Consolidated Financial Statements). The proceeds were used to redeem $8.2 million (7,475 shares) of the Series A Preferred Stock outstanding, including accrued dividends. The remaining 25 shares of Series A Preferred were redeemed in April 2004 for $0.03 million. At December 31, 2004 there are no Series A Preferred outstanding. During the first quarter of 2004, we redeemed 2,286 shares of the Series B Preferred for $2.4 million, including accrued dividends. In April 2004, we redeemed 2,285 shares of the total of 2,314 shares of the Series B Preferred outstanding for $2.5 million, including accrued dividends. At December 31, 2005, 29 shares of Series B Preferred Stock remain outstanding.

In connection with the original issuance of the subordinated debentures, we issued to the affiliate detachable warrants to purchase 1,912,833 shares of our common stock, of which 293,055 warrants were transferred in 2003 to settle certain litigation (See Note 9 to the Consolidated Financial Statements) and 858,678 warrants were cancelled in 2003. The balance of 761,100 warrants was exercised in the first quarter of 2004 at an exercise price of $2.25.

During 2003, we entered into an agreement to facilitate the private placement of approximately 1,650,000 shares of our common stock owned by an affiliate and certain investors. The sale of the stock covered by this agreement closed in the fourth quarter of 2003, resulting in our receipt of $0.4 million cash which is reflected as a reduction in our general and administrative expenses in the accompanying Consolidated Financial Statements.

During 2003, in order to facilitate a settlement of ongoing litigation between certain of our affiliates, we agreed to re-price and extend the maturity dates of certain warrants owned by the defendant affiliates but transferred in settlement of the litigation to the plaintiff affiliates. The exercise prices of the transferred warrants ranged from $2.25 $6.00 per share. The maturity dates of the transferred warrants ranged from November 1, 2004 to July 1, 2005. The transferred warrants were re-priced at $1.54 per share and the maturity dates were extended to November 1, 2006. Our statement of operations includes a non-recurring charge of approximately $0.1 million representing the differences in the fair market value of the originally issued warrants and the re-priced warrants. In 2004 all re-priced warrants were exercised.

On May 17, 2005, we entered into a Securities Purchase Agreement with certain of our affiliates and executive officers to issue up to $5.0 million of Series C Preferred in conjunction with the completion of the Term A Loan more fully described above. Our Series C Preferred is convertible into our common stock at a conversion price of $1.95 per share and includes detachable warrants to purchase up to 6,550,000 additional shares of our common stock at exercise prices ranging between $1.95 and $3.50 per share. The transactions contemplated by the Securities Purchase Agreement closed in two tranches. On May 17, 2005, the closing date of the first tranche, we issued an aggregate of 3,500 shares of Series C Preferred Stock and warrants to acquire 4,585,000 shares of our common stock, in exchange for $3,500,000. The second tranche closed on August 29, 2005, at which time the remainder of the Series C Preferred and warrants were issued generating proceeds of $1.5 million and we granted the remaining 1,965,000 warrants.

The Term A Loan and the Term B Loan restrict the payment of cash dividends. Consequently, the dividend obligation related to the Series C Preferred has been satisfied through the issuance of PIK dividends. The PIK dividends are paid through the issuance of additional shares of Series C Preferred. These additional shares of preferred stock do not have warrants attached to them. During the year ended December 31, 2005, 128 shares of Series C Preferred were issued as PIK dividends at par.

**Critical Accounting Policies And Estimates**

**Use Of Estimates**

The discussion and analysis of financial condition and results of operation are based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate our estimates on an on-going

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basis, based on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

**Accounts Receivable**

We extend credit to customers and other parties in the normal course of business. We regularly review outstanding receivables, and provide for estimated losses through an allowance for doubtful accounts. In evaluating the level of established reserves, we make judgments regarding the parties ability to make required payments, economic events and other factors. As the financial condition of these parties change, circumstances develop or additional information becomes available, adjustments to the allowance for doubtful account may be required. Due to the nature of our industry, we may periodically have concentration of credit risks. As a result, adjustments to the allowance for doubtful accounts may be significant.

**Inventory**

We have made significant investments in inventory to service our equipment. On a routine basis, we use judgments in determining the level of reserves required to state inventory at the lower of cost or market. Technological innovations, market activity levels and the physical condition of products primarily influence our estimates. Changes in these or other factors may result in adjustments to the carrying value of inventory.

**Income Taxes**

Deferred tax assets and liabilities are recognized for differences between the book basis and tax basis of our net assets. In providing for deferred taxes, we consider current tax regulations, estimates of future taxable income and available tax planning strategies. We have established reserves to reduce our net deferred tax assets to estimated realizable value. If tax regulations change, operating results or the ability to implement tax planning strategies vary, adjustments to the carrying value of our net deferred tax assets and liabilities may be required. In making this determination, we have considered future income in assessing the ultimate recoverability of the recognized net deferred tax asset.

We record liabilities for environmental obligations when remedial efforts are probable and the costs can be reasonably estimated. Our estimates are based on currently enacted laws and regulations. As more information becomes available or environmental laws and regulations change, such liabilities may be required to be adjusted. Additionally, in connection with acquisitions, we obtain indemnifications from the seller related to environmental matters. If the indemnifying parties do not fulfill their obligations, adjustments of recorded amounts may be required.

We maintain insurance coverage for various aspects of our business and operations. We retain a portion of losses that occur through the use of deductibles and, to a limited extent, self-funded insurance programs. We regularly review estimates of reported and unreported claims and provide for losses through insurance reserves. As claims develop and additional information becomes available, adjustments to loss reserves may be required.

**Stock Based Compensation**

We account for employee stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees* ( Opinion No. 25 ). Accordingly, the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* permits the continued use of the method prescribed by Opinion No. 25, but requires additional disclosures, including pro forma calculations of earnings and net earnings per share as if the fair value method of accounting prescribed by SFAS No. 123 had been applied. As required by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure,* which amended SFAS No. 123, a table illustrating the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation is presented in Note 1 of the accompanying Consolidated Financial Statements included herein.

**Discontinued Operations**

In accordance with SFAS No. 144 *Accounting for the Impairment and Disposal of Long-Lived Assets* ( SFAS No. 144 ), we are accounting for the Brazoria market as a separate unit within American Helicopters, Inc. and have accounted for our exit from this market as discontinued operations in 2004. Effective June 30, 2005, we sold the equipment and related assets of our Aviation Transportation Services segment for a cash price of $11.0 million. The proceeds were used to repay advances under our Term A Loan and for additional working capital. See Note 13 to the Consolidated Financial Statements included herein.

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In order to facilitate comparability between the periods, the revenues and expenses of the Aviation Transportation Services segment have been reclassified to income (loss) on discontinued operations in the accompanying financial information for the years ended December 31, 2001 through 2005. There was no effect on net income (loss) as a result of the reclassifications.

**Impairment Of Long-Lived Assets And Assets Held For Sale**

We review our long lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144. If the carrying amount of the asset, including any intangible assets associated with that asset, exceeds its estimated undiscounted net cash flow, before interest, we will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value.

Assets held for sale are recorded at the lower of their net book value or their net realizable value, which is determined based upon an estimate of their fair market value less the cost of selling the assets. An impairment is recorded to the extent that the amount that was carried on the books is in excess of the net realizable value. Assets held for sale at December 31, 2005 are comprised of eight marsh buggies. Three helicopters held for sale at December 31, 2004 totaling $3.5 million were disposed of during the three months ended March 31, 2005 generating proceeds of $573,000 and the extinguishment of lease obligations of approximately $2.9 million. An impairment loss of $0.6 million related to these helicopters was recognized during the year ended December 31, 2004 and there was no gain or loss recorded upon their disposition.

During the quarter ended June 30, 2005, the aviation-related improvements at the Mouton Cove facility were deemed to be impaired as a result of the sale of our Aviation Transportation Services segment. A charge was recorded against operations in the amount of $0.5 million reflecting the impairment of the value of that facility. The facility was not included in the sale of our Aviation Transportation Services segment.

**Commitments And Contingencies**

On June 30, 2004, we amended Restricted Stock Incentive Agreements with certain executive officers into Amended and Restated Incentive Agreements (collectively referred to hereinafter as the Incentive Agreements ) that award stock and/or cash on various vesting dates. Under the terms and conditions of the Incentive Agreements, two executive officers received 40,454 shares and 50,000 shares. The stock was held in escrow, registered in the name of the executive officers, until it vested 100% on November 4, 2004. Tax equalization payments were also paid to the two executive officers totaling $0.1 million at June 30, 2004. The awards were fair valued at a per share price of $5.05 at June 30, 2004 and recorded, in full, as compensation expense of $0.5 million.

The Incentive Agreements also grant these executive officers the right to receive two cash payments each equal to the fair market value of 60,673 shares and 75,000 shares of our common stock, respectively, on the first business day following our annual stockholders meeting in 2005 and in 2006. The amounts of such stock-based awards to the executive officers on each vesting date may be paid in cash or, at the sole option of the Compensation Committee, in additional common stock, provided such shares are available for issuance pursuant to the terms of the Fourth Amended and Restated OMNI Energy Services Corp. Stock Incentive Plan (hereinafter the Plan ). Such shares were not available until November 30, 2004, when the number of shares available under the Plan was increased after approval by the stockholders. From June 30, 2004 until November 30, 2004, the awards were accounted for under FASB Interpretation (FIN) No. 28 *Accounting for Stock Appreciation Right and Other Variable Stock Option or Award Plans* as a variable plan, which requires that compensation will be measured at the end of each period at the quoted market price of a share of our common stock and the change in the value of the incentive awards be charged to expense. As such, the awards were revalued at the end of each reporting period at the quoted market price of a share of our common stock. At November 30, 2004, the market value of a share of our common stock was $2.93 resulting in compensation expense under variable accounting of $0.5 million to be recognized through that date. Effective November 30, 2004, the Company amended these incentive agreements to provide for 100% vesting of the restricted stock and have put into escrow the number of shares of common stock to settle the award. Accordingly the previous unvested portion of the award was charged to expense which totaled $0.8 million and was recorded as compensation expense as of December 31, 2004.

We also entered into Stock-Based Award Incentive Agreements (hereinafter SBA ) with certain executive officers on June 30, 2004. The SBA shall become computed and payable: (a) on the date of the Employee s termination of employment (for any reason other than resignation or termination for cause), (b) 90 days after the executive s death or disability or (c) upon a Change in Control. The executive managers were awarded 45% and 55%, respectively, of: (1) 10% of the fair market value (hereinafter FMV ), defined as the average closing price per share on the NASDAQ National Market over the five prior trading days times the number of issued and outstanding shares of the Company, of a share of the Company s common stock greater than or equal to $1.00 but less than $1.50, plus (2) 15% of the FMV of a share of the Company s common stock greater than or equal to $1.50 but less than $2.50, plus (3) 20% of the FMV of a share of the Company s common stock greater than or equal to $2.50 but less than $10.00, plus (4) 15% of the FMV of a share of the Company s common stock

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greater than or equal to $10.00 but less than $20.00, plus (5) 10% of the FMV of a share of the Company s common stock greater than or equal to $20.00. If no payments have been made, the right terminates on December 31, 2008 or upon termination of employment for resignation or cause, whichever occurs first. The intrinsic value of this award at December 31, 2005 is $6.7 million but no compensation expense has been recorded at December 31, 2005 because the award is contingent on future events, none of which are considered probable at December 31, 2005.

In addition, we entered into employment contracts with certain key executive management effective until various dates ranging from December 31, 2006 through February 2009 with automatic extensions for additional, successive one year periods, unless either party gives notice of non-renewal as provided for under the terms of the employment contracts.

In connection with the Trussco acquisition, we entered into employment contracts with three former Trussco stockholders effective until December 31, 2006 with automatic extensions for additional, successive one year periods commencing January 1, 2007, unless either party gives notice of non-renewal as provided for under the terms of the employment contracts. During 2005, two of these employment contracts were terminated.

**Trussco Earnout**

In connection with the acquisition of Trussco, we issued to certain former stockholders of Trussco a promissory note ( Earnout Note ) that will earn interest at a rate of 5% per annum of the amount owed. Under the terms of the Earnout Note, we agree to pay these stockholders on or before June 30, 2007, the lesser of (i) the amount of $3 million, or (ii) the sum of the product of 3.12 times Trussco s average annual EBITDA (earnings before interest, taxes, depreciation and amortization) for the 36-month period ending December 31, 2006, less the sum of $9 million, plus the long-term and former stockholder debt existing as of June 30, 2004 of Trussco that we assumed, which totaled $1.5 million.

On May 18, 2005, we entered into early Debt Extinguishment Agreements on $2.0 million of the Stockholder Notes and $1.0 million of the Earnout Note more fully described in Note 8 of our Consolidated Financial Statements contained herein. Under the terms of the Debt Extinguishment Agreements, in full and complete satisfaction of $2.0 million of the Stockholder Notes and $1.0 million of the Earnout Note, we agreed to (i) immediately issue 0.2 million shares of our common stock; and, (ii) pay certain holders of the Stockholder Notes $1.0 million on or before August 16, 2005, in full and complete satisfaction of $2.0 million of the Stockholder Notes and $1.0 million of the Earnout Note. At December 31, 2005, we had a $2.0 million contingent Earnout Note payable, none of which had been earned. Based upon current estimates, the amounts due and payable by the end of the term of the Earnout Notes, if any, will be immaterial.

**Contractual Debt Obligations**

We have the following contractual debt obligations as of December 31, 2005:

| | PAYMENTS DUE BY PERIOD | | | |
|---|---|---|---|---|
| | **TOTAL** | **LESS THAN 1 YEAR** | **1-3 YEARS** | **AFTER 4 YEARS** |

| | | | | |
|---|---|---|---|---|
| | | (In thousands) | | |
| Long-term debt | $ 17,054 | $ 2,273 | $ 8,209 | $ 6,572 |
| Capital lease obligations | 1,670 | 653 | 1,007 | 10 |
| Line of credit | 4,750 | 4,750 | | |
| Insurance notes | 1,692 | 1,692 | | |
| Total Contractual Cash | $ 25,166 | $ 9,368 | $ 9,216 | $ 6,582 |

We have the following operating lease commitments as of December 31, 2005:

| | PAYMENTS DUE BY PERIOD | | |
|---|---|---|---|
| | 2006 | 2007 | 2008 |
| | | (In thousands) | |
| Operating leases | $ 376 | $ 278 | $ 164 |

We believe that cash flow generated from operations in 2006 will be sufficient to fund our working capital needs, satisfy our debt service requirements and contractual commitments, and fulfill our un-financed capital expenditure needs for at least the next twelve months.

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**Off Balance Sheet Arrangements**

As mentioned above, we have various vehicle and facilities leases which are classified as operating leases for reporting purposes. The total future commitments under these leases is $0.8 million.

**Recently Issued Unimplemented Accounting Pronouncements**

On December 16, 2004, as amended on April 14, 2005, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS No. 123(R) ). SFAS No. 123(R) will require companies to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. In addition, the adoption of SFAS No. 123(R) requires additional accounting and disclosure related to the income tax and cash flow effects resulting from share-based payment arrangements. SFAS No. 123(R) is effective beginning as of the first interim reporting period for fiscal years beginning after December 15, 2005. Based upon current estimates, we believe that the charge to earnings in 2006 related to SFAS No. 123 (R) will be approximately $0.3 million.

In December 2004, SFAS No. 153, *Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29 Accounting for Nonmonetary Transactions,* ( SFAS No. 153 ) is effective for fiscal years beginning after June 15, 2005. This Statement addresses the measurement of exchange of nonmonetary assets and eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, and replaces it with an exception for exchanges that do not have commercial substance. The adoption of SFAS No. 153 is not expected to have an impact on our consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 30* ( SFAS No. 154 ). This statement changes the requirements for accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Adoption of SFAS No. 154 is not expected to have an effect on our consolidated financial statements.

**Subsequent Events**

On February 14, 2006, we completed the acquisition of Preheat, Inc. ( Preheat ) pursuant to a Stock Purchase and Sale Agreement dated December 29, 2005 between us and the shareholders of Preheat. We purchased 100% of the outstanding common stock of Preheat for a purchase price of $22.5 million consisting of $16 million in cash plus the issuance of 900,000 shares of our common stock and $4 million in buyer promissory notes. In addition, we assumed $1.6 million of certain long-term debt of Preheat. As a condition of closing, Preheat was required to have on hand at closing excess working capital in excess of $4.5 million.

## CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

There were no changes in or disagreements with accountants on accounting and financial disclosures during 2005.

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## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Interest Rate Risk

We are exposed to interest rate risk due to changes in interest rates, primarily in the United States. Our policy is to manage interest rates through the use of a combination of fixed and floating rate debt. We currently do not use any derivative financial instruments to manage our exposure to interest rate risk. The table below provides information about the future maturities of principal for outstanding debt instruments at December 31, 2005 subject to interest rate risk. All instruments described are non-traded instruments and approximated fair value.

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| | | | (dollars in thousands) | | |
| Long-term debt | | | | | |
| Fixed Rate | $ 1,038 | $ 1,838 | $ 782 | $ 62 | $ 110 |
| Average interest rate | 5.3% | 5.4% | 8.3% | 7.9% | 8.0% |
| Variable Rate | $ 1,888 | $ 1,891 | $ 2,486 | $ 2,157 | $ 6,472 |
| Average interest rate | 10.7% | 10.7% | 11.8% | 12.3% | 11.7% |
| Short-term debt | | | | | |
| Fixed Rate | $ 1,692 | | | | |
| Average interest rate | 4.7% | | | | |
| Variable Rate | $ 4,750 | | | | |
| Average interest rate | 9.3% | | | | |

### Interest Rate Exposure

Our exposure to changes in interest rates primarily results from our long-term debt with both fixed and floating interest rates. The debt on our consolidated financial statements at December 31, 2005 with fixed interest rates totals $2.2 million. At December 31, 2005, 87% of our consolidated long-term debt was subject to variable interest rates. The detrimental effect of a hypothetical 100 basis point increase in interest rates would be to increase net loss before provision for income taxes by approximately $0.2 million for the year ended December 31, 2005.

### Foreign Currency Risks

We transact 100% of our business in U.S. dollars, thus we are not subject to foreign currency exchange risks.

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## THE FUSION TRANSACTION

### General

On November 11, 2005, we entered into the Purchase Agreement with Fusion Capital pursuant to which Fusion Capital agreed, under certain conditions, to purchase on each trading day $25,000 of our common stock up to an aggregate of $12.5 million over a 25 month period, subject to earlier termination at our discretion. In our discretion, we may elect to sell more of our common stock to Fusion Capital than the minimum daily amount. The purchase price of the shares of common stock will be equal to a price based upon the future market price of the common stock. Fusion Capital does not have the right or the obligation to purchase shares of our common stock in the event that the price of our common stock is less than $1.50. In addition, we are not required or permitted to issue any shares of common stock under the Purchase Agreement if such issuance would breach our obligations under the rules or regulations of the Nasdaq National Market. At any time from November 11, 2005 until 30 days after we have sold $12.5 million of our stock to Fusion Capital, we have the right in our sole discretion to enter into a new purchase agreement with Fusion Capital for the purchase of up to $12.5 million. If we exercise such option we cannot enter into such a new agreement until all $12.5 million is purchased by Fusion Capital under the November 11, 2005 agreement.

Fusion Capital, the selling shareholder under this prospectus, is offering for sale up to 3,000,000 shares of our common stock. In connection with entering into the Purchase Agreement, we authorized the purchase by Fusion Capital of up to $12.5 million of our common stock and agreed to register up to 3,000,000 shares of our common stock. We have the right but not the obligation to issue more than 3,000,000 shares to Fusion Capital. In the event we elect to issue more than 3,000,000 shares offered hereby, we will be required to file a new registration statement and have it declared effective by the U.S. Securities & Exchange Commission to cover such additional shares. The number of shares ultimately offered for sale by Fusion Capital is dependent upon the number of shares purchased by Fusion Capital under the Purchase Agreement.

### Purchase Of Shares Under The Purchase Agreement

Under the Purchase Agreement, on each trading day Fusion Capital is obligated to purchase a specified dollar amount of our common stock. Subject to our right to suspend such purchases at any time, and our right to terminate the Purchase Agreement at any time, each as described below, Fusion Capital shall purchase on each trading day during the term of the Purchase Agreement $25,000 of our common stock. This daily purchase amount may be decreased by us at any time. We also have the right to increase the daily purchase amount at any time by notifying Fusion Capital of the new daily purchase amount; provided however, we may not increase the daily purchase amount above $25,000 unless the purchase price is at least $2.75 per share for the five consecutive trading days immediately prior to the notification.

The purchase price per share is equal to the lesser of:

- the lowest sale price of our common stock on the purchase date; or
- the average of the three (3) lowest closing sale prices of our common stock during the twelve (12) consecutive trading days prior to the date of a purchase by Fusion Capital.

The purchase price will be adjusted for any reorganization, recapitalization, non-cash dividend, stock split, or other similar transaction occurring during the trading days in which the closing bid price is used to compute the purchase price. Fusion Capital may not purchase shares of our common stock under the Purchase Agreement if Fusion Capital, together with its affiliates, would beneficially own more than 9.9% of our common stock outstanding at the time of the purchase by Fusion Capital. Fusion Capital has the right at any time to sell any shares purchased under the Purchase Agreement which would allow it to avoid the 9.9% limitation. Therefore, Fusion Capital has informed us that it does not expect to breach the 9.9% limitation.

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The following table sets forth the amount of proceeds we would receive from Fusion Capital from the sale of shares of our common stock offered by this prospectus at varying purchase prices:

| **Assumed Average Purchase Price** | **Number of Shares to be Issued if Full Purchase** | **Percentage of Outstanding After Giving Effect to the Issuance to Fusion Capital(1)** | | **Proceeds from the Sale of up to 2,750,000 Shares to Fusion Capital under the Purchase Agreement** |
|---|---|---|---|---|
| $1.50(2) | 2,750,000 | 15.8% | $ | 4,125,000 |
| $2.00(2) | 2,750,000 | 15.8% | $ | 5,500,000 |
| $2.39(2) | 2,750,000 | 15.8% | $ | 6,572,500 |
| $4.00 | 2,750,000 | 15.8% | $ | 11,000,000 |
| $5.00 | 2,500,000 | 14.7% | $ | 12,500,000 |
| $6.04(3) | 2,069,536 | 12.7% | $ | 12,500,000 |
| $7.00 | 1,785,714 | 12.7% | $ | 12,500,000 |
| $8.00 | 1,562,500 | 12.7% | $ | 12,500,000 |
| $9.00 | 1,388,889 | 9.3% | $ | 12,500,000 |

(1) Based on 16,254,570 shares outstanding as of April 20, 2006. Includes the issuance of 250,000 shares of common stock issuable to Fusion Capital as a commitment fee and the number of shares issuable at the corresponding assumed purchase price set forth in the adjacent column.

(2) In order to be in compliance with the Nasdaq National Market rules, we cannot be required to sell shares of our common stock to Fusion Capital at a price below $2.39, which represents the greater of the book value per share of our common stock or the closing price per share of our common stock on November 10, 2005. If we elect to sell our shares to Fusion Capital at a price per share below $2.39, we first would be required to obtain shareholder approval in order to be in compliance with the Nasdaq National Market rules.

(3) Closing sale price of our common stock on April 20, 2006.

In connection with entering into the Purchase Agreement, we authorized the sale to Fusion Capital of up to $12.5 million of our common stock. We agreed to register 3,000,000 shares of our common stock under the Purchase Agreement (which includes the 177,000 shares issued and 73,000 shares issuable to Fusion Capital as the commitment fee), all of which are included in this offering. We have the right to terminate the Purchase Agreement without any payment or liability to Fusion Capital at any time. We have the right but not the obligation to sell more than 3,000,000 shares to Fusion Capital. In the event we elect to sell more than the 3,000,000 shares offered hereby, we will be required to file a new registration statement and have it declared effective by the Securities and Exchange Commission.

**Minimum Purchase Price**

Under the Purchase Agreement, we have set a minimum purchase price ( floor price ) of $1.50. However, we shall not effect any sales under the Purchase Agreement and Fusion Capital shall not have the right nor the obligation to purchase any shares of our common stock in the event that the purchase price would be less than the floor price. Specifically, Fusion Capital shall not have the right or the obligation to purchase shares of our common stock on any trading day that the market price of our common stock is below $1.50.

In addition to floor price restriction, in order to be in compliance with the Nasdaq National Market rules, we cannot be required to sell shares of our common stock to Fusion Capital at a price below $2.39, which represents the greater of the book value per share of our common stock or the closing price per share of our common stock on November 10, 2005. If we elect to sell our shares to Fusion Capital at a price per share below $2.39, we first would be required to obtain shareholder approval in order to be in compliance with the Nasdaq National Market rules.

**Our Right to Suspend Purchases**

We have the unconditional right to suspend purchases at any time for any reason effective upon one trading day s notice. Any suspension would remain in effect until our revocation of the suspension. To the extent we need to use the cash proceeds of the sales of common stock under the Purchase Agreement for working capital or other business purposes, we do not intend to restrict purchases under the Purchase Agreement.

**Our Right To Increase and Decrease the Amount to be Purchased**

Under the Purchase Agreement, Fusion Capital has agreed to purchase on each trading day during the 25 month term of the Purchase Agreement, $25,000 of our common stock up to an aggregate of $12.5 million. We have the unconditional right to

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decrease the daily amount to be purchased by Fusion Capital at any time for any reason effective upon one trading day s notice.

In our discretion, we may elect to sell more of our common stock to Fusion Capital than the minimum daily amount. First, in respect of the daily purchase amount, we have the right to increase the daily purchase amount as the market price of our common stock increases. Specifically, for every $0.25 increase in Threshold Price above $2.50, the Company shall have the right to increase the daily purchase amount by up to an additional $5,000. For example, if the Threshold Price is $3.25 we would have the right to increase the daily purchase amount to up to an aggregate of $40,000. The  Threshold Price  is the lowest sale price of our common stock during the five trading days immediately preceding our notice to Fusion Capital to increase the daily purchase amount. If at any time during any trading day the sale price of our common stock is below the Threshold Price, the applicable increase in the daily purchase amount will be void.

In addition to the daily purchase amount, we may elect to require Fusion Capital to purchase on any single trading day our shares in an amount up to $500,000 provided that our share price is above $5.00 during the five trading days prior thereto. The price at which such shares would be purchased will be the lowest Purchase Price (as defined above) during the previous fifteen (15) trading days prior to the date that such purchase notice was received by Fusion Capital. We may increase this amount to $1,000,000 if our share price is above $7.50 during the five trading days prior to our delivery of the purchase notice to Fusion Capital. We may deliver multiple purchase notices; however at least ten (10) trading days must have passed since the most recent non-daily purchase was completed. The daily purchases shall be suspended for ten (10) trading days each time any such notice is delivered.

Non-qualified Deferred
Compensation Earnings
(4)

All Other
Compensation
($)

Total
($)

Greg Cooper
- - $11,445 - - - $11,445
Cherian Mathai
- - 11,445 - - - 11,445
Scott Widham
- - 11,445 - -
--
11,445

(1) Dollar amounts reflect the aggregate grant date fair value computed in accordance with FASB authoritative guidance.

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Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

As of March 14, 2013, there were 532,438,834 shares of our common stock issued and outstanding. Each share of common stock entitles the holder thereof to one vote with respect to each item to be voted on by holders of the shares of common stock. We have 51 shares of Series C Preferred stock outstanding, held by our Named Executives, as detailed in the chart below.

The following table sets forth information with respect to the beneficial ownership of shares of our common stock as of March 15, 2013, by:

Each person whom we know beneficially owns more than 5% of the common stock;
each of our directors individually;
each of our named executive officers individually; and
all of our current directors and executive officers as a group

Unless otherwise indicated, to our knowledge, all persons listed below have sole voting and investment power with respect to their shares of common stock. Each person listed below disclaims beneficial ownership of their shares, except to the extent of their pecuniary interests therein. Shares of common stock that an individual or group has the right to acquire within 60 days of March 15, 2013, pursuant to the exercise of options or restricted stock are deemed to be outstanding for the purpose of computing the percentage ownership of such person or group, but are not deemed outstanding for the purpose of calculating the percentage owned by any other person listed.

| Name and Address | Number of Shares of Common Stock Beneficially Owned | | Percent of Shares of Common Stock Beneficially Owned | | Number of Shares of Series C Preferred Stock Beneficially Owned (7) | | Percent of Shares of Series C Preferred Stock Beneficially Owned | |
|---|---|---|---|---|---|---|---|---|
| G3 Connect, LLC<br>321 Newark Street 3rd Floor<br>Hoboken, NJ 07030 | 96,947,250 | (1) | 16.17 | % | | | | |
| Paul H. Riss<br>Pervasip Corp.<br>75 South Broadway, Suite 400<br>White Plains, New York 10601 | 23,271,866 | (2) | 4.31 | % | 48 | (8) | 94.12 | % |
| Mark Richards<br>75 South Broadway, Suite 400<br>White Plains, New York 10601 | 6,774,333 | (3) | 1.80 | % | 3 | (9) | 5.88 | % |
| Greg M. Cooper<br>Cooper, Niemann & Co., CPAs, LLP<br>PO Box 190<br>Mongaup Valley, New York 12762 | 171,667 | (4) | * | | | | | |
| Scott Widham | 167,667 | (5) | * | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Alpheus Communications<br>1301 Fannin, 20th Floor<br>Houston, Texas 77002 | | | | | | | |
| Cherian Mathai<br>75 South Broadway, Suite 400<br>White Plains, New York 10601 | 167,667 | (6) | * | | | | |
| All directors and executive officers as a group (five individuals) | 30,553,200 | | 5.64 | % | 51 | 100 | % |

* Less than 1%.

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(1) Includes 7,239,333 shares of common stock subject to warrants and options that are presently exercisable or exercisable within 60 days after March 15, 2013.

(2) Includes 1,500,000 shares of common stock subject to options and warrants that are presently exercisable or exercisable within 60 days after March 14, 2012.

(3) Includes 12,000 shares of common stock subject to options that are presently exercisable or exercisable within 60 days after March 15, 2013.

(4) Includes 21,000 shares of common stock subject to options that are presently exercisable or exercisable within 60 days after March 15, 2013.

(5) Includes 11,000 shares of common stock subject to options that are presently exercisable or exercisable within 60 days after March 15, 2013.

(6) Each one share of Series C Preferred has voting rights equal to (x) 0.019607 multiplied by the total issued and outstanding Common Stock eligible to vote at the time of the respective vote (the "Numerator"), divided by (y) 0.49, minus (z) the Numerator.

(7) Mr. Paul Riss owns 48 shares of Series C Preferred Stock, which is representative of 296,987,537 shares solely for voting purposes.

(8) Mr. Mark Richards owns 3 shares of Series C Preferred Stock, which is representative of 18,561,721 shares solely for voting purposes.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Certain Relationships and Related Transactions

We paid fees to an intellectual property development firm ("Consultant") of $192,000 in fiscal 2012 and 2011, respectfully. All such work performed by the Consultant is the property of our company. An officer of our company has performed work for the Consultant, including disbursement services, in which funds that were remitted by us to the Consultant were subsequently transferred to a company controlled by the officer to distribute such funds to appropriate vendors.

At November 30, 2012 the total amount due to our chief executive officer, including loans, unpaid salary, interest and expenses amounted to $752,755

At November 30, 2012, unpaid salary owed to our chief information officer amounted to $23,465.

We paid fees of $2,000 in fiscal 2012 and $4,000 in fiscal 2011 to Cooper, Neimann & Company CPA, LLP for preparation of our federal and state income tax returns, and we owe $4,800 in unpaid fees. Our board member, Greg Cooper, is a partner in this firm.

At November 30, 2012 and 2011, we owed G3 Connect LLC, $5,548 and $1,967 in unpaid commissions, respectively.

Director Independence

Our common stock is currently quoted on the OTCQB marketplace and is not listed on the Nasdaq Stock Market or any other national securities exchange. Accordingly, we are not currently subject to the Nasdaq continued listing requirements or the requirements of any other national securities exchange. Nevertheless, in determining whether a director or nominee for director should be considered "independent" the board utilizes the definition of independence set forth in Rule 4200(a)(15) of the Nasdaq Marketplace Rules. Greg M Cooper, Cherian Mathai and Scott Widham qualify as "independent" under this rule.

Item 14. Principal Accounting Fees and Services.

The following table presents fees for professional audit services rendered by Nussbaum Yates Berg Klein & Wolpow LLP for the audit of our annual financial statements for the years ended November 30, 2012 and 2011, and fees billed for other services rendered by Nussbaum Yates Berg Klein & Wolpow LLP during those periods.

| | 2012 | 2011 |
|---|---|---|
| Audit fees | $ 97,500 | $ 97,500 |
| Audit related fees | – | – |
| Tax fees | – | – |
| All other fees | – | |
| Total | $ 97,500 | $ 97,500 |

In the above table, in accordance with the SEC's definitions and rules, "audit fees" are fees we paid Nussbaum Yates Berg Klein & Wolpow LLP for professional services for the audit of our annual financial statements and review of financial statements included in our quarterly reports filed with the SEC, as well as for work generally only the independent auditor can reasonably be expected to provide, such as statutory audits and consultation regarding financial accounting and/or reporting standards; "audit-related fees" are fees billed by Nussbaum Yates Berg Klein & Wolpow LLP for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements; "tax fees" are fees for tax compliance, tax advice and tax planning; and "all other fees" are fees billed by Nussbaum Yates Berg Klein & Wolpow LLP for any services not included in the first three categories.

Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors

Consistent with SEC policies regarding auditor independence, the Audit Committee has responsibility for appointing, setting compensation and overseeing the work of the independent auditor. In recognition of this responsibility, the Audit Committee has established a policy to pre-approve all audit and permissible non-audit services provided by the independent auditor.

Prior to engagement of the independent auditor for the next year's audit, management will submit an aggregate of services expected to be rendered during that year for each of four categories of services to the Audit Committee for approval.

1. Audit services include audit work performed in the preparation of financial statements, as well as work that generally only the independent auditor can reasonably be expected to provide, including comfort letters and reviews of our financials statements included in our Quarterly Reports on Form 10-Q.

2. Audit-Related services are for assurance and related services that are traditionally performed by the independent auditor, including due diligence related to mergers and acquisitions, employee benefit plan audits, and special procedures required to meet certain regulatory requirements.

3. Tax services include all services performed by the independent auditor's tax personnel except those services specifically related to the audit of the financial statements, and includes fees in the areas of tax compliance, tax planning, and tax advice.

4. Other services are those associated with services not captured in the other categories. We generally do not request such services from the independent auditor.

Prior to engagement, the Audit Committee pre-approves these services by category of service. The Audit Committee may delegate pre-approval authority to one or more of its members. The member to whom such authority is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

| Exhibit No. | Document |
|---|---|
| 3.1 | Certificate of Incorporation, as amended, incorporated by reference to our Registration Statement on Form S-1 filed with the SEC on August 27, 1969 under Registration Number 2-34436. |
| 3.2 | Certificate of Amendment of the Certificate of Incorporation, incorporated by reference to our definitive proxy statement filed with the SEC in connection with our Annual Meeting of Shareholders held in May 1984. |
| 3.3 | Certificate of Amendment to the Certificate of Incorporation, incorporated by reference to Exhibit 3(b) to our Annual Report on Form 10-K for the year ended November 30, 1988. |
| 3.4 | Certificate of Amendment to the Certificate of Incorporation, incorporated by reference to Exhibit 3(e) to our Annual Report on Form 10-K for the year ended November 30, 1994, as amended. |
| 3.5 | Certificate of Amendment of the Certificate of Incorporation, incorporated by reference to Exhibit 3 to our Quarterly Report on Form 10-Q for the quarter ended August 30, 1995. |
| 3.6 | Certificate of Amendment of the Certificate of Incorporation, incorporated by reference to Exhibit 3(f) to our Annual Report on Form 10-K for the year ended November 30, 1998. |
| 3.7 | Certificate of Amendment of the Certificate of Incorporation, incorporated by reference to Exhibit 3.2 to our Quarterly Report on Form 10-Q for the quarter ended August 31, 1998. |
| 3.8 | Certificate of Amendment of the Certificate of Incorporation, incorporated by reference to Exhibit 3(1) to our Current Report on Form 8-K dated November 16, 1999. |
| 3.9 | Certificate of Amendment of the Certificate of Incorporation, incorporated by reference to Exhibit 3(1) to our Current Report on Form 8-K dated December 28, 2007. |
| 3.10 | Certificate of Amendment of the Certificate of Incorporation, incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K dated January 23, 2012. |
| 3.11 | Certificate of Amendment of the Certificate of Incorporation, incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K dated August 21, 2012. |
| 3.12 | Certificate of Amendment of the Certificate of Incorporation, incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K dated January 18, 2013. |
| 3.13 | By-laws, amended and restated as of December 1996, incorporated by reference to Exhibit 3(e) to our Annual Report on Form 10-K for the year ended November 30, 1996. |
| 4.1 | Secured Term Note, dated as of September 28, 2007, issued in favor of Calliope Capital Corporation (as filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, as filed with the SEC on October 4, |

| | |
|---|---|
| | 2007). |
| 4.2 | Secured Term Note, dated as of September 28, 2007, issued in favor of Valens Offshore SPV II, Corp. (as filed as Exhibit 10.3 to the Company’s Current Report on Form 8-K, as filed with the SEC on October 4, 2007). |
| 4.3 | Third Amended and Restated Secured Term Note, dated as of September 28, 2007, issued in favor of Laurus Master Fund, Ltd. (as filed as Exhibit 10.6 to the Company’s Current Report on Form 8-K, as filed with the SEC on October 4, 2007). |

| | |
|---|---|
| 4.4 | Amended and Restated Secured Term Note, dated as of September 28, 2007, issued in favor of Laurus Master Fund, Ltd. (as filed as Exhibit 10.7 to the Company's Current Report on Form 8-K, as filed with the SEC on October 4, 2007). |
| 4.5 | Secured Term Note, dated as of May 28, 2008, issued in favor of Valens Offshore SPV II, Corp. (as filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, as filed with the SEC on May 28, 2008). |
| 4.6 | Amended and Restated Secured Term Note, dated as of May 28, 2008, issued in favor of Valens Offshore SPV I, Corp. (as filed as Exhibit 10.3 to the Company's Current Report on Form 8-K, as filed with the SEC on May 28, 2008). |
| 4.7 | Amended and Restated Secured Term Note, dated as of May 28, 2008, issued in favor of Valens Offshore SPV II, Corp(as filed as Exhibit 10.4 to the Company's Current Report on Form 8-K, as filed with the SEC on May 28, 2008). |
| 4.8 | Fourth Amended and Restated Secured Term Note, dated as of May 28, 2008, issued in favor of Valens Offshore SPV I, Ltd. (as filed as Exhibit 10.6 to the Company's Current Report on Form 8-K, as filed with the SEC on May 28, 2008). |
| 4.9 | Second Amended and Restated Secured Term Note, dated as of May 28, 2008, issued in favor of Valens Offshore SPV I, Ltd. (as filed as Exhibit 10.7 to the Company's Current Report on Form 8-K, as filed with the SEC on May 28, 2008). |
| 4.10 | Secured Term Note, dated as of October 15, 2008, issued in favor of Valens Offshore SPV I, Corp. (as filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, as filed with the SEC on October 15, 2008). |
| 4.11 | Second Amended and Restated Secured Term Note, dated as of December 12, 2008, issued in favor of Valens Offshore SPV I, Corp. (as filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, as filed with the SEC on December 12, 2008). |
| 4.12 | Secured Term Note, dated February 18, 2009, issued in favor of Valens Offshore SPV I, Corp. (as filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, as filed with the SEC on February 18, 2009). |
| 4.13 | Secured Term Note, dated February 18, 2009, issued in favor of Valens Offshore SPV I, Corp. (as filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, as filed with the SEC on February 18, 2009). |
| 4.14 | $50,000 Demand Note, dated November 5, 2009, issued in favor of Valens U.S. SPV I, LLC (as filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the SEC on November 12, 2009) |
| 4.15 | 6% Convertible Promissory Note, dated November 22, 2011, issued in favor of G3 Connect (as filed as Exhibit 4.17 to the Company's Annual Report on Form 10-K, as filed with the SEC on March 15, 2012) |
| 4.16 | 6% Secured Amended & Restated Convertible Debenture, dated November 30, 2005, issued in favor of 112359 Factor Fund, LLC (as filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, as filed with the SEC on March 6, 2013) |
| 4.17 | 2% Secured Amended & Restated Convertible Debenture, dated May 31, 2006, issued in favor of 112359 Factor Fund, LLC (as filed as Exhibit 10.3 to the Company's Current Report on Form 8-K, as filed with the SEC on March 6, 2013) |

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|---|---|
| 10.1 | 1996 Restricted Stock Award Plan, incorporated by reference to Exhibit A to our Proxy Statement dated October 24, 1996 |
| 10.2 | Non-Employee Director Stock Option Plan, dated March 30, 2001, incorporated by reference to Exhibit 10(c) to our Annual Report on Form 10-KSB for the year ended November 30, 2003 |
| 10.3 | 2004 Equity Incentive Plan, incorporated by reference to Annex A to our Proxy Statement dated April 12, 2005. |
| 10.4 | Subsidiary Guaranty, dated as of February 8, 2005, executed by New Rochelle Telephone Corp., Telecarrier Services, Inc., Vox Communications Corp., Line One, Inc., AVI Holding Corp. and TelcoSoftware.com Corp., incorporated by reference to Exhibit 10.5 to our Current Report on Form 8-K dated February 8, 2005. |
| 10.5 | Securities Purchase Agreement, dated as of November 30, 2005, our Company and Laurus Master Fund, Ltd., incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K dated November 30, 2005. |
| 10.6 | Reaffirmation and Ratification Agreement, dated as of November 30, 2005, executed by our Company, New Rochelle Telephone Corp., Telecarrier Services, Inc., Vox Communications Corp., Line One, Inc., AVI Holding Corp. and TelcoSoftware.com Corp. incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K dated November 30, 2005. |
| 10.7 | Securities Purchase Agreement, dated as of May 31, 2006, between our Company and Laurus Master Fund, Ltd., incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K dated May31, 2006. |
| 10.8 | Reaffirmation and Ratification Agreement, dated as of May 31, 2006, executed by our Company, New Rochelle Telephone Corp., Telecarrier Services, Inc., Vox Communications Corp., Line One, Inc., AVI Holding Corp. and TelcoSoftware.com Corp. incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K dated May 31, 2006. |
| 10.9 | Stock Purchase Agreement dated as of December 14, 2006 by and among our Company, CYBD Acquisition, Inc. and Cyber Digital, Inc., with respect to the capital stock of New Rochelle Telephone Corp., incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K dated December 14, 2006. |
| 10.10 | Stock Purchase Agreement dated as of December 14, 2006 by and among our Company, CYBD Acquisition II, Inc. and Cyber Digital, Inc., with respect to the capital stock of Telecarrier Services, Inc., incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K dated December 14, 2006. |
| 10.11 | 2007 Equity Incentive Plan, incorporated by reference to Annex B to our Proxy Statement dated May 15, 2007. |
| 10.12 | Securities Purchase Agreement dated as of September 28, 2007, among our Company, LV Administrative Services, Inc., Calliope Capital Corporation and Valens Offshore SPV II, Corp., incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K dated October 4, 2007. |

| | |
|---|---|
| 10.13 | Reaffirmation and Ratification Agreement, dated as of September 28, 2007, executed among our Company, Vox Communications Corp., Line One, Inc. AVI Holding Corp. and TelcoSoftware.com Corp., incorporated by reference to Exhibit 10.8 to our Current Report on Form 8-K dated October 4, 2007. |
| 10.14 | Subsidiary Guarantee dated as of September 28, 2007 by Vox Communications Corp., AVI Holding Corp., Telcosoftware.com Corp. and Line One, Inc., incorporated by reference to Exhibit 10.9 to our Current Report on Form 8-K dated October 4, 2007. |
| 10.15 | Master Security Agreement dated as of September 28, 2007 among our Company, Vox Communications Corp., Line One, Inc., AVI Holding Corp., TelcoSoftware.com Corp. and LV Administrative Services Inc., as agent, incorporated by reference to Exhibit 10.11 to our Current Report on Form 8-K dated October 4, 2007. |
| 10.16 | Stock Pledge Agreement dated as of September 28, 2007 among LV Administrative Services Inc., as agent, our Company., Vox Communications Corp., Line One, Inc., AVI Holding Corp. and TelcoSoftware.com Corp., incorporated by reference to Exhibit 10.12 to our Current Report on Form 8-K dated October 4, 2007. |
| 10.17 | 2007 Contingent Option Plan, as amended, incorporated by reference to Exhibit 10 (ll) to our Annual Report on Form 10-KSB for the year ended November 30, 2007. |
| 10.18 | Securities Purchase Agreement dated as of May 28, 2008, among Pervasip Corp., LV Administrative Services, Inc. and the Purchasers listed therein, incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K dated May 28, 2008. |
| 10.19 | Reaffirmation and Ratification Agreement, dated as of May 28, 2008, executed among Pervasip Corp., Vox Communications Corp., Line One, Inc., AVI Holding Corp., TelcoSoftware.com Corp. and Valens Offshore SPVI, Ltd., incorporated by reference to Exhibit 10.7 to our Current Report on Form 8-K dated May 28, 2008, incorporated by reference to Exhibit 10.8 to our Current Report on Form 8-K dated May 28, 2008. |
| 10.20 | Subsidiary Guarantee dated as of May 28, 2008 by Vox Communications Corp., AVI Holding Corp., Telcosoftware.com Corp. and Line One, Inc., incorporated by reference to Exhibit 10.10 to our Current Report on Form 8-K dated May 28, 2008. |
| 10.21 | Master Security Agreement dated as of May 28, 2008 among Pervasip Corp., Vox Communications Corp., Line One, Inc., AVI Holding Corp., TelcoSoftware.com Corp. and LV Administrative Services Inc., as agent, incorporated by reference to Exhibit 10.12 to our Current Report on Form 8-K dated May 28, 2008. |
| 10.22 | Stock Pledge Agreement dated as of May 28, 2008 among LV Administrative Services Inc., as agent, Pervasip Corp., Vox Communications Corp., Line One, Inc., AVI Holding Corp. and TelcoSoftware.com Corp., incorporated by reference to Exhibit 10.13 to our Current Report on Form 8-K dated May 28, 2008. |
| 10.23 | Amendment to September 28, 2007 Securities Purchase Agreement dated May 28, 2008, executed among Pervasip Corp., LV Administrative Services, Inc., as agent, Valens Offshore SPV I, Ltd. and Valens Offshore SPV II, Corp., incorporated by reference to Exhibit 10.13 to our Current Report on Form 8-K dated May 28, 2008. |
| 10.24 | Letter Agreement dated as of October 15, 2008, among Pervasip Corp., LV Administrative Services, Inc. and Valens Offshore SPV I, Ltd., incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K dated October 15, 2008. |

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| | |
|---|---|
| 10.25 | Letter Agreement dated as of December 12, 2008, among Pervasip Corp., LV Administrative Services, Inc. and Valens Offshore SPV I, Ltd., incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K dated December 12, 2008. |
| 10.26 | Letter Agreement dated as of February 18, 2009 among Pervasip Corp., LV Administrative Services, Inc. and Valens Offshore SPV I, Ltd., incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K dated February 18, 2009. |
| 10.27 | 2009 Equity Incentive Plan, incorporated by reference to Annex A to our Proxy Statement dated April 9, 2009. |
| 10.28 | Securities Purchase Agreement by and between Pervasip Corp. and 112359 Factor Fund, LLC, incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K dated March 6, 2013 |
| 31.1 | Certification by the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a) or Rule 15d-14(a)).* |
| 31.2 | Certification by the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a) or Rule 15d-14(a)).* |
| 32.1 | Certification by the Principal Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.* |
| 32.2 | Certification by the Principal Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.* |

* filed herewith

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PERVASIP CORP.

| | | |
|---|---|---|
| Date: March 15, 2013 | By: | /s/ Paul H. Riss |
| | Name: | Paul H. Riss |
| | Title: | Chief Executive Officer<br>(Principal Executive Officer)<br>Chief Financial Officer<br>(Principal Financial Officer)<br>(Principal Accounting Officer) |

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ Paul H. Riss<br><br>Paul H. Riss | Chief Executive Officer (Principal Executive Officer), Chief Financial Officer (Principal Financial Officer) (Principal Accounting Officer), Treasurer and Chairman | March 15, 2013 |
| /s/ Greg M. Cooper<br>Greg M. Cooper | Director | March 15, 2013 |
| /s/ Mark Richards<br>Mark Richards | Chief Information Officer and Director | March 15, 2013 |
| /s/ Cherian Mathai<br>Cherian Mathai | Director | March 15, 2013 |
| /s/ Scott Widham<br>Scott Widham | Director | March 15, 2013 |

PERVASIP CORP. AND SUBSIDIARIES

# CONSOLIDATED FINANCIAL STATEMENTS AND REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

AS OF AND FOR THE
YEARS ENDED NOVEMBER 30, 2012 AND 2011

PERVASIP CORP. AND SUBSIDIARIES

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

CONTENTS

Report of Independent Registered Public Accounting Firm

The Board of Directors
Pervasip Corp.
White Plains, New York

We have audited the accompanying consolidated balance sheets of Pervasip Corp. and subsidiaries as of November 30, 2012 and 2011 and the related consolidated statements of income (loss), stockholders' equity deficiency and comprehensive income (loss), and cash flows for each of the years then ended. Pervasip Corp.'s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pervasip Corp. and subsidiaries as of November 30, 2012 and 2011, and the results of their operations and their cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As further discussed in Note 2 to the financial statements, the Company, among other matters, has negative working capital, a stockholders' equity deficiency, has suffered recurring losses from operations and is unable to meet its obligations as they become due, which raises substantial doubt about the Company's ability to continue as a going concern. Management's plans regarding to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NUSSBAUM YATES BERG KLEIN & WOLPOW, LLP

Melville, New York
March 15, 2013

PERVASIP CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF NOVEMBER 30, 2012 AND 2011

| | 2012 | | 2011 | |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 12,366 | $ | 9,608 |
| Accounts receivable, net of allowance of $24,108 in 2012 and $18,489 in 2011 | | 75,494 | | 109,682 |
| Prepaid expenses and other current assets | | 20,558 | | 44,613 |
| Total current assets | | 108,418 | | 163,903 |
| Other assets | | 69,658 | | 43,950 |
| Total assets | $ | 178,076 | $ | 207,853 |
| LIABILITIES AND STOCKHOLDERS' EQUITY DEFICIENCY | | | | |
| Current liabilities: | | | | |
| Current portion of long-term debt and capital lease obligations | $ | 7,444,490 | $ | 14,412,961 |
| Accounts payable and other current liabilities | | 2,297,242 | | 2,550,172 |
| Due to Pension Benefit Guaranty Corporation | | 1,821,464 | | 1,730,727 |
| Derivative liabilities | | 361,760 | | 274,908 |
| Total current liabilities | | 11,924,956 | | 18,968,768 |
| Mandatorily redeemable preferred stock | | - | | - |
| Long-term debt | | 358,614 | | 314,355 |
| Total liabilities | | 12,283,570 | | 19,283,123 |
| Stockholders' equity deficiency: | | | | |
| Preferred stock, $.001 par value; 1,000,000 shares authorized, 51 shares issued and outstanding in 2012 and 2011 | | - | | - |
| Common stock, $.001 par value; 400,000,000 shares authorized; 303,187,814 and 99,489,749 shares issued and outstanding in 2012 and 2011 | | 303,187 | | 99,490 |
| Capital in excess of par value | | 39,216,866 | | 35,623,697 |
| Accumulated other comprehensive income | | 1,211 | | 2,232 |
| Deficit | | (51,626,758) | | (54,800,689) |

| | | | | |
|---|---|---|---|---|
| Total stockholders’ equity deficiency | | (12,105,494) | | (19,075,270) |
| Total liabilities and stockholders’ equity deficiency | $ | 178,076 | $ | 207,853 |

See accompanying notes to consolidated financial statements.

PERVASIP CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (LOSS)

FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

| | 2012 | 2011 |
|---|---|---|
| Revenues | $999,822 | $1,291,789 |
| | | |
| Cost and expenses: | | |
| Costs of services | 447,427 | 767,816 |
| Selling, general and administrative | 2,094,148 | 2,111,123 |
| Provision for bad debts | 5,619 | 12,817 |
| | | |
| Total costs and expenses | 2,547,194 | 2,891,756 |
| | | |
| Loss from operations | (1,547,372) | (1,599,967) |
| | | |
| Other income (expense): | | |
| Interest expense | (2,196,119) | (3,578,057) |
| Other, net | 171,468 | 22,070 |
| Gain on troubled debt restructuring | 6,338,601 | - |
| Gain (loss) on settlement of liabilities | 314,481 | 106,929 |
| Gain on extinguishment of derivative liability | - | 497,667 |
| Mark to market adjustment of derivative liabilities | 92,872 | 101,474 |
| | | |
| Total other income (expense) | 4,721,303 | (2,849,917) |
| | | |
| Net income (loss) | $3,173,931 | $(4,449,884) |
| | | |
| Basic earnings (loss) per share | $.02 | $(0.10) |
| Diluted earnings (loss) per share | $.01 | $(0.10) |

See accompanying notes to consolidated financial statements.

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PERVASIP CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY DEFICIENCY AND COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

| | Common Stock | | Capital in Excess of | | Accumulated Other Comprehensive Income | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| | Shares | Amount | Par Value | Deficit | (Loss) | Deficiency |
| Balance, December 1, 2010 | 6,871,606 | $6,872 | $32,532,873 | $(50,350,805) | $ 1,789 | $(17,809,271) |
| Net loss | | | | (4,449,884 ) | | (4,449,884 ) |
| Foreign currency translation adjustment | | | | | 443 | 443 |
| Comprehensive loss | | | | | | (4,449,441 ) |
| Employee stock based compensation and conversions | | | 144,670 | | | 144,670 |
| Issuance of common stock | 2,100,000 | 2,100 | 207,900 | | | 210,000 |
| Common stock issued for services | 3,161,000 | 3,161 | 42,422 | | | 45,583 |
| Issuance of common stock for satisfaction of liabilities | 87,282,143 | 87,282 | 2,688,407 | | | 2,775,689 |
| Exercise of stock options | 75,000 | 75 | 7,425 | | | 7,500 |
| Balance, November 30, 2011 | 99,489,749 | 99,490 | 35,623,697 | (54,800,689) | 2,232 | (19,075,270) |
| Net income | | | | 3,173,931 | | 3,173,931 |
| Foreign currency translation adjustment | | | | | (1,021 ) | (1,021 ) |
| Comprehensive income | | | | | | 3,172,910 |
| Employee stock based compensation | | | 129,935 | | | 129,935 |
| Issuance of common stock | 34,673,250 | 34,673 | 646,327 | | | 681,000 |
| Common stock issued for services | 6,000,000 | 6,000 | 78,063 | | | 84,063 |
| Issuance of common stock for satisfaction of liabilities | 163,024,815 | 163,024 | 2,738,844 | | | 2,901,868 |
| Balance, November 30, 2012 | 303,187,814 | $303,187 | $39,216,866 | $(51,626,758) | $ 1,211 | $(12,105,494) |

See accompanying notes to consolidated financial statements.

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PERVASIP CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

| | 2012 | 2011 |
|---|---|---|
| Operating activities: | | |
| Net income (loss) | $3,173,931 | $(4,449,884) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Non-cash stock based compensation | 129,935 | 144,670 |
| Common stock, options and warrants granted for services | 84,063 | 45,583 |
| Provision for bad debts | 5,619 | 12,817 |
| Gain on settlement of liabilities | (314,481) | (604,596) |
| Gain on troubled debt restructuring | (6,338,601) | - |
| Amortization of debt discount | 1,782,813 | 2,061,472 |
| Reversal of accounts payables | (172,768) | - |
| Mark to market adjustment of derivative liabilities | (92,872) | (101,474) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 28,569 | (32,461) |
| Prepaid expenses and other current assets | 24,055 | (3,652) |
| Other assets | (25,708) | (131) |
| Accounts payable, other current liabilities and pension related liabilities | 845,829 | 2,302,958 |
| Net cash used in operating activities | (869,616) | (624,698) |
| | | |
| Financing activities: | | |
| Net proceeds from borrowings | 413,500 | 397,280 |
| Proceeds from exercise of stock options | - | 7,500 |
| Proceeds from issuance of common stock | 581,000 | 210,000 |
| Payments of debt | (122,126) | (12,127) |
| Net cash provided by financing activities | 872,374 | 602,653 |
| Increase (decrease) in cash and cash equivalents | 2,758 | (22,045) |
| Cash and cash equivalents at beginning of year | 9,608 | 31,653 |
| Cash and cash equivalents at end of year | $12,366 | $9,608 |
| Cash paid during the year for: | | |
| Interest | $23,309 | $22,337 |
| Taxes | $ - | $ - |

Supplemental disclosure of non-cash investing and financing activities:

See Notes 3, 8 and 12 for non-cash investing and financing activities.

See accompanying notes to consolidated financial statements.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

1. Description of Business and Summary of Accounting Principles

Description of Business and Concentrations

Pervasip Corp. ("Pervasip", or the "Company") is a provider of low-cost voice and video telephone services, connecting people through cloud-connected devices worldwide. Most of the Company's revenues are derived from customers in the United States that are broadband service providers or other telephone service providers. The Company provides them with a customized private label Internet protocol ("IP") telephony service, as well as a back-office and web suite of services. The Company uses Session Initiation Protocol technology to provide all the components needed to support its IP telephony service.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries after elimination of significant intercompany balances and transactions.

Income Taxes

The Company accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income and the reversal of deferred tax liabilities during the period in which related temporary differences become deductible. A valuation allowance has been established to eliminate the Company's deferred tax assets as it is more likely than not that none of the deferred tax assets will be realized.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon settlement with the tax authorities. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest related to unrecognized tax benefits in interest expense and penalties in income tax expense. The Company has determined that it had no significant uncertain tax positions requiring recognition or disclosure.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

1. Description of Business and Summary of Accounting Principles (Continued)

Revenue Recognition

Revenues from voice, data and other telecommunications-related services are recognized in the period in which subscribers use the related services. Revenues for carrier interconnection and access are recognized in the period in which the service is provided.

Costs of Services

Costs of telephony services consist primarily of direct costs that we pay to third parties in order to provide telephone services. These costs include access and interconnection charges that we pay to other telephone companies to terminate domestic and international phone calls on the public switched telephone network. In addition, these costs include the cost to lease phone numbers, to co-locate in other telephone companies' facilities, to provide enhanced emergency dialing capabilities to transmit 911 calls, and to provide local number portability. These costs also include taxes that the Company pays on telecommunications services from our suppliers or are imposed by government agencies. These costs do not include indirect costs such as depreciation and amortization, payroll, and facilities costs.

Development Expenses

Costs for research, including predevelopment efforts prior to establishing technological feasibility of software expected to be marketed, are expensed as incurred. Development costs are capitalized when technological feasibility has been established and anticipated future revenues support the recoverability of the capitalized amounts. Capitalization stops when the product is available for general release to customers. Due to the short time period between achieving technological feasibility and product release and the insignificant amount of costs incurred during such periods, we have not capitalized any software development, and have expensed these costs as incurred. These costs are included in selling, general and administrative expense.

Collectibility of Accounts Receivable

Trade receivables potentially subject the Company to credit risk. The Company extends credit to certain wholesale customers and generally requires a deposit to minimize its credit risk. Once a wholesale customer is billed for services, the Company actively manages the accounts receivable and may return the deposit if the customer has a track record of making timely payments of invoices for six consecutive months. Individual consumers, including all consumers that use the Company's mobile Voice over Internet Protocol ("VoIP") application, are required to prepay for all mobile telephone services via a credit card or an online payment service, such as Paypal.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

1. Description of Business and Summary of Accounting Principles (Continued)

Collectibility of Accounts Receivable (Continued)

In order to record the Company's accounts receivable at their net realizable value, the Company must assess their collectibility. A considerable amount of judgment is required in order to make this assessment, including an analysis of historical bad debts and other adjustments, a review of the aging of the Company's receivables, and the current creditworthiness of the Company's customers. Generally, when a customer account reaches a certain level of delinquency, the Company disconnects the customer's service and provides an allowance for the related amount receivable from the customer. The Company has recorded allowances for receivables that it considers uncollectible, including amounts for the resolution of potential credit and other collection issues, such as disputed invoices and pricing discrepancies. However, depending on how such potential issues are resolved, or if the financial condition of any of the Company's customers was to deteriorate and its ability to make required payments became impaired, increases in these allowances may be required. The Company writes off the accounts receivable balance from a customer and the related allowance established when it believes it has exhausted all reasonable collection efforts.

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted-average number of shares outstanding. To the extent that stock options and warrants are anti-dilutive, they are excluded from the calculation of diluted earnings (loss) per share. Diluted earnings per share includes the dilutive effect of stock options and warrants. For 2012 and 2011, the Company excluded from its net income (loss) per share calculations potentially dilutive securities of 22,243,000 and 90,424,594, respectively, because their effect on net income (loss) per share was anti-dilutive.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. The Company did not have any cash equivalents during 2012 and 2011.

Concentrations

As of November 30, 2012 and 2011, the Company had one customer that constituted 22% and 12%, respectively, of its accounts receivable. For the years ended November 30, 2012 and 2011, one customer accounted for 29% and 24% of the Company's revenues, respectively.

The Company is dependent on the availability and functionality of the networks of its two primary suppliers and is vulnerable to a cessation or disruption of service if the Company is not able to pay these vendors timely.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

1. Description of Business and Summary of Accounting Principles (Continued)

Foreign Currency Translation

Assets and liabilities of the Company's foreign subsidiary are translated at year-end exchange rates, and income and expenses are translated at average exchange rates prevailing during the year with the resulting adjustments accumulated in stockholders' equity and comprehensive income (loss).

Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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. The most significant estimates relate to the allowance for doubtful accounts receivable, income tax valuation allowance, and the derivative liabilities. On a continual basis, management reviews its estimates, utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such reviews, and if deemed appropriate, those estimates are adjusted accordingly. Actual results could differ from those estimates.

Accounting for Derivative Instruments

The Company accounts for derivative instruments under the Financial Accounting Standards Board ("FASB") authoritative guidance, which establishes accounting and reporting standards for derivative instruments and hedging activities, including certain derivative instruments embedded in other financial instruments or contracts and requires recognition of all derivatives on the balance sheet at fair value, regardless of the hedging relationship designation. Accounting for the changes in the fair value of the derivative instruments depends on whether the derivatives qualify as hedge relationships and the types of the relationships designated are based on the exposures hedged. Changes in the fair value of derivatives designated as fair value hedges are recognized in earnings along with fair value changes of the hedged item. Changes in the fair value of derivatives designated as cash flow hedges are recorded in other comprehensive income (loss) and are recognized in earnings when the hedged item affects earnings. Changes in the fair value of derivative instruments which are not designated as hedges are recognized in earnings as other income (loss). At November 30, 2012 and 2011, the Company did not have any derivative instruments that were designated as hedges.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

1. Description of Business and Summary of Accounting Principles (Continued)

Stock Based Compensation

The Company issues stock and stock options to its employees, outside directors and consultants pursuant to stockholder approved and non-approved stock option programs.

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period. For the years ended November 30, 2012 and 2011, the Company recorded approximately $130,000 and $145,000 in employee stock-based compensation expense and approximately $77,000 and $46,000 in consultant compensation expense, which is included in selling, general and administrative expenses. As of November 30, 2012 and 2011, there was approximately $53,000 and $117,000, respectively, of unrecognized stock-compensation expense for previously granted unvested options that will be recognized over a period of up to three years.

The Company's 2004 Equity Incentive Plan (the "2004 Plan") provides for the grant of up to 100,000 incentive stock options, non-qualified stock options, tandem stock appreciation rights, and stock appreciation rights of shares of common stock. Under the 2004 Plan, incentive stock options may be granted at no less than the fair market value of the Company's stock on the date of grant, and in the case of an optionee who owns directly or indirectly more than 10% of the outstanding voting stock (an "Affiliate"), 110% of the market price on the date of grant. As of November 30, 2012 and 2011, 11,500 and 56,153 option shares, respectively remain unissued.

The Company's 2007 Equity Incentive Plan (the "2007 Plan") provides for the grant of up to 200,000 incentive stock options, non-qualified stock options, tandem stock appreciation rights, and stock appreciation rights of shares of common stock. Under the 2007 Plan, incentive stock options may be granted at no less than the fair market value of the Company's stock on the date of grant, and in the case of an optionee who is an Affiliate, 110% of the market price on the date of grant. As of November 30, 2012 and 2011, 109,500 and 67,000 option shares, respectively remain unissued.

The Company's 2007 Contingent Stock Option Plan (the "Contingent Plan") provided for the grant of up to 789,351 contingent stock options. Under the Contingent Plan, contingent stock options could be granted at no less than the fair market value of the Company's stock on the date of grant, and in the case of an optionee who is an Affiliate, 110% of the market price on the date of grant. As of November 30, 2011 all options were granted under this plan. All of the options expired on November 19, 2012. These options were scheduled to vest when the Company generated, for three consecutive months, positive cash flow from operations before interest, taxes, depreciation and amortization expense. From the time when the Contingent Plan was established in 2007, the Company had determined that the performance condition was not probable of achievement, and accordingly, no compensation cost was recognized during the years ended November 30, 2012 and 2011.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

1. Description of Business and Summary of Accounting Principles (Continued)

Stock Based Compensation (Continued)

The Company's 2009 Equity Incentive Plan (the "2009 Plan") provides for the grant of up to 500,000 incentive stock options, non-qualified stock options, tandem stock appreciation rights, and stock appreciation rights of shares of common stock. Under the 2009 Plan, incentive stock options may be granted at no less than the fair market value of the Company's stock on the date of grant, and in the case of an optionee who is an Affiliate, 110% of the market price on the date of grant. As of November 30, 2012 and 2011, approximately 21,000 option shares remain unissued and are available for future issuance.

The Company's 2010 Equity Incentive Plan (the "2010 Plan"), as amended, provides for the grant of up to 25,000,000 incentive stock options, non-qualified stock options, tandem stock appreciation rights, and stock appreciation rights of shares of common stock. Under the 2010 Plan, incentive stock options may be granted at no less than the fair market value of the Company's stock on the date of grant, and in the case of an optionee who is an Affiliate, 110% of the market price on the date of grant. The 2010 Plan was amended in fiscal 2012 from 5,000,000 option shares to 25,000,000 option shares. As of November 30, 2012 and 2011, 20,000,000 option shares and –0- option shares, respectively, remain unissued.

The Company's 2011 Equity Incentive Plan (the "2011 Plan") provides for the grant of up to 20,000,000 incentive stock options, non-qualified stock options, tandem stock appreciation rights, and stock appreciation rights of shares of common stock. Under the 2011 Plan, incentive stock options may be granted at no less than the fair market value of the Company's stock on the date of grant, and in the case of an optionee who is an Affiliate, 110% of the market price on the date of grant. As of November 30, 2012 and 2011, 5,900,000 option shares remain unissued.

The Company's Non-employee Director Stock Option Plan provides for the grant of options to purchase 1,000 shares of the Company's common stock to each non-employee director on the first business day following each annual meeting of the shareholders of the Company. Under this Plan, options may be granted at no less than the fair market value of the Company's common stock on the date of grant.

The fair value of each stock option grant is based upon the fair value of services rendered to the Company. In fiscal 2011, the fair value of stock options granted to employees was estimated on the date of grant using the Black Scholes option-pricing model with the following weighted average assumptions: annual dividends of $-0-, expected volatility of 270%, risk-free interest rate of 1%, and expected life of up to five years, depending on the individual grant. The weighted-average fair value of all stock options granted in 2011 was $.02. No stock options were granted to employees in fiscal 2012.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

1. Description of Business and Summary of Accounting Principles (Continued)

Stock Based Compensation (Continued)

As the stock-based compensation expense recognized on the consolidated statements of operations is based on awards ultimately expected to vest, such amount has been reduced for estimated forfeitures. ASC 718, "Compensation-Stock Compensation" requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on the Company's historical experience.

With the above valuation methods, the total value of stock options granted in 2012 and 2011 was $–0- and approximately $177,000, respectively, which are amortized ratably over the related vesting periods, which ranged from immediate vesting to five years.

Recent Accounting Pronouncements

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (ASC Topic 220): Presentation of Comprehensive Income," ("ASU 2011-05") which amends current comprehensive income guidance. This accounting update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, comprehensive income must be reported in either a single continuous statement of comprehensive income, which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. ASU 2011-05 will be effective for public companies during the annual periods beginning after December 15, 2011 and the interim period within that year with early adoption permitted. The Company does not believe that the adoption of ASU 2011-05 will have a material impact on the Company's consolidated results of operation and financial condition.

In December 2011, the FASB issued ASU No. 2011-12, Comprehensive Income (Topic 220) - Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 ("ASU 2011-12"). ASU 2011-12 defers changes in Update 2011-05 that relate to the presentation of reclassification adjustments. ASU 2011-12 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company does not believe that the adoption of ASU 2011-12 will have a material impact on the Company's consolidated results of operation and financial condition.

In February 2013, the FASB issued ASU No. 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," an accounting standard update, which requires companies to present information about reclassifications out of accumulated other comprehensive income in a single note or on the face of the financial statements. The updated standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012, with early adoption permitted. The Company does not believe that the adoption of this updated accounting standard will not have a significant impact on our consolidated financial position, results of operations, or cash flows.

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PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

2. Going Concern Matters and Realization of Assets

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. However, the Company has sustained recurring substantial losses from its continuing operations and as of November 30, 2012 has negative working capital of $11,816,538 and a stockholders' equity deficiency of $ 12,105,494. In addition, the Company is unable to meet its obligations as they become due and sustain its operations. The Company believes that its existing cash resources are not sufficient to fund its continuing operating losses, capital expenditures, lease and debt payments and working capital requirements.

The Company may not be able to raise sufficient additional debt, equity or other cash on acceptable terms, if at all. Failure to generate sufficient revenues, achieve certain other business plan objectives or raise additional funds could have a material adverse effect on the Company's results of operations, cash flows and financial position, including its ability to continue as a going concern, and may require it to significantly reduce, reorganize, discontinue or shut down its operations.

In view of the matters described above, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon continued operations of the Company which, in turn, is dependent upon the Company's ability to meet its financing requirements on a continuing basis, and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in its existence. Management's plans include:

1. Seek to raise debt or equity for working capital purposes and to pay off existing debt agreements. With sufficient additional cash available to the Company, it can begin to cover monthly cash losses and allocate funds toward marketing its products to achieve additional sales and consequently cut monthly operating losses.

2. Continue to create new variations of our Android app to obtain new subscribers. In order to capitalize on the rapid growth of Android devices, the Company also launched a video application that allows users of certain Android devices to make video calls to other users of the Company's video application. The video calling application is a free download. It is designed to attract more subscribers to our network so that we can offer them low-cost calling rates for mobile telephone calls that are audio only.

3. Continue to develop new uses and distribution channels for its mobile VoIP service. The Company's mobile VoIP application allows for low-cost calling to any landline or cell phone in the world. The Company plans to create a mobile VoIP and video app for iPhone and Blackberry users so that users can make video calls from an iPhone or a Blackberry phone to an Android phone or tablet.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

2. Going Concern Matters and Realization of Assets (Continued)

4. Find new sources for the Android app and offer it to telephone entities, such as prepaid calling card companies that desire to utilize a digital product, and to mobile wallet companies that are seeking to (i) obtain higher revenues from their customer base by offering more revenue-generating services or (ii) use Mobile VoIP, text messaging and video telephony as an innovative service to attract additional mobile wallet customers.

There can be no assurance that the Company will be able to achieve its business plan objectives or be able to achieve or maintain cash-flow-positive operating results. If the Company is unable to generate adequate funds from operations or raise sufficient additional funds, the Company may not be able to repay its existing debt, continue to operate its network, respond to competitive pressures or fund its operations. As a result, the Company may be required to significantly reduce, reorganize, discontinue or shut down its operations. The financial statements do not include any adjustments that might result from this uncertainty.

3. Debt

The following table summarizes components of long-term debt and capital lease obligations as of November 30, 2012 and 2011:

| Principal lender: | 2012 | | 2011 | | Interest Rate | |
|---|---|---|---|---|---|---|
| Note dated November 30, 2005 | $ | 986,271 | $ | 2,080,349 | 5.25 | %(1) |
| Note dated May 31, 2006 | | 716,041 | | 1,510,673 | 5.25 | %(1) |
| Note dated September 28, 2007 | | 2,378,733 | | 4,960,260 | 9.75 | %(1) |
| Note dated May 28, 2008 | | 1,148,254 | | 2,332,294 | 20.00 | %(1) |
| Note dated October 29, 2008 | | 709,001 | | 1,425,045 | 15.00 | %(1) |
| Note date February 15, 2009 | | 402,797 | | 812,531 | 20.00 | %(1) |
| Note dated October 6, 2009 | | 3,802 | | 7,835 | 5.25 | %(1) |
| Note dated November, 2009 | | 23,179 | | 48,600 | 5.25 | %(1) |
| | | | | | | |
| Total principal lender debt | | 6,368,078 | | 13,177,587 | | |
| | | | | | | |
| Short-term borrowings | | 1,068,867 | | 1,203,274 | 0.00% - 24.00 | % |
| Capital lease obligations | | 7,545 | | 32,100 | 12.00% - 17.38 | % |
| Total short-term debt | | 7,444,490 | | 14,412,961 | | |
| Long-Term Debt | | 358,614 | | 314,355 | | |
| Total Debt | $ | 7,803,104 | $ | 14,727,316 | | |

(1) Effective February 1, 2012, the interest rate to the principal lender was revised to 0%.

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PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

3. Debt (Continued)

Debt with Principal Lender

As of November 30, 2012 and 2011, the Company owed its principal lender ("Lender") $6,368,078 and $13,177,587, respectively. All of such debt became due by its terms on September 28, 2010. The Company has not made payments of principal or interest when due, and is not in compliance with its agreements with the Lender. The Lender has not issued a default notice and has signed two agreements over the past fourteen months to sell all of its debt at a discount to a third party.

On February 3, 2012, the Lender entered into a contract to sell such debt to JDM Group, LLC ("JDM"). JDM agreed to pay the Lender in installments over time, $1,500,000 to acquire all of the debt from the Lender. The first installment of $600,000 was due on February 15, 2012, and the balance of $900,000 was payable on the 30th day of each month in installments of $100,000 beginning on March 30, 2012. For each $100,000 paid to the lender, $930,000 in debt would be reduced to the lender. In conjunction with this agreement, the Lender agreed to not charge any interest on the debt owed, beginning on February 1, 2012. JDM also entered into an agreement with which required the Company to pay JDM $1,700,000, without interest, in August 2013 to repay such debt to JDM assuming that JDM had paid the full $1,500,000 to the lender. The debt to JDM was convertible by JDM into shares of our common stock at a conversion rate equal to a 10% discount to the volume weighted average trading price of the Company common stock for the three trading days prior to such conversion. The conversion price was subject to a minimum conversion price of $.02 per share.

When the first payment of $600,000 by JDM was due to the lender in February 2012, JDM sold the required installment payment of $600,000 of such debt to other parties in exchange for cash, which was then paid to the Lender. The Company then issued 15,833,713 shares of common stock to settle $350,000 of such debt with the other parties, and the Company issued two new convertible notes aggregating $300,000 to such other parties. As a result of the first $600,000 payment to the Lender, the liability to the Lender was reduced by approximately $5,580,000.

The Company made the $100,000 payment due to the Lender on March 30, 2012 on behalf of JDM, and JDM signed over to the Company a $930,000 debt reduction that was assigned to JDM by the Lender. JDM assigned the $100,000 payment due on April 30, 2012 to a third-party investor for a payment to the lender of $100,000, and an additional $930,000 of debt reduction was achieved with the lender. The Company granted the new investor the ability to convert the debt into stock at a 37.5% discount to the market price of our common stock, as defined in the agreement. Subsequent to such assignment, JDM asked the lender for a deferral of the monthly payments and did not make any of the monthly payments due on May 30, 2012 or thereafter, leaving $700,000 remaining to pay to the Lender under this agreement. Through the $800,000 in payments to the lender under this agreement, the Company achieved a reduction in the debt to the lender of $7,340,000. The Company has no further obligation to JDM (see below).

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

3. Debt (Continued)

Debt with Principal Lender (Continued)

As the Company is experiencing financial difficulties and JDM has granted the Company a concession by extending the term of the debt and reducing the amount of debt the Company is required to pay, the Company accounted for such transaction as a troubled debt restructuring under ASC 470-60. As the total future cash payments to JDM are less than the carrying value, an adjustment was made to the carrying value of the debt to reflect the portion of the debt that had been cancelled due to the cash payments made during the year ended November 30, 2012 and a gain from troubled debt restructuring was recognized of $6,338,601. The basic and diluted earnings per share on the gain was $0.04 and $0.02.

On February 6, 2013, the Lender cancelled its agreement with JDM and entered into a contract to sell all remaining debt due by the Company to another party, NetCapital.com, LLC. (“NCC”) for a price of $350,000 on the condition that the Company also issue three-year warrants to the Lender to purchase 10 million shares of common stock of the Company at a price of $0.01 per share. The Company issued such warrants on February 15, 2013 and NCC agreed to pay the Lender a minimum of $25,000 per installment so that a total of $350,000 was to be paid over an eight-week period, to acquire all debt due to the Lender. NCC assigned its rights to 112359 Factor Fund, LLC (the “Investor”) effective February 15, 2013, and the Investor subsequently made a payment of $250,000 under the agreement between the Lender and NCC. The Investor plans to make additional payments totaling $100,000 by April 15, 2013 to the Lender so that the existing liens on the Company’s assets are transferred from the Lender to the Investor. See Note 13.

In connection with the financings, the Company has agreed, so long as 25% of the principal amount of the financings are outstanding, to certain restrictive covenants, including, among others, that the Company will not declare or pay any dividends, issue any preferred stock that is subject to mandatory redemption prior to the one year anniversary of the maturity date as defined in the agreement, redeem any of its preferred stock or other equity interests, dissolve, liquidate or merge with any other party unless, in the case of a merger, the Company is the surviving entity, materially alter or change the scope of the Company’s business incur any indebtedness except as defined in the agreement, or assume, guarantee, endorse or otherwise become directly or contingently liable in connection with any other party’s obligations. To secure the payment of all obligations to the lender, the Company entered into a Master Security Agreement that assigns and grants to the lender a continuing security interest and first lien on all of the assets of the Company and its subsidiaries.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

3. Debt (Continued)

Short-Term Borrowings

As of November 30, 2012 and 2011, short-term borrowings are :

| | | 2012 | 2011 | Interest Rate |
|---|---|---|---|---|
| Demand noted payable to Chief Executive Officer | a | $ 502,426 | $ 477,730 | 12% - 24% |
| Other demand notes | b | 118,642 | 493,346 | 0% to 12% |
| Convertible notes | c | 447,799 | 232,198 | 0% to 12% |
| | | $ 1,068,867 | $ 1,203,274 | |
| Weighted average interest rate on short-term borrowings | | 8.7 % | 8.1 % | |

a) Demand notes payable to the Company's Chief Executive Officer total of $502,426 and $477,730, at November 30, 2012 and 2011, respectively, at annual interest rates ranging from 12% and 24%.

b) Short-term borrowings at November 30, 2012 include three demand notes of $50,000, $18,000 and $18,000 at a zero percent interest rate and a past-due note of $32,642 that is in default at an annual interest rate of 14%.

   Short-term borrowings at November 30, 2011 also include three demand notes, at a zero percent interest rate, totaling $144,276, and one demand note totaling $349,070 at an annual interest rate of 12%.

c) Short-term borrowings at November 30, 2012 also include 11 convertible notes (the "Convertible Notes") at annual interest rates ranging from 0% to 12%, totaling $447,799. The Convertible Notes consist of six notes totaling $239,499 that we issued in exchange for cash payments to our Company, one note of $19,000 that we issued in exchange for services rendered, and four notes totaling $189,300 that we issued in exchange for existing non-convertible notes payable. Conversion features allow the holders of the Convertible Notes to convert into shares of our common stock at a discount to the trading price of our common stock, as defined, ranging from 10% to 55%. For a limited period of time before a conversion notice is submitted, the Company has the right to pre-pay some or all of the Convertible Notes at a 15% to 50% premium to the principal amount that is retired.

   Short-term borrowings at November 30, 2011 also include 5 convertible notes (the "2011 Convertibles") at annual interest rates ranging from 0% to 8%, totaling $232,198. The 2011 Convertibles consist of two notes that we issued in exchange for cash payments to our Company aggregating $105,000, and three notes that which we issued in the aggregate total of $329,610, in exchange for existing notes payable, including notes payable to our Chief Executive Officer of $54,610. Conversion features allow the holders of the Convertible Notes to convert into shares of our common stock at a discount to the trading price of our common stock, as defined, ranging from 10% to 50%. For a limited period of time before a conversion notice is submitted, the Company has the ability to pre-pay some or all of the Convertible Notes at a 15% to 30% premium to the principal amount that is retired.

The conversion features embedded in the Convertible Notes were evaluated to determine if such conversion feature should be bifurcated from its host instrument and accounted for as a freestanding derivative. In six of the eleven Convertible Notes for 2012, and four of five Convertible Notes in 2011, the conversion feature was accounted for as a derivative liability. The derivatives associated with the Convertible Notes were recognized as a discount to the debt instrument and the discount is being amortized over the expected life of the notes with any excess of the derivative value over the note payable value recognized as additional interest expense at the issuance date. Five of the eleven Convertible Notes for 2012 and one of the five Convertible Notes for 2011 are convertible into common stock at a fixed number of shares and the conversion option is not a derivative liability.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

3. Debt (Continued)

Short-Term Borrowings (Continued)

The derivative liability for the Convertible Notes was calculated using the Black Scholes method over the expected terms of the convertible debentures, with a risk free interest rate of 1% and volatility of 243% for 2012 and a risk free interest rate of 1% and volatility of 270% for 2011. In accordance with authoritative guidance, the embedded derivatives are revalued at each balance sheet date and marked to fair value with the corresponding adjustment as a gain or loss on the change in the fair value of the derivatives, which were recorded as other income or expense in our consolidated statement of income (loss). As of November 30, 2012 and 2011, the fair value of such derivative totaled \$361,760 and \$274,908. During the years ended November 30, 2012 and 2011, the Company recognized income arising from the change in fair value of the derivatives of \$92,872 and \$101,474 respectively.

Long-term Debt

On November 23, 2011, the Company entered into an agreement with an unsecured lender under which the Company assigned a total of six unsecured convertible notes (the “Notes”) with a carrying value of \$292,148 and a face value of \$400,004 to a new unsecured third-party lender. The Notes had a stated 6% interest rate and were due at various dates during 2012. Such notes also contained embedded beneficial conversion features for an undeterminable number of shares, which was bifurcated and accounted for as a derivative liability calculated using the Black Scholes method described above and was valued at \$497,667 on November 23, 2011.

Upon such assignment, the Company and the new lender restructured the terms of the outstanding notes, creating one new convertible note (the “New Note”) with a face value of \$400,004, an interest rate of 6% and a three-year term stating that all principal and accrued interest shall be due on November 23, 2014. Additionally, the New Note contained a beneficial conversion feature allowing the new lender to convert any outstanding principal balance in to shares of the Company’s common stock at a rate of \$0.006 per share.

As the Company is experiencing financial difficulties and the creditor has granted a concession by extending the term of the notes, the Company accounted for such transaction as a troubled debt restructuring under ASC 470-60. As the total future cash payments of the New Note are greater than the carrying value, no adjustment has been made to the carrying value of the debt. The New Note bears interest under its new effective interest rate of 16.412% representing the rate that equates the present value of the total future cash payments to the carrying value of the debt. The New Note has a carrying value of \$344,954 and \$292,148 at November 30, 2012 and 2011. Additionally, as the Company no longer has a derivative liability associated with the Notes as the beneficial conversion feature associated with the New Note is for a fixed and determinable number of shares, the Company extinguished the remaining derivative liability and recorded a gain on extinguishment of liabilities of \$497,667 for the year ended November 30, 2011.

Capital Lease Obligation

The Company has one capital lease obligation that is payable in quarterly installments of \$2,305, ending on February 2, 2016 of which \$7,545 is classified as a short-term liability and \$13,660 as long-term debt.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

4. Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures of financial instruments on a recurring basis.

Fair Value Hierarchy

The Fair Value Measurements Topic of the FASB Accounting Standards Codification establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

| | |
|---|---|
| Level 1 | inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. |
| Level 2 | inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. |
| Level 3 | inputs are unobservable inputs for the asset or liability. |

Determination of Fair Value

Under the Fair Value Measurements Topic of the FASB Accounting Standards Codification, the Company bases its fair value on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is the Company's policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy. Fair value measurements for assets and liabilities where there exists limited or no observable market data and, therefore, are based primarily upon management's own estimates, are often calculated based on current pricing policy, the economic and competitive environment, the characteristics of the asset or liability and other such factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, that could significantly affect the results of current or future value.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value and for estimating fair value where it is practicable to do so for financial instruments not recorded at fair value (disclosures required by the Fair Value Measurements Topic of the FASB Accounting Standards Codification).

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

4. Fair Value Measurements (Continued)

Cash and cash equivalents, accounts receivable, and accounts payable

In general, carrying amounts approximate fair value because of the short maturity of these instruments.

Debt

At November 30, 2012 and 2011, long-term debt was carried at its face value plus accrued interest due to the fact that the debt is fully callable by the lender. Based on the financial condition of the Company, it is impracticable for the Company to estimate the fair value of the short and long-term debt.

Liabilities Measured and Recognized at Fair Value on a Recurring Basis

The following table presents the amounts of liabilities measured at fair value on a recurring basis as of November 30, 2012 and 2011.

Derivative Liability

The fair value of the derivatives that are traded in less active over-the counter markets are generally measured using pricing models with market observable inputs such as interest rates and equity index levels. These measurements are classified as Level 2 within the fair value of hierarchy.

| | Total | (Level 1) | (Level 2) | (Level 3) |
|---|---|---|---|---|
| November 30, 2012 | | | | |
| Derivative liability | $361,760 | - | $361,760 | - |
| November 30, 2011 | | | | |
| Derivative liabilities | $274,908 | - | $274,908 | - |

The Company has no instruments with significant off balance sheet risk.

5. Income Taxes

The Company has accumulated net operating losses of $29 million and $34 million for United States federal tax purposes at November 30, 2012 and 2011, respectively, some of which may be limited in their utilization pursuant to Section 382 of the Internal Revenue Code, and which may not be available entirely for use in future years. These losses expired in fiscal years 2019 though 2031.

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PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

5. Income Taxes (Continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of November 30, 2012 and 2011 were as follows:

| | 2012 | 2011 |
|---|---|---|
| Deferred tax assets, net: | | |
| Net operating loss carryforwards | $9,840,000 | $12,420,000 |
| Allowance for doubtful accounts | 10,000 | 20,000 |
| Stock based compensation | 120,000 | 120,000 |
| Accrued pension | 620,000 | 550,000 |
| Interest | 760,000 | 1,280,000 |
| Other | | 110,000 |
| | 11,350,000 | 14,500,000 |
| Valuation allowance | 11,350,000 | 14,500,000 |
| | | |
| Net deferred assets | $ - | $ - |

The valuation allowance decreased to $11,350,000 at November 30, 2012 from $14,500,000 at November 30, 2011.

The following is a reconciliation of the tax provisions for the years ended November 30, 2012 and 2011 with the statutory Federal income tax rates:

| | Percentage of Pre-Tax Income | |
|---|---|---|
| | 2012 | 2011 |
| Statutory Federal income tax rate | 34.0 % | (34.0 )% |
| Reduction of tax attributes due to discharge of indebtedness | (34.0 ) | |
| Loss generating no tax benefit | - | 34.0 |
| | | |
| Effective tax rate | - | - |

Under Section 108(a) of the Internal Revenue Code, the gain of approximately $6,650,000 in fiscal 2012 that is attributable to debt forgiveness and settlement of liabilities is not included in taxable income to the Company as the Company is deemed insolvent for tax purposes. The Company's net operating loss carryforwards have been reduced by the amount of non-taxable debt forgiveness.

The Company did not have any material unrecognized tax benefits as of November 30, 2012 and 2011. The Company does not expect the unrecognized tax benefits to significantly increase or decrease within the next twelve months. The Company recorded no interest and penalties relating to unrecognized tax benefits as of and during the years ended November 30, 2012 and 2011. The Company is subject to U.S. federal income tax, as well as taxes by various state jurisdictions. The Company is currently open to audit under the statute of limitations by the federal and state jurisdictions for the years ending November 30, 2009 through 2012.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

6. Pension Plans

Defined Benefit Plan

The Company received a letter dated July 27, 2011 from the Pension Benefit Guaranty Corporation, ("PBGC"), stating that the Company's defined benefit pension plan (the "Plan") was terminated as of September 30, 2010, and the PBGC was appointed trustee of the Plan. Pursuant to the agreement, the PBGC has a claim to the Company for the total amount of the unfunded benefit liabilities of the Plan of plus accrued interest. The PBGC has notified the Company that the liability is due and payable as of the termination date, and interest accrues on the unpaid balance at the applicable rate provided under Section 6621(a) of the Internal Revenue Code. The total amount outstanding to the PBGC at November 30, 2012 and 2011 was $1,821,464 and $1,730,727, including accrued interest, which is recorded as a current liability. The Company made no payments to the Plan in fiscal 2012 and 2011. The Plan covers approximately 40 former employees.

Effective June 30, 1995, the Plan was frozen, ceasing all benefit accruals and resulting in a plan curtailment. As a result of the curtailment, it has been the Company's policy to recognize the unfunded status of the Plan as of the end of the fiscal year with a corresponding charge or credit to earnings for the change in the unfunded liability. Pension expense amounted to $248,312 for the year ended November 30, 2011. There was no pension expense recorded in fiscal year ended November 30, 2012.

Defined Contribution Plan

The Company has a 401(k) profit sharing plan for the benefit of all eligible employees, as defined. The plan provides for voluntary contributions not to exceed the statutory limitation provided by the Internal Revenue Code. The Company may make discretionary contributions. There were no contributions made for the years ended November 30, 2012 and 2011.

7. Commitments and Contingencies

Operating Leases

The Company leases facilities under operating lease agreements that can be canceled with 90-day advance notice.

Rent expense was approximately $17,000 and $15,000 in fiscal 2012 and 2011, respectively.

Capital Lease Obligations

The Company has one obligation under a capital lease that has been recorded in the accompanying financial statements in fiscal year ended November 30, 2012. The obligation under the capital lease has been recorded in the financial statements at the present value of the future minimum lease payment at an annual interest rate of 17.38% (see Note 3).

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PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

7. Commitments and Contingencies (Continued)

Litigation

The Company is subject to legal proceedings and claims that arise in the ordinary course of its business. In the opinion of management, the amount of ultimate liability, if any, is not likely to have a material effect on the financial condition, results of operations or liquidity of the Company. However, as the outcome of litigation or legal claims is difficult to predict, significant changes in the estimated exposures could occur.

8. Stockholders' Equity

The Company is authorized to issue 1,000,000 shares of preferred stock, par value $0.001 per share, with rights and privileges to be determined by the Board of Directors. The Company is authorized to issue up to 400,000,000 shares of its common stock, par value $0.001.

On October 20, 2011, the Board authorized a series C of the Company's previously authorized preferred stock and designated a par value per share of $0.001 (the "Series C Preferred"). The number of shares of Series C Preferred was set at 51 shares, with no dividend rights and no liquidation rights. The shares were issued to two individuals, the Company's Chief Executive officer and Chief Information Officer. Unless otherwise voted on by the disinterested members of the Board, the Company shall redeem all shares of Series C Preferred, in cash, for the aggregate amount of $1.00 on November 21, 2013. All shares of Series C Preferred rank senior to the Company's (i) common stock, par value $0.001, (ii) Series A Convertible Preferred Stock, par value $.001 per share, (iii) Series B Convertible Preferred Stock, par value $.001 per share, and any other class or series of capital stock of the Company creates, except for stock created (a) pari passu with any class or series of capital stock of the Company hereafter created and specifically ranking, by its terms, on par with the Series C Preferred (the "Pari Passu Shares") and (b) junior to any class or series of capital stock of the Company hereafter created specifically ranking, by its terms, senior to the Series C Preferred (the "Senior Shares"), in each case as to distribution of assets upon liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary.

Each one (1) share of the Series C Preferred has voting rights equal to (x) 0.019607 multiplied by the total issued and outstanding shares of Common Stock eligible to vote at the time of the respective vote (the "Numerator"), divided by (y) 0.49, minus (z) the Numerator.

With respect to all matters upon which stockholders are entitled to vote or to which stockholders are entitled to give consent, the holders of the outstanding shares of Series C Preferred Stock shall vote together with the holders of Common Stock without regard to class, except as to those matters on which separate class voting is required by applicable law or the Certificate of Incorporation or by-laws.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

8. Stockholders' Equity (Continued)

So long as any shares of Series C Preferred are outstanding, the Company shall not, without first obtaining the unanimous written consent of the holders of Series C Preferred, (i) alter or change the rights, preferences or privileges of the Series C Preferred so as to affect adversely the holders of Series C Preferred or (ii) create Pari Passu Shares or Senior Shares.

On October 20, 2011, the Board approved a change in the authorized shares to 250,000,000 and a change in the par value of the common stock to $0.001 (together, the "Actions"). On November 28, 2011, the Series C Preferred shareholders, representing 51% of the voting equity of the Company, approved each of the Actions by written consent in lieu of a meeting. A certificate of amendment to the Company's certificate of incorporation, reflecting such Actions, was filed with the State of New York Department of State on January 23, 2012.

On August 21, 2012, the Company filed an amendment to the Company's articles of incorporation with the State of New York to increase the Company's authorized common stock from two hundred and fifty million (250,000,000) to four hundred million (400,000,000) shares of common stock, par value $0.001 per share.

On January 18, 2013, the Company filed an amendment to the Company's articles of incorporation with the Secretary of State of the State of New York increasing the Company's authorized common stock from four hundred million (400,000,000) shares of common stock to eight hundred million (800,000,000) shares of common stock.

The following is a summary of outstanding options:

| | Number of Shares | Exercise Price Per Share | Weighted-Average Exercise Price |
|---|---|---|---|
| Outstanding December 1, 2010 | 1,220,194 | $ .10 - $ 3.30 | $ 2.09 |
| Granted during year ended November 30, 2011 | 14,100,000 | $ .01 - $ .10 | $ .02 |
| Exercised/canceled during year ended November 30, 2011 | (165,000) | $ .10 - $ 1.00 | $ 1.00 |
| Outstanding November 30, 2011 | 15,155,194 | $ .01 - $ 3.30 | $ .17 |
| Granted during year ended November 30, 2012 | - | - | - |
| Exercised/canceled during year ended November 30, 2012 | (704,694) | $ 1.60 - $ 3.30 | $ 1.00 |

| | | | | |
|---|---|---|---|---|
| Outstanding November 30, 2012 | 14,450,500 | $ .01 - $ 2.65 | $ | .04 |
| Options exercisable, November 30, 2012 | 5,040,500 | $ .01 - $ 2.65 | $ | .11 |

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PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

8. Stockholders' Equity (Continued)

The following table summarizes information about the options outstanding at November 30, 2011 and 2010:

| Range of Exercise Prices | Options Outstanding Number Outstanding | Weighted-Average Remaining Contractual Life (Years) | Weighted-Average Exercise Price | Options Exercisable Number Outstanding | Weighted-Average Exercise Price |
|---|---|---|---|---|---|
| As of November 30, 2012 | | | | | |
| $0.01 - $2.65 | 14,450,500 | 3.92 | $0.04 | 5,040,500 | $0.11 |
| As of November 30, 2011 | | | | | |
| $0.10 - $3.30 | 15,155,194 | 4.92 | $0.17 | 353,233 | $1.53 |

On October 24, 1996, the shareholders of the Company adopted the eLEC Communications Corp. 1996 Restricted Stock Award Plan (the "Restricted Stock Award Plan"). An aggregate of 40,000 shares of common stock of the Company have been reserved for issuance in connections with awards granted under the Restricted Stock Award Plan. Such shares may be awarded from either authorized and unissued shares or treasury shares. The maximum number of shares that may be awarded under the Restricted Stock Award Plan to any individual officer or key employee is 10,000. No shares were awarded during fiscal 2012 and 2011.

In December 2010, the Company issued 75,000 shares of common stock, at a price of $0.10 per share, in conjunction with the exercise of stock options granted under our equity incentive plans.

During the first quarter of fiscal 2011, the Company issued stock and warrants to purchase stock in conjunction with a private placement of securities. In December 2010, we issued 200,000 shares of common stock and a warrant to purchase 400,000 shares of common stock at a price of $0.10 per share, to an employee for an aggregate purchase price of $20,000.

In fiscal 2011, the Company issued 1,900,000 shares of common stock and warrants to purchase 800,000 shares of common stock at a price of $0.10 per share, to our chief executive officer for an aggregate purchase price of $190,000.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

8. Stockholders' Equity (Continued)

As discussed in Note 3, the Company entered into various transactions during the years ended November 31, 2012 and 2011 where it issued convertible notes to third parties in exchange for existing notes payable with various lenders. Such convertible notes allowed the new debt holders to convert outstanding debt principal into shares of the Company's common stock at a discount to the trading price of the common stock. To the extent, if any, that there was a beneficial conversion feature associated with these debts, the beneficial conversion feature was bifurcated from the host instrument and accounted for as a freestanding derivative. As a result of such conversions, during the course of fiscal 2012 a total of $1,210,830 of outstanding debt principal was converted into 155,422,765 shares of the Company's common stock. During 2011, a total of $1,313,480 of outstanding debt principal was converted into 86,688,055 shares of the Company's common stock.

Additionally, during fiscal 2011, one debt holder settled outstanding debt principal of $148,522 for 594,088 shares of the Company's common stock, which was valued at $41,586 at the time of conversion, resulting in a gain on the settlement of liabilities of $106,929.

In fiscal 2011, the Company issued 3,161,000 shares of common stock, valued at $45,483, in exchange for services rendered by independent contractors.

During the second quarter of fiscal 2012, three debt holders settled outstanding debt and interest payable of $471,189 for 6,102,050 shares of common stock, which was valued at $156,708 at the time of conversion, resulting in a net gain on the settlement of liabilities of $314,481.

In fiscal 2012, the Company issued 6,000,000 shares of common stock, valued at $84,063, for services rendered by independent contractors.

In fiscal 2012, in conjunction with a private placement of securities, the Company issued 34,673,250 shares of common stock at a purchase price of $681,000.

During the third quarter of fiscal 2012, the Company's chief executive officer converted $18,500 of outstanding debt into 1,500,000 shares of common stock.

From the period of December 1, 2012 to March 14, 2013, the Company issued 229,251,020 shares of common stock to settle debts of $752,064.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

9. Net Earnings (Loss) Per Common Share

Basic net income (loss) per share is computed by dividing net income available to common stockholders (numerator) by the weighted average number of vested, unrestricted common shares outstanding during the period (denominator). Diluted net income per share is computed on the basis of the weighted average number of shares of common stock outstanding plus the effect of dilutive potential common shares outstanding during the period using the if-converted method. Dilutive potential common shares include shares issuable upon exercise of outstanding stock options, warrants and convertible debt agreements.

| | 2012 | | 2011 | |
|---|---|---|---|---|
| Net income (loss) – numerator basic | $ | 3,173,931 | $ | (4,449,884 ) |
| Interest expense attributable to convertible notes, net | | 1,131,519 | | - |
| Net income (loss) plus interest expense attributable to convertible notes, net – numerator diluted | $ | 4,305,450 | $ | (4,449,884 ) |
| Weighted average common shares outstanding – denominator basic | | 165,946,987 | | 43,965,736 |
| Effect of dilutive securities, stock options and preferred stock | | 147,939,567 | | - |
| Weighted average dilutive common shares outstanding | | 313,886,554 | | 43,965,736 |
| Weighted average dilutive common shares outstanding – denominator diluted | | | | |
| Net income (loss) per common share – basic | $ | 0.02 | $ | (0.10 ) |
| | | | | |
| Net income (loss) per common share – diluted | $ | 0.01 | $ | (0.10 ) |

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PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

10. Risks and Uncertainties

The Company has created a proprietary IP telephony network and has transitioned from a reseller of traditional wireline telephone services into a facilities-based broadband service provider to take advantage of the network cost savings that are inherent in an IP network. Although the IP telephony business continues to grow, the Company faces strong competition. The Company has built its IP telephony business with significantly less financial resources than many of its competitors. The survival of the business is currently dependent upon the success of the IP operations. Future results of operations involve a number of risks and uncertainties. Factors that could affect future operating results and cash flows and cause actual results to vary materially from historical results include, but are not limited to:

- The availability of additional funds to successfully pursue our business plan;
- The cooperation of our secured and unsecured lenders;
- Our ability to market our services to current and new customers and generate customer demand for our products and services in the geographical areas in which we operate;
- The cooperation of industry service partners that have signed agreements with us;
- The impact of changes the Federal Communications Commission or State Public Service Commissions may make to existing telecommunication laws and regulations, including laws dealing with Internet telephony;
- The ability to comply with provisions of our financing agreements;
- The highly competitive nature of our industry;
- The acceptance of telephone calls over the Internet by mainstream consumers;
- Our ability to retain key personnel;
- Our ability to maintain adequate customer care and manage our churn rate;
- Our ability to maintain, attract and integrate internal management, technical information and management information systems;
- The impact of adverse tax or regulatory rulings or actions affecting our operations, including the imposition of taxes, fees and penalties;
- Our ability to manage rapid growth while maintaining adequate controls and procedures;
- The availability and maintenance of suitable vendor relationships, in a timely manner, at reasonable cost;
- The decrease in telecommunications prices to consumers;
- General economic conditions.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

11. Accounts Payable and Accrued Expenses

| | 2012 | 2011 |
|---|---|---|
| Trade payables | $813,962 | $996,151 |
| Payable from sale of subsidiaries | 796,499 | 796,499 |
| Customer deposits | 136,912 | 135,912 |
| Due to investor | - | 100,000 |
| Other, individually less than 5% of current liabilities | 549,869 | 521,610 |
| | $2,297,242 | $2,550,172 |

When the Company sold certain subsidiaries in December 2006, the Company agreed to reimburse the purchaser for certain disputed claims on the books of the subsidiaries, if the sold subsidiaries were required to pay such claims. At November 30, 2012 and 2011, the Company has recorded a payable of $796,499 in conjunction with the sale of the subsidiaries. The subsidiary filed for bankruptcy on September 23, 2008, which is still ongoing. If claims are reduced or eliminated by the subsidiaries, and the purchaser provides the Company with appropriate documentation that the Company's liability has been reduced, such reduction will be reflected on the books of the Company.

In the fourth quarter of fiscal 2011, the Company received $100,000 from an investor pursuant to a stock subscription agreement whereby the Company is required to either issue 5,000,000 shares to the investor or refund to the investor the amount received. In fiscal 2012 the Company received an additional $493,745 from the same investor and on October 4, 2012 the Company issued and sold an aggregate of 29,687,250 shares of common stock at a purchase price of $0.02 per share in exchange for the aggregate proceeds of $593,745.

The Company reversed accounts payable amounting to $172,768, which is included in the income statement under the caption of other income, net, to reflect a reversal of unpaid invoices which the Company determined were no longer payable.

12. Related Party Transactions

The Company paid fees to a software consulting firm ("Consultant") of $192,000 in both fiscal 2012 and 2011. All such work performed by the Consultant is the property of the Company. An officer of the Company has performed work for the Consultant, including disbursement services, in which funds that were remitted by the Company to the Consultant were subsequently transferred to a company controlled by the officer to distribute such funds to appropriate vendors.

At November 30, 2012 and 2011, total unpaid salary owed to the Company's chief executive officer was $318,946 and $244,450, which has been converted into unsecured short-term loans bearing interest at 12%. Accrued interest on such loans was $51,233 and $19,840 as of November 30, 2012 and 2011 which is included in the other current liabilities.

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PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

12. Related Party Transactions (Continued)

Additionally, the Company owes its chief executive officer $183,480 and $233,280 as of November 30, 2012 and 2011 for cash loans made directly to the Company. Accrued interest payable on such loans was $74,345 as of November 30, 2012 and $29,953 as of November 30, 2011 which is included in other current liabilities.

The Company also owes its chief executive officer $104,571 and $109,222 for unreimbursed business expenses, which are included in the Company's accounts payable balance as of November 30, 2012 and 2011.

At November 30, 2012, the Company owes $20,000 each to its chief executive officer and chief information officer for unissued common stock that was purchased by its chief executive officer and converted by its chief information officer from debt into equity during fiscal 2012.

13. Subsequent Events

On February 8, 2013, the Company's Lender entered into an assignment and assumption agreement (the "Assignment Agreement"), as assignor, with NCC, as assignee, pursuant to which the Lender assigned the secured debt, with a carrying value of $6,368,078 as of November 30, 2012 (the "Debt") (See Note 3), and all rights owing thereunder, to NCC. As further consideration, the Company issued to the Lender a series of three-year warrants to purchase an aggregate of 10 million shares of Common Stock at a price of $0.01.

Effective February 8, 2013, NCC assigned 100% of its right, title and interest in, to and under the Assignment Agreement to 112359 Factor Fund, LLC (the "Fund") in exchange for the Fund's agreement to satisfy the payment obligations due under the Assignment Agreement.

Effective February 15, 2013, Company entered into a securities purchase agreement with the Fund pursuant to which the Company issued to the Fund (i) an amended convertible debenture in the principal amount of $1,000,000 ("Amended Note 1") and (ii) a second amended convertible debenture in the principal balance of $1,000,000 ("Amended Note 2" and together with Amended Note 1, the "Amended Notes"). The Amended Notes were sold to the Fund, in exchange for the Fund's assumption and payment of the Assignment Agreement, payment to the Company of $150,000, the agreement to cancel the remainder of the Debt that was assigned by the Lender to the Fund, and the agreement to purchase and cancel an existing convertible debenture in the amount of approximately $37,000.

Absent earlier redemption with no redemption for early redemption, the Amended Notes mature on December 31, 2014. Interest accrues on the unpaid principal and interest on the notes at a rate per annum equal to six percent (6%) for Amended Note 1 and two percent (2%) for Amended Note 2.

PERVASIP CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

AS OF AND FOR THE YEARS ENDED NOVEMBER 30, 2012 AND 2011

13. Subsequent Events (Continued)

Principal and interest payments on Amended Note 1 can be made at any time by the Company, or the Fund can elect at any time to convert any portion of Amended Note 1 into shares of common stock of the Company at 100% of the market price (as defined) subject to a limit of 4.99% of the Company's outstanding shares of common stock. In February 2013 the Fund converted $78,690 of principal into 39,345,576 shares of common stock. Amended Note 2 converts into ten percent (10%) of the outstanding shares of common stock of the Company upon the full payment of Amended Note 1, subject to a maximum of 100,000,000 shares. Any principal or interest amount can be paid in cash.

The Amended Notes are secured by a blanket lien on substantially all of the Company's assets pursuant to the terms of security agreements executed by the Company and its subsidiaries in favor of the Fund. In addition, the Company's chief executive officer and chief information officer pledged their combined voting control of the Company pursuant to a stock pledge agreement executed by the two officers in favor of the Fund, to further secure the Company's obligations under the Amended Notes. If an event of default occurs under the security agreement, the stock pledge agreement or the Amended Notes, the secured parties have the right to accelerate payments under such promissory notes and, in addition to any other remedies available to them, to foreclose upon the assets securing such promissory notes.