

SKYLYNX COMMUNICATIONS INC  
Form 10QSB  
May 23, 2006

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington D.C. 20549

**FORM 10-QSB**

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended: March 31, 2006

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number: 0-27635

**SKYLYNX COMMUNICATIONS, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization)

37-1465836  
(I.R.S. Employer  
Identification No.)

1528 Stickney Point Road  
Sarasota, Florida 34231  
(Address of principal executive offices, including zip code)

Registrant's Telephone No., including area code: (941) 926-2510

1502 Stickney Pont Road Sarasota, Florida 34231

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

Check whether the issuer is not required to file reports pursuant to section 13 or 15(d) of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

Issuer's net revenues for its most recent fiscal quarter ended March 31, 2006 was \$267,651.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, \$.0001 par value 31,203,726

Class Number of shares outstanding at  
March 31, 2006.

Transitional Small Business Format (check one). Yes [ ] No [  ]

**Part 1.****Financial Statements**

**SKYLYNX COMMUNICATIONS, INC.**  
**Condensed Consolidated Balance Sheet**  
**(Unaudited)**  
**March 31, 2006**

**Assets**

## Current assets:

Cash	\$	251,302
Accounts receivable, net		44,520
Notes receivable		200,000
Notes receivable, in default		205,000
Prepaid expenses		4,042
Prepaid loan costs		13,770
Other current assets		<u>21,385</u>
Total current assets.		740,019
Property and equipment, net		18,106
Deferred loan costs		78,889
Other assets		<u>2,500</u>
Total assets	\$	<u>839,514</u>

**Liabilities and Shareholders' Deficit**

## Current liabilities:

Accounts payable		\$599,549
Accrued salaries		314,763
Other accrued liabilities		73,216
Deferred revenues		30,289
Derivative liability		561,471
Loan payable		500,000
Loan payable to related parties		<u>2,800</u>
Total current liabilities		2,082,088
Convertible debentures		147,520
Convertible debentures, related parties		105,038
Note payable net of discount of \$201,659		<u>1,494,312</u>

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Total liabilities  
Shareholders' deficit:  
Common stock  
Additional paid-in capital  
Retained deficit  
  
Total shareholder's deficit

\$

See accompanying notes to condensed consolidated financial statements.

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**SKYLYNX COMMUNICATIONS, INC.**  
**Condensed Consolidated Statements of Operations**  
**(Unaudited)**

	<b><u>Three Months Ended</u></b>	
	<b><u>March 31,</u></b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>
Internet service revenue	\$ 89,563	\$ 9,563
Operating expenses:		
Costs of revenue	60,922	5,922
Selling, general and administrative	407,974	27,974
Costs of terminated merger	-	-
Research & development costs	44,474	12,474
Stock-based compensation:		
Salaries	-	7,000
Board services	37,211	-
Consulting	5,133	15,133
Total operating expenses	<u>555,714</u>	<u>68,474</u>
Loss from operations	(466,151)	(584,151)
Other income (expense):		

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Cash paid for income taxes	\$ _____ -
Cash paid for interest	\$ _____ -
Non-cash financing transactions:	
Convertible debenture issuance for loans payable, accrued salaries, and accounts payable	\$ _____ -

See accompanying notes to condensed consolidated financial statements.

**SKYLYNX COMMUNICATIONS, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**Note 1: Basis of presentation**

The financial statements presented herein have been prepared by the Company in accordance with the accounting policies in its Form 10-KSB dated June 30, 2005 and should be read in conjunction with the notes thereto.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) which are necessary to provide a fair presentation of operating results for the interim period presented have been made. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the year.

Inherent in the Company's business are various risks and uncertainties, including its historical operating losses and dependence upon strategic alliances. The Company's future success will be dependent upon its ability to create and provide effective and competitive automatic vehicle location services and the Company's ability to develop and provide new services that meet customers changing requirements; including the effective use of leading technologies to continue to enhance its current services and to influence and respond to emerging industry standards and other technological changes on a timely and cost-effective basis.

Management plans to seek additional funding through equity offerings and debt financing and ultimately, to achieve profitability.

Financial data presented herein are unaudited.

**Note 2: Notes Receivable, Default**

During the nine months ended March 31, 2006, the Company advanced \$205,000 to Digital Computer Integration Corporation, a merger candidate and a Texas corporation ("DCI") due on April 28, 2005, with 12.5% interest. At the time of the loans, DCI and the Company had executed a definitive Agreement and Plan of Merger (see Note 8: Acquisitions), and as of March 31, 2006, the Merger was terminated without consummation.

Subsequent to March 31, 2006, DCI defaulted on the note receivable. The Company is pursuing collection of the amounts owed via the perfected collateral and through the exploration of selling or assigning the note receivable to third parties. Management believes the note, plus accrued interest, is fully collectible. However, should management determine that it is probable that the Company will be unable to collect all amounts due, the Company will record a valuation allowance up to the entire balance of the note receivable.

**Note 3: Related party transactions**

The Company has loan payables due to its officers and director as follows:

As of March 31, 2006 the Company has loan payables due to its officers and director as follows:

demand	Loans payable to a board member, at interest of 8%, unsecured, due on <u>\$ 2,800</u>
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During the nine months ended March 31, 2006, the Company issued 90,000 shares of its common stock in exchange for services rendered from officers and directors of the company. The stock issuances were recorded at the market value of the Company's common stock on the transaction date. Stock based compensation expense of \$6,600 was recognized in the accompanying consolidated financial statements for the nine months ended March 31, 2006.

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**Note 4: Income taxes**

The Company records its income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". The Company incurred net operating losses during the nine months ended March 31, 2006 resulting in a deferred tax asset, which was fully allowed for; therefore, the net benefit and expense resulted in \$-0- income taxes.

**Note 5: Note Payable**

During the nine months ended March 31, 2006, the Company entered into a Securities Purchase Agreement providing for the issuance of 8% Callable Secured Convertible Notes in the aggregate principal amount of \$3,000,000 and warrants to purchase an aggregate of 10,000,000 shares of common stock for the aggregate consideration of \$3,000,000.

As of March 31, 2006, the Company had issued convertible notes of \$2,000,000 due July 29, 2008 that are convertible into approximately 60,606,606 shares of common stock at an effective conversion price of \$.033 per share. The debentures were issued at par and pay interest of 8% annually. The holder has the right to convert at any time on or prior to the earlier of the maturity date, the date of payment of a default amount or optional prepayment amount. However, in no event shall the note holder be entitled to convert any portion of the note in excess of that portion of which the sum of (i) the number of shares of common stock beneficially owned by the holder and its affiliates and (ii) the number of shares of common stock issuable upon conversion that would result in beneficial ownership by the holder and its affiliates of more than 4.99% of the outstanding shares of common stock of the Company.

As of March 31, 2006, the Company issued to the holders of the 8% Callable Secured Convertible Notes warrants to purchase 6,665,066 shares of the Company's common stock.

The warrant holders have the right to convert at any time at an exercise price of \$0.20 per share. The warrants may be exercised by the holder upon payment to the Company in cash or, if the resale of the warrant shares by the holder is not registered pursuant to an effective registration statement, by delivery to the Company of a written notice of an election to affect a "Cashless Exercise." In a Cashless Exercise, in lieu of paying the exercise price in cash, the holder would surrender the warrant for the number of shares of Common Stock determined by multiplying the number of Warrant Shares to which it would otherwise be entitled by a fraction, the numerator of which is the difference between the current market price per share of common stock and the exercise price, and the denominator of which would be the current market price per share of common stock.

In no event shall the warrant holder be entitled to exercise a number of warrants in excess of the number of warrants upon exercise of which the sum of (i) the number of shares of Common Stock beneficially owned by the holder and its affiliates and (ii) the number of shares of Common Stock issuable upon exercise of the Warrants would resulting beneficial ownership by the holder and its affiliates of more than 4.9% of the outstanding shares of Common Stock.

Pursuant to the Registration Rights Agreement, the Company must use its best efforts to obtain effectiveness of a Registration Statement covering all shares under the Security Agreement as soon as practicable. If the statement is not declared effective by the SEC on or prior to 105 days from the date of closing (now extended to June 7, 2006), the Company will make payments to the investors as partial relief for the damages to the Investors in an amount equal to two percent 2% per month of the then outstanding principal amount until sales could be made pursuant to such Registration Statement. Such amounts may be paid in cash or, at the Company's option, in shares of common stock priced at the conversion price on such payment date.

The Company also issued a Security Agreement in connection with the above agreement to provide a first priority security interest in certain property of the Company in order to secure the prompt payment, performance and discharge of all of the Company's obligations under the convertible note and warrant agreements.

Because the financing included registration rights related to share settlement of the embedded conversion features and the warrants that the Company has determined not to be within its control and because the number of shares issuable under the financings are variable, the Company has allocated the proceeds between the various instruments

and derivative elements at their fair value pursuant to EITF 00-19. As of March 31, 2006, none of the debt was converted.

The following table presents the allocation of proceeds of the financing:

Principal balance of the notes	\$	2,000,000
Less reduction for:		
Fair value of the warrants		(483,771)
Fair value of beneficial conversion option		(126,633)

Recorded at closing	\$	1,389,596
Amortization of discount (interest expense) through March 31, 2006		104,716
Carrying value at March 31, 2006	\$	1,494,312

Both the Company and the lender recognize that the Company will have to affect either a reverse split or increase the number of authorized shares to be able to issue all the shares potentially issuable under the NIR convertible note and warrants. However, due to other contractual limitations of the investors' ownership percentage in the Company, we do not anticipate any difficulty in fulfilling our obligations.

On April 12, 2006, the Company and investors entered into a Letter Agreement amending the conversion price of the note payable to the lesser of (i) \$.0815 per share or (ii) 50% of the market value of the common stock, as defined in the note payable, on the conversion date. In consideration of the reduction in the conversion price, the investors agreed to extend the deadline by which a registration statement registering for resale under the Securities Act of 1933, as amended the shares of common stock issuable upon conversion of the note payable and exercise of the warrants to June 7, 2006.

#### **Note 6: Derivative Financial Instruments**

The Company generally does not use derivative instruments to hedge exposures to cash-flow risks or market-risks that may affect the fair values of its financial instruments. However, certain other financial instruments, such as warrants and embedded conversion features, are classified as liabilities when either (a) the holder possesses rights to net-cash settlement or (b) physical or net-share settlement is not within the control of the Company. In such instances, net-cash settlement is assumed for financial accounting and reporting. Such financial instruments are initially recorded at fair value and subsequently adjusted to fair value at the close of each reporting period.

As of December 31, 2005, the derivative liability is composed of the following:

		<b>Number of Shares Derivative Liability Can Be Settled</b>
Free standing warrants	\$ 448,990	6,665,066
Embedded beneficial conversion option	112,481	1,638,844
	\$ 561,471	8,303,910



A derivative gain in the amount of \$48,933 was recognized and is related to the individual derivatives as follows:

Free-standing warrants: \$34,781

Imbedded beneficial conversion option: \$14,152

\$48,933

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**Note 7: Shareholders' deficit**

**Nine Months Ended March 31, 2005**

During the three months ended March 31, 2005, the Company issued 750,000 shares of its common stock in exchange for financial advisory and other consulting services. The transactions were recorded at the market value of the Company's common stock on the transaction date. Stock-based compensation expense of \$95,000 was recognized in the accompanying consolidated financial statements for the three months ended March 31, 2005.

During the three months ended March 31, 2005, the Company issued 93,986 shares of its common stock in exchange for office improvement materials. The transaction was recorded at the market value of the Company's common stock on the transaction date. Stock-based compensation expense of \$12,218 was recognized in the accompanying consolidated financial statements for the three months ended March 31, 2005.

During the nine months ended March 31, 2005, the Company sold 1,452,073 shares of its common stock to investors for gross proceeds totaling \$100,000. During the nine months ended March 31, 2004, the Company sold 693,739 shares of its common stock to investors for gross proceeds totaling \$295,944. The sales were made solely to persons who qualified as accredited investors within the meaning of Regulation D in reliance upon an exemption from the registration requirements of the Securities Act of 1933, as amended. Shares were sold in two successive private offerings: the first at a price of \$.60 per share and the second at a price equal to 70% of the market price of the common stock on the date of the investment.

**Nine Months Ended March 31, 2006**

During the nine months ended March 31, 2006, the Company issued 90,000 shares of its common stock in exchange for services rendered from officers and directors of the company. The stock issuances were recorded at the market value of the Company's common stock on the transaction date. Stock based compensation expense of \$6,600 was recognized in the accompanying consolidated financial statements for the nine months ended March 31, 2006.

During the nine months ended March 31, 2006, the Company issued 800,000 shares of its common stock in exchange for services rendered from a consultant. The stock issuance was recorded at the market value of the Company's common stock on the transaction date. Stock based compensation expense of \$65,600 was recognized in the accompanying consolidated financial statements for the nine months ended March 31, 2006.

During the nine months ended March 31, 2006, the Company issued 30,000 shares of its common stock in exchange for the settlement of a payable. The stock issuance was recorded at the fair value of the services provided.

Following is a schedule of changes in shareholders' deficit for the nine months ended March 31, 2006:

	<u>Common stock</u>		<u>Additional</u>	<u>Retained</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-In</u>	<u>Deficit</u>
			<u>Capital</u>	
Balance, June 30, 2005	30,019,442	\$ 3,001	\$ 6,067,870	\$ (7,833,328) \$
Adjustment to issuance of common stock	264,284	27	(27)	-
Common stock issued in exchange for services	890,000	89	72,111	-
Common stock issued in exchange for relief of a payable	30,000	3	2,997	-
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Additional payments for purchase of Inforum			(10,500)	
Issuance of options to board members			37,212	
Issuance of options to consultants			5,133	
Net loss for the nine months ended March 31, 2006	-	-	-	(1,334,032)
Balance, March 31, 2006	<u>31,203,726</u>	<u>\$ 3,120</u>	<u>\$ 6,174,796</u>	<u>\$ (9,167,360)</u>

### Stock Warrants and Options

On July 29, 2005, the Company granted to the Buyers of the convertible notes under the Securities Purchase Agreement described in Note 5 above, warrants to purchase 3,332,533 shares of its Common Stock, also on January 9, 2006, the Company issued additional warrants to purchase 3,332,533 shares of its Common Stock. The warrants carry an exercise price of \$0.20 per share and vest on the date of grant. No warrants have yet been exercised.

The market price of the Company's common stock on the dates of grant was \$0.079 and \$.07, respectively. The weighted average exercise price and weighted average fair value of these warrants as of March 31, 2006 was \$0.20 and \$.08, respectively.

The fair value for the warrants granted during the nine months ended March 31, 2006 was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

Risk-free interest rate	4.02% - 4.83%
Dividend yield	0.00%
Volatility factor	296.50%
Weighted average expected life	2.55 □ 3 years

On January 9, 2006, the Company granted 660,000 options to various directors, employees and consultants under the Incentive Stock Option Plan. The market price of the Company's common stock on the date of grant was \$.07 and the weighted average exercise price and weighted average fair value of these options as of March 31, 2006 was \$.08 and \$.07, respectively.

The fair value for the options granted during the nine months ended March 31, 2006 was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	4.83%
Dividend yield	0.00%
Volatility factor	285.30%
Weighted average expected life	1.5 years

Prior to 2006, the Company accounted for its stock based compensation plans under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. The Company did not issue any options during the nine months ended March 31, 2005. Effective December 15, 2005, the Company adopted the fair value recognition provisions of FASB Statement No. 123,

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Accounting for Stock-Based Compensation. The following table illustrates the effect on net income and earnings per share if the fair value based method had been applied to all outstanding and unvested awards in each period.

	<b><u>Nine months ended March 31, 2006</u></b>	<b><u>Nine months ended March 31, 2005</u></b>
Net loss, as reported	\$ (2,076,590)	\$ (1,808,924)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	-	-
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	-	-

Pro forma net income	\$	(2,076,590)	\$	(1,808,924)
Basic and diluted earnings per share as reported:	\$	(0.07)	\$	(0.11)
Basic and diluted earnings per share pro forma:	\$	(0.07)	\$	(0.11)

During the three months ended March 31, 2006, options to purchase no shares of common stock granted under APB Opinion No. 25 vested. The Company recognized \$0 of compensation cost under the modified prospective method in accordance with FASB Statement No. 123.

Additionally, options to purchase 0 shares of common stock granted to consultants vested. The company recognized \$0 of compensation cost pursuant to FASB Statement No. 123.

The following schedule summarizes the changes in the Company's outstanding stock awards:

	<u>Options Outstanding</u>		Weighted Average
	<u>Number of Shares</u>	<u>Exercise Price Per Share</u>	<u>Exercise Price Per Share</u>
Balance at June 30, 2005	486,823	\$3.00	\$ 3.00
Awards granted	7,325,066	\$0.08 to \$0.20	\$ 0.18
Awards exercised	-	\$0.00	\$ -
Awards cancelled/expired	-	\$0.00	\$ -
Balance at March 31, 2006	<u>7,811,889</u>	\$0.08 to \$3.00	\$ <u>0.49</u>

### **Note 8: Commitments and Contingencies**

Optigate, Inc. v. Rover Telcom, Inc., (hereafter called "Rover"). OptiGate, Inc., (hereafter "OptiGate") filed suit against Rover, a wholly owned subsidiary of the Company in the U. S. District Court for the Northern District of California, Fresno Div., CA No. 03 CE CG 03733. The claim asserts breach of contract by Rover. The amount claimed is \$150,000 for the alleged breach. Rover has counterclaimed for damages, breach and that the contract is void

from inception. After suit was filed, service had and pleadings filed by both parties, OptiGate filed for Chapter 7 proceedings in the U. S. Bankruptcy Court, Middle District of California. The U. S. Trustee has opened negotiations to settle the matter by offering to accept \$100,000 and we have countered by offering \$10,000, which was subsequently rejected. Any judgment we obtain is expected to be not collectable. Management of the Company believes that the likelihood of a material adverse outcome is remote.

The company had employment agreements with Fred Anderson, Jon Fatula and Kevin Gorman. Under those agreements the company agreed to negotiate a reimbursement to these employees certain sums allegedly owed them by StarCom Wireless, Inc., (hereafter called "StarCom"). Mr. Fatula and Mr. Gorman filed secured claims against the bankrupt estate of StarCom in the case referred to in item 1 above. Mr. Anderson did not file a civil claim despite being urged to do so. Mr. Anderson did file a claim in the Ch. 11 and Ch. 7 bankruptcy cases of StarCom.

Mr. Anderson says that some amount in excess of \$300,000 is due him and that is disputed. First he made no claim in bankruptcy for any amount. Secondly he was urged to file suit against StarCom more two years ago and declined. Thirdly his claim against SkyLynx includes salary claims on behalf of his wife who is not a party to our agreement. Fourth the amount claimed includes sales by a company owned by Mr. Anderson and allegedly not paid for by StarCom. SkyLynx did not agree to reimburse him for any of those items. Finally it appears that Mr. Anderson was being paid back salary by StarCom and AllCom, Inc., an affiliate of StarCom, but not giving any credit to SkyLynx for the amounts paid.

In all instances negotiated amounts may be owed. No such negotiations have occurred or been requested by these employees. Therefore, only a *de minimis* amount is due on any of these matters at present. The contracts do not specify any amount and further are subject to "...the final terms and conditions being negotiated between us."

On January 24, 2006, SkyLynx Communications, Inc. (the "Company"), was served with a Summons and Petition that was filed in the District Court of Dallas County, Texas, B-44<sup>th</sup> Judicial District, Cause No. 06-00451 by New Market Technology, Inc., as plaintiff, against the Company, Digital Computer Integration Corporation ("DCI") and other parties. The factual nexus of the claims center around transactions that occurred between DCI, the plaintiff and other parties. In December, 2005, the Company announced that it had entered into a definitive Agreement and Plan of Merger to acquire DCI. In the Petition, the plaintiff asserts numerous claims against the other defendants and the Company, including claims based upon tortious interference with contract and conspiracy. The Company has been dismissed from this case.

#### **Note 9: Acquisitions**

On November 29, 2005, SkyLynx Communications, Inc. (the "Company") executed a definitive Agreement and Plan of Merger ("the Merger Agreement") between and among the Company, an acquisition subsidiary SkyLynx Acquisition Company ("SAC") a wholly owned subsidiary, and Vetco Hospitals, Inc., a California corporation ("VETCO").

The Merger Agreement provides for the Merger of SAC with and into VETCO, with VETCO to be the surviving corporation.

Upon consummation of the Merger, all issued and outstanding shares of VETCO common

stock will be converted automatically into an aggregate of 1,000,000 SkyLynx Series A Convertible Preferred Stock having a stated value of \$3.00 per share (the "Series A Preferred"). The number of shares of Series A Preferred to be issued to the VETCO shareholders shall be adjusted at the time of closing such that the total number of shares of SkyLynx common stock issuable upon conversion of the Series A Preferred (the "Conversion Stock") shall represent, at closing, 55% of the

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total issued and outstanding shares of SkyLynx common stock, on the closing date, on a fully diluted basis, excluding shares of common stock issued or reserved for issuance pursuant to Securities Purchase Agreements and related instruments entered into by SkyLynx with NIR Group investors.

At the effective time, all issued and outstanding options, warrants and other rights to acquire shares of VETCO common stock, if any, shall be converted into identical rights with respect to SkyLynx common stock. No new options are to be granted prior to closing.

As of March 31, 2006, the Merger has not been consummated; therefore none of the operations of VETCO have been included in the attached consolidated financial statements. However, subsequent to March 31, 2006, the Merger was consummated.

On December 16, 2005, SkyLynx Communications, Inc. the (the "Company") executed a definitive Agreement and Plan of Merger ("the Merger Agreement") between and among the Company, an acquisition subsidiary SkyLynx Acquisition Company ("SAC"), and Digital Computer Integration Corporation, a Texas corporation ("DCI"), Defense Technology Systems, Inc., a Delaware corporation ("DFTS"), a shareholder of DCI, and Zenon Maciekowicz and Clara Jane Maciekowicz, individually, collectively and as shareholders of DCI.

As of March 31, 2006, the Merger was terminated without consummation.

**Note 10: Subsequent Event**

On April 28, 2006, the Company closed in escrow its Agreement and Plan of Merger dated November 29, 2005 (the "Merger") as amended on February 21, 2006, March 9, 2006 and March 30, 2006 (the "Merger Agreement") between and among the Company, a wholly-owned acquisition subsidiary of the Company SkyLynx Acquisition Corp. ("SAC"), and Vetco Hospitals, Inc., a California corporation ("VETCO").

Under the terms of the Closing Escrow Agreement, the shares of Series A Convertible Preferred Stock issuable on the effective date of the Merger, the Agreement of Merger that is required to be filed with the California Secretary of State and the Statement of Merger that is required to be filed with the Colorado Secretary of State were delivered into escrow pending receipt of confirmation satisfactory to both SkyLynx and Vetco that the Vetco financial statements could be audited in conformity with applicable legal requirements. On May 1, 2006, the parties to the Merger received such confirmation and authorized the release from escrow and filing of the Agreement of Merger and Statement of Merger.

On May 5, 2006, the Effective Date of the Merger, all outstanding shares of VETCO common

stock converted automatically into an aggregate of 988,338 shares of Series A Preferred. The shares were issued to a total of five Vetco shareholders. In addition, SkyLynx entered into a convertible promissory note on April 26, 2006, which may be converted at any time by the holder thereof into a maximum of 11,662 shares of the Series A Preferred. Each of the Vetco shareholders and the holder of the convertible promissory note represented that he qualified as an accredited investor within the meaning of Rule 501(a) of Regulation D. The shares and the note were taken for investment purposes and are subject to restrictions on transfer under federal securities laws. The shares of Series A Preferred and the convertible promissory note were issued without registration under the Securities Act in reliance upon the exemption from the registration requirements of the Securities Act contained in Section 4(2) and Rule 506 of Regulation D.

The Merger resulted in a change of control of SkyLynx. As a result of the Merger, the former VETCO shareholders would be deemed the beneficial owners, within the meaning of Rule 13d-3 under the Exchange Act, of an aggregate of 37,983,411 shares of common stock, consisting of 988,338 shares of Series A Convertible Preferred Stock of SkyLynx. These securities represent approximately 55% of the issued and outstanding shares of voting securities of the Company, after giving effect to Merger, calculated in accordance with Rule 13d-3 under the Exchange Act.

This merger will be treated as a recapitalization of VETCO with SkyLynx as the legal surviving entity.

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

The following discussion and analysis covers material changes in the financial condition of SkyLynx Communications, Inc., (the "Company") since June 30, 2005 and material changes in our results of operations for the three and nine months ended March 31, 2006, as compared to the same period in 2005. This discussion and analysis should be read in conjunction with "Management's Discussion and Analysis" included in the Company's Annual Report on Form 10-KSB for the year ended June 30, 2005, including audited financial statements contained therein, as filed with the Securities and Exchange Commission.

### **Special note regarding forward-looking statements**

This report contains forward-looking statements within the meaning of federal securities laws. These statements plan for or anticipate the future. Forward-looking statements include

statements about our future business plans and strategies, statements about our need for working capital, future revenues, results of operations and most other statements that are not historical in nature. In this Report, forward-looking statements are generally identified by the words "intend", "plan", "believe", "expect", "estimate", and the like. Investors are cautioned not to put undue reliance on forward-looking statements. Except as otherwise required by applicable securities statutes or regulations, the Company disclaims any intent or obligation to update publicly these forward-looking statements, whether as a result of new information, future events or otherwise. Because forward-looking statements involve future risks and uncertainties, these are factors that could cause actual results to differ materially from those expressed or implied.

## **Results of Operations**

### **Three and Nine Months Ended March 31, 2006 versus Three and Nine Months Ended March 31, 2005**

We incurred a net loss of \$439,017 for the three months ended March 31, 2006, as compared to a net loss of \$632,259 for the three months ended March 31, 2005 due to the following:

For the three months ended March 31, 2006, the Company incurred total research and development costs of \$44,474 compared to \$124,784 for the three months ended March 31, 2005. Research and development expenses have been reduced during the three months ended March 31, 2006 as a result of a decrease in the number of employees and consultants that were employed or that performed services during the quarter. Research and development expenses consist of engineering and project management salaries; consulting expenses, prototype equipment costs and travel related expenses. All expenses incurred during the research and development stage are expensed as incurred.

General and administrative costs increased approximately 48 percent, from \$275,540 for the three months ended March 31, 2005, to \$407,974 for the three months ended March 31, 2006. General and administrative costs incurred in the Sarasota, Florida and Seattle, Washington operations consist mainly of salaries, travel and professional fees related to the development of our new business opportunities.

Stock based compensation for the three months ended March 31, 2006 decreased from \$225,718 for the three months ended March 31, 2005 to \$42,344 for the three months ended March 31, 2006. The reduction is a result of not awarding as many options or common stock to compensate employees, directors and consultants in the three months ended March 31, 2006.

For the three months ended March 31, 2005, our Costa Rican operations generated revenues of \$13,519 and operating expenses of \$16,330, resulting in an operating loss of \$2,811. The Costa Rican operations were sold effective April 21, 2005.

The net loss of \$1,334,032 for the nine months ended March 31, 2006 is an increase over the prior period's net loss of \$1,808,924 for the nine months ended March 31, 2005. Overall general and administrative expenses increased



\$160,663 while stock based compensation decreased \$259,074 and research and development fees decreased \$476,696.

For the nine months ended March 31, 2006, the Company incurred total research and development costs of \$67,080 compared to \$543,776 for the nine months ended March 31, 2005. Research and development expenses consist of engineering and project management salaries; consulting expenses, prototype equipment costs and travel related expenses. All expenses incurred during the research and development stage are expensed as incurred.

General and administrative increased approximately 17 percent, from \$926,257 for the nine months ended March 31, 2005, to \$ 1,086,920 for the nine months ended March 31, 2006. General and administrative costs incurred in the Sarasota, Florida and Seattle, Washington operations consist mainly of salaries, travel and professional fees related to the development of our new business opportunities.

Stock based compensation for the nine months ended March 31, 2006 decreased 69 percent from \$373,618 for the nine months ended March 31, 2005 to \$114,545 for the nine months ended March 31, 2006.

### **Liquidity and Capital Resources**

We have current assets of \$740,019 (including \$251,302 in cash) compared with current liabilities of \$2,082,088, resulting in a working capital deficit of \$1,342,069 as of March 31, 2006. Our auditors have questioned our ability to continue as a going concern in our June 30, 2005 annual audited financial statements due to our significant operating losses incurred since inception and our working capital deficit. We rely on loans and private sales of equity to maintain liquidity. Our capital resources include private stock sales and cash advances from principal shareholders.

Our cash balance increased \$225,239 from \$26,063 at June 30, 2005 to \$251,302 as of March 31, 2006. The increase was the result of the cash proceeds from the note payable offset by negative cash flows from operations of \$1,340,220. Negative cash flows from operations consisted primarily of our \$2,053,745 net loss, offset by stock-based compensation of \$114,545 and the amortization and discount of the conversion feature of the note payable of \$798,339.

Until we establish profitable operations, our sources of liquidity will continue to be shareholder loans and common stock sales. Our internet service provider operations incurred a net loss of approximately \$2,053,745 during the nine months ended March 31, 2006 and are not expected to provide operating cash in the foreseeable future.

During the nine months ended March 31, 2006, the Company advanced \$205,000 to Digital Computer Integration Corporation, a merger candidate and a Texas corporation ("DCI") due on April 28, 2005, with 12.5% interest. At the time of the loans, DCI and the Company had executed a definitive Agreement and Plan of Merger (see Note 8: Acquisitions), and as of March 31, 2006, the Merger was terminated without consummation.

Subsequent, to March 31, 2006, DCI defaulted on the note receivable. The Company is pursuing collection of the amounts owed via the perfected collateral and through the exploration of selling or assigning the note receivable to third parties. Management believes the note, plus accrued interest, is fully collectible. However, should management determine

that it is probable that the Company will be unable to collect all amounts due; the Company will record a valuation allowance up to the entire balance of the note receivable.

The Company's future success will be dependent upon its ability to create and provide effective and competitive automatic vehicle location services and the Company's ability to develop and provide new services that meet customers changing requirements; including the effective use of leading technologies to continue to enhance its current services and to influence and respond to emerging industry standards and other technological changes on a timely and cost-effective basis. There can be no assurance that we will achieve these goals.

### **ITEM 3. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our Management, including our Principal Executive Officer and Principal Accounting Officer, we conducted an evaluation of the effectiveness of the design and operations of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the period covered by this report. Based on this evaluation, our Principal Executive Officer and Principal Accounting Officer concluded that our financial disclosure controls and procedures were not effective so as to timely identify, correct and disclose information required to be included in our Securities and Exchange Commission ("SEC") reports due to the Company's limited internal resources and lack of ability to have multiple levels of transaction review. Through the use of external consultants and the audit process, management believes that the financial statements and other information presented herewith are materially correct.

There have been no significant changes in the Company's internal control over financial reporting or, to our knowledge, in other factors that could significantly affect the Company's internal controls over financial reporting subsequent to the evaluation date.

Certification by each Director and Executive Officer has been executed.

### **PART 2. OTHER INFORMATION**

#### **Item 1 - Legal Information:**

Optigate, Inc. v. Rover Telcom, Inc., (hereafter called "Rover"). OptiGate, Inc., (hereafter "OptiGate") filed suit against Rover, a wholly owned subsidiary of the Company in the U. S. District Court for the Northern District of California, Fresno Div., CA No. 03 CE CG 03733. The claim asserts breach of contract by Rover. The amount claimed is \$150,000 for the alleged breach. Rover has counterclaimed for damages, breach and that the contract is void from inception. After suit was filed, service had and pleadings filed by both parties, OptiGate filed for Chapter 7 proceedings in the U. S. Bankruptcy Court, Middle District of California. The U. S. Trustee has opened negotiations to settle the matter by offering to accept \$100,000 and we have countered by offering \$10,000, which was subsequently rejected. Any judgment we obtain is expected to be not collectable. Management of the Company believes that the likelihood of a material adverse outcome is remote.

The company had employment agreements with Fred Anderson, Jon Fatula and Kevin Gorman. Under those agreements the company agreed to negotiate a reimbursement to

these employees certain sums allegedly owed them by StarCom Wireless, Inc., (hereafter called "StarCom"). Mr. Fatula and Mr. Gorman filed secured claims against the bankrupt estate of StarCom in the case referred to in item 1 above. Mr. Anderson did not file a civil claim despite being urged to do so. Mr. Anderson did file a claim in the Ch. 11 and Ch. 7 bankruptcy cases of StarCom.

Mr. Anderson says that some amount in excess of \$300,000 is due him and that is disputed. First he made no claim in bankruptcy for any amount. Secondly he was urged to file suit against StarCom more two years ago and declined. Thirdly his claim against SkyLynx includes salary claims on behalf of his wife who is not a party to our agreement. Fourth the amount claimed includes sales by a company owned by Mr. Anderson and allegedly not paid for by StarCom. SkyLynx did not agree to reimburse him for any of those items. Finally it appears that Mr. Anderson was being paid back salary by StarCom and AllCom, Inc., an affiliate of StarCom, but not giving any credit to SkyLynx for the amounts paid.

In all three instances negotiated amounts may be owed. No such negotiations have occurred or been requested by these employees. Therefore, only a *de minimis* amount is due on any of these matters at present. The contracts do not specify any amount and further are subject to "the final terms and conditions being negotiated between us."

On January 24, 2006, SkyLynx Communications, Inc. (the "Company"), was served with a Summons and Petition that was filed in the District Court of Dallas County, Texas, B-44<sup>th</sup> Judicial District, Cause No. 06-00451 by New

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Market Technology, Inc., as plaintiff, against the Company, Digital Computer Integration Corporation ("DCI") and other parties. The factual nexus of the claims center around transactions that occurred between DCI, the plaintiff and other parties. In December, 2005, the Company announced that it had entered into a definitive Agreement and Plan of Merger to acquire DCI. In the Petition, the plaintiff asserts numerous claims against the other defendants and the Company, including claims based upon tortious interference with contract and conspiracy. The Company has been dismissed from this case.

For the reasons enumerated above no amount should be specified. At the most a footnote of potential undetermined sums may be owed.

No other known or asserted claims against the Company exist to the knowledge of management.

## **Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds**

In August 2005, the Company issued an aggregate of 40,000 shares of common stock to employees in consideration of services. The persons receiving the securities qualified as "accredited investors" within the meaning of Rule 502(a) of Regulation D. The securities, which were taken for investment purposes and were subject to appropriate transfer restrictions and restrictive legend, were issued without registration under the Securities Act in reliance upon the exemption set forth in Section 4(2) of the Securities Act.

In December 2005, the Company issued an aggregate of 50,000 shares of common stock to a director in consideration of services. The person receiving the securities qualified as an "accredited investor" within the meaning of Rule 502(a) of Regulation D. The securities, which were taken for investment purposes and were subject to appropriate transfer restrictions and restrictive legend, were issued without registration under the Securities Act in reliance upon the exemption set forth in Section 4(2) of the Securities Act.

Also in December 2005, the Company issued an aggregate of 30,000 shares of common stock to vendor in settlement of a payable valued at \$3,000.

Finally, in December 2005, the Company issued an aggregate of 800,000 shares of common stock to a consultant in consideration of services. The person receiving the securities qualified as an "accredited investor" within the meaning of Rule 502(a) of Regulation D. The securities, which were taken for investment purposes and were subject to appropriate transfer restrictions and restrictive legend, were issued without registration under the Securities Act in reliance upon the exemption set forth in Section 4(2) of the Securities Act.

**Item 3 - Defaults upon Senior Securities:**

None.

**Item 4 - Submission of Matters to a Vote of Security Holders:**

None.

**Item 5 - Other information:**

None.

**Item 6 - Exhibits and Reports on Form 8-K**

(a) Exhibits:

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Exhibit No.

Description

31. Certification

32. Certification Pursuant to U.S.C. Section 1350

(b) Reports on Form 8-K:

On February 21, 2006, the Company filed a Current Report on Form 8-K, announcing the entry into a material definitive agreement.

On March 1, 2006, the Company filed a Current Report on Form 8-K, announcing the termination of a material definitive agreement.

On March 9, 2006, the Company filed a Current Report on Form 8-K, announcing the entry into a material definitive agreement.

On March 13, 2006, the Company filed a Current Report on Form 8-K, announcing the entry into a material definitive agreement.

On March 30, 2006, the Company filed a Current Report on Form 8-K, announcing the entry into a material definitive agreement.

On April 28, 2006, the Company filed a Current Report on Form 8-K, announcing the entry into material definitive agreements; the completion of acquisition of assets; the unregistered sale of equity securities; a change in control; the departure of directors and principal officers; the election of directors; the appointment of principal officers; and an amendment of certificate of incorporation.

### **SIGNATURES**

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

**SKYLYNX COMMUNICATIONS, INC.**

Date: May 22, 2006

By:

/s/ Gary L. Brown  
President and Acting Chief Financial Officer