ELEC COMMUNICATIONS CORP
Form 10-K
March 02, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended November 30, 2005

|_| TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________ to___________ .

Commission File No. 0-4465
eLEC COMMUNICATIONS CORP.
(Exact Name of Registrant as Specified in Its Charter)

New York	13-2511270
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S Employer Identification No.)

75 South Broadway, Suite 302, White Plains, New York	10601
(Address of Principal Executive Offices)	(Zip Code)

(914) 682-0214
(Registrant's Telephone Number, Including Area Code)

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

None

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

Common Stock, par value $.10 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes |_| No |X|

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes |_| No |X|

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 |X|

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K |_|

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer |_| Accelerated filer |_| Non-accelerated filer |X|.

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

On February 15, 2006, 16,839,282 shares of registrant's common stock were outstanding. The aggregate market value of the voting stock held by non-affiliates as of May 31, 2005 was approximately $7,520,000.

Documents Incorporated by Reference: None

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The statements contained in this Report that are not historical facts are "forward-looking statements" within the meaning of the Private Securities

Litigation Reform Act of 1995 with respect to our financial condition, results of operations and business, which can be identified by the use of forward-looking terminology, such as "estimates," "projects," "plans," "believes," "expects," "anticipates," "intends," or the negative thereof or other variations thereon, or by discussions of strategy that involve risks and uncertainties. Management wishes to caution the reader of the forward-looking statements that such statements, which are contained in this Report, reflect our current beliefs with respect to future events and involve known and unknown risks, uncertainties and other factors, including, but not limited to, economic, competitive, regulatory, technological, key employee, and general business factors affecting our operations, markets, growth, services, products, licenses and other factors discussed in our other filings with the Securities and Exchange Commission, and that these statements are only estimates or predictions. No assurances can be given regarding the achievement of future results, as actual results may differ materially as a result of risks facing us, and actual events may differ from the assumptions underlying the statements that have been made regarding anticipated events. Factors that may cause our actual results, performance or achievements, or industry results, to differ materially from those contemplated by such forward-looking statements include, without limitation:

- The availability of additional funds to successfully pursue our business plan;
- 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 highly competitive nature of our industry;
- The acceptance of VoIP technology by mainstream consumers;
- Our ability to retain key personnel;
- Our ability to maintain adequate customer care and manage our churn rate;
- The cooperation of incumbent carriers and industry service partners that have signed agreements with us;
- Our ability to maintain, attract and integrate internal management, technical information and management information systems;
- 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 availability and maintenance of suitable vendor relationships, in a timely manner, at reasonable cost;
- Our ability to manage rapid growth while maintaining adequate controls and procedures;
- The decrease in telecommunications prices to consumers; and
- General economic conditions.

These forward-looking statements are subject to numerous assumptions, risks and uncertainties that may cause our actual results to be materially different from any future results expressed or implied by us in those statements. Some of these risks are described in "Risk Factors" in Item 1A of this Report.

These risk factors should be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue. All written and oral forward looking statements made in connection with this Report that are attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Given these uncertainties, we

caution investors not to unduly rely on our forward-looking statements. We do not undertake any obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events. Further, the information about our intentions contained in this document is a statement of our intention as of the date of this document and is based upon, among other things, the existing regulatory environment, industry conditions, market conditions and prices, the economy in general and our assumptions as of such date. We may change our intentions, at any time and without notice, based upon any changes in such factors, in our assumptions or otherwise.

PART I

In this Annual Report on Form 10-K, we will refer to eLEC Communications Corp., a New York corporation, as "our company," "we," "us," and "our."

Item 1. - Business

Overview

We are a provider of local and long distance voice telephone services and integrated Voice over Internet Protocol ("VoIP") telephony services. Internet Protocol ("IP") telephony is the real time transmission of voice communications in the form of digitized "packets" of information over the Internet or a private network, which is analogous to the way in which e-mail and other data is transmitted. We use proprietary softswitch technology that runs on Cisco and Dell hardware to provide wholesale telephony services to other service providers and directly to retail consumers. Our technology enables telecom service providers, cable operators, wireless carriers, Internet service providers, resellers or any company seeking to offer premier packet communications services the ability to provide a feature-rich VoIP service offering.

The anticipated rollout of worldwide VoIP services is expected to allow consumers and businesses to communicate at dramatically reduced costs in comparison to traditional telephony networks. Traditionally, telephony carriers have built networks based on circuit switching technology, which creates and maintains a dedicated path for individual telephone calls until the call is terminated. While circuit-switched networks have provided reliable voice communications services for more than 100 years, transmission capacity is not efficiently utilized in a circuit-switched system. Under circuit-switching technology, when a person makes a telephone call, a circuit is created and remains dedicated for the entire duration of that call, rendering the circuit unavailable for the transmission of any other calls. Because of the high cost and inefficiencies of a circuit-switched network, we have leased circuit-switched network elements from other carriers in order to provide wireline services to customers.

Data networks, such as IP networks, utilize packet switching technology that divides signals into packets and simultaneously routes them over different channels to a final destination where they are reassembled into the original order in which they were transmitted. No dedicated circuits are required and a fixed amount of bandwidth is not needed for the duration of each call. The more efficient use of network capacity results in the ability to transmit significantly higher amounts of traffic over a packet-switched network than a circuit-switched network. Packet-switching technology enables service providers to converge traditional voice and data networks in an efficient manner by carrying voice, fax, video and data traffic over the same network. IP networks are therefore less expensive for carriers to operate, and these cost savings can be passed on to the consumer in the form of lower costs for local, long distance and international long distance telephone services.

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Because of the network cost savings that are inherent in an IP network, we have created our own proprietary IP platform and have transitioned into a facilities-based VoIP service provider. In addition to the cost savings we obtain from the efficient use of network capacity, we believe our network equipment costs are lower than most other carriers as our network and technology require significantly less capital expenditures than a traditional Class 5 telecom switch in a circuit-switched network, and less equipment costs than our VoIP competitors that utilize a packet-switched network. Our proprietary softswitch, however, provides more than 20 of the Class 5 call features, voice mail and enhanced call handling on our own Session Initiation Protocol ("SIP") server suite. Our VoIP features are controlled by us instead of a software vendor, as we write the code for any new features that we desire to offer our customers. We have no software licensing fees and our other variable network costs are expected to drop as we increase our network traffic and as we attract more pure VoIP users with traffic that does not incur the cost of originating or terminating on a circuit switched network.

Our SIP servers are part of a cluster of servers, which we refer to as a server farm, in which each server performs different network tasks, including back-up and redundant services. We believe the server farm structure can be easily and cost-effectively scaled as our VoIP business grows. In addition, servers within our server farm can be assigned different tasks as demand on the network dictates. If an individual server ceases to function, our server farm is designed in a manner that subscribers should not have a call interrupted. We support origination and termination using both the G.711 and G.729 voice codecs. Codecs are the algorithms that enable us to carry analog voice traffic over digital lines. There are several codecs that vary in complexity, bandwidth required and voice quality. We primarily use G.711 and G.729 codecs. G.711 is a standard to represent 8 bit compressed pulse code modulation samples for signals of voice frequency. It creates a 64 kilobit per second bitstream, and we find that approximately 90% of the current VoIP traffic in the United States uses G.711. We frequently process G.711 VoIP traffic because some of our wholesale customers do not have the ability to handle G.729. We prefer the G.729 codec, which allows us to utilize VoIP in more cost effective ways. It allows for compressing more calls in limited bandwidth, reducing the call to 8 kilobits per second. For all of our retail customers and our more sophisticated wholesale accounts, we use G.729 to save cost and enhance the quality of the call.

Some VoIP carriers use only G.711 compression under the theory that when more bandwidth is used, the voice quality is normally better. We find, however, that our G.729 VoIP traffic provides a higher quality voice conversation than the G.711 processed by other VoIP carriers because when we utilize only 8 kilobits per second of bandwidth, fewer packets are lost. Under G.711, with the wider bitstream, the packets are more susceptible to dropping off and not reaching their intended destination, resulting in sound jitter or periods of silence during a telephone call. In addition to the high quality of our G.729 product, it requires only one-eighth the bandwidth of G.711 to bring customer traffic into and out of our switch, further reducing our costs of providing VoIP service. Similarly, using G.729 compression, we offer a bandwidth cost savings to our customers. A small office that uses six of our VoIP lines is able to support the data and telephony needs of the office with only one standard residential high-speed Internet connection with a 384 kilobits per second upstream speed. This customer would need to buy significantly more bandwidth if the VoIP lines were utilizing G.711 compression. With the quality and cost advantages of G.729, we anticipate G.729 will become increasingly utilized by VoIP carriers.

Development of Business

We were incorporated in the State of New York under the name Sirco Products Co. Inc. in 1964 and developed a line of high quality handbags, totes, luggage and sport bags. Between 1995 and 1999, we divested our handbag and luggage operations, which had experienced several years of operating losses.

We commenced operations in the telecommunications industry in fiscal 1998 by acquiring Essex Communications, Inc. ("Essex"), a newly-formed Competitive Local Exchange Carrier ("CLEC") formed to attract and retain a geographically concentrated customer base in the metropolitan New York region, primarily through the resale of products and services of incumbent and alternative facilities-based local providers.

In January 2000, we acquired Telecarrier Services, Inc. ("TSI"), a CLEC that operated in the states of Massachusetts, New Jersey, New York and Rhode Island and provided long distance service in 13 states. Most of TSI's operations were acquired by Essex after the acquisition was complete, and TSI maintained its licenses as an inactive subsidiary. On July 29, 2002, TSI commenced a case under chapter 11 of the Bankruptcy Code. In February 2004, TSI filed a plan of reorganization pursuant to which the capital stock of a reorganized TSI would be sold by competitive bid and the proceeds from the sale of such stock would be used to make distributions to creditors of TSI. In April 2004, the court accepted our plan to purchase all the stock of a reorganized TSI for a price of $325,000. The purchase of TSI and its emergence from bankruptcy was completed in October 2004.

On December 31, 2002, we sold certain assets of Essex to Essex Acquisition Corp. ("EAC"), a wholly-owned subsidiary of BiznessOnline.com, Inc. ("Biz"). EAC purchased selected assets and assumed certain liabilities in conjunction with this transaction. The remaining shell of Essex was sold to Glad Holdings, LLC on September 11, 2003. As a result of such sale, we recorded a gain of approximately $7,314,000 in the fourth quarter of fiscal 2003.

In November 2002, we began the operations of New Rochelle Telephone Corp. ("NRTC") as a start-up CLEC. We have since been able to rebuild a customer base in NRTC similar to the one we had sold to EAC.

On August 4, 2004, we incorporated VoX Communications Corp. ("VoX") as our wholly-owned VoIP subsidiary to pursue the deployment of our own VoIP network. In addition to the general cost advantages of VoIP service noted above, the market research firm of In-Stat has estimated that VoIP communications services will grow to 55 million VoIP subscribers worldwide generating over $17 billion in annual revenue by 2009. We believe that IP communications technologies will continue to rapidly advance and will further the potential for the Internet to become the preferred medium of communications and commerce. Consequently, in fiscal 2005 we expended a vast amount of our resources on the planning, development and implementation of our VoIP network. In February 2006, we successfully relaunched our web site (www.voxcorp.net), which supports the wholesale and retail sales of our VoIP services, which enable local, national and international calling. We also completed the implementation of 911 emergency services for every VoIP line that we sell. In February 2006, our VoIP network processed approximately 500,000 minutes of voice traffic, whereas our wireline business carried approximately 17 million minutes of traffic.

Available Information

We maintain a corporate website with the address www.elec.net. We have not incorporated by reference into this Report on Form 10-K the information on any of our websites and you should not

consider any of such information to be a part of this document. Our website addresses are included in this document for reference only. We make available free of charge through our corporate website our Annual Reports on Form 10-K or 10-KSB, Quarterly Reports on Form 10-Q or Form 10-QSB and Current Reports on Form 8-K, and amendments to these reports, through a link to the EDGAR database, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission.

Our Products and Services

Our service offerings are tailored to meet the specific needs of both wholesale and retail customers. As a facilities-based VoIP carrier, we market to wholesale accounts that have an existing customer base of residential and small business users. We provide a compelling product offering to CLECs, Internet Service Providers ("ISPs"), cable providers, affinity groups and others. Our IP based services include:

- Rapid market entry in U.S. and eventually worldwide
- High-quality, reliable voice services
- Disruptive technology
- Free use of our softswitch and application servers
- Low priced services
- Flexibility to change platform to needs of individual carrier
- Customer service web site
- End user web site
- Automatic sign-up on the Internet

Our wholesale customers are able to buy our VoIP services and quickly roll out a private-labeled solution to their customers. We have identified approximately 1,100 independent cable companies that do not have a VoIP solution. Many of these companies are already providing high-speed Internet access to their customers. We believe upselling VoIP services to their Internet subscribers is a natural fit. Under our private label program, we give each wholesaler its own customer support web site that is branded with the wholesaler's own logo so the wholesaler's customers will view the wholesaler as the VoIP service provider. Our product empowers our wholesale customers to sell VoIP services rapidly and inexpensively, without risking their own capital on expensive switches and custom IP software. We anticipate significant growth in our wholesale business in fiscal 2006, as we have signed wholesale service agreements with several carriers, some of which have the resources to obtain more than 100,000 VoIP customers. One reason we have focused much of our resources on building a robust wholesale platform is that we believe the rapid growth of wholesale VoIP revenue will not require significant amounts of our cash. Our wholesale customers will incur the customer acquisition cost of signing up a new subscriber, the cost of an integrated access device or IP telephone and the cost of providing customer service. As these accounts scale, we will incur additional network costs and technical support costs, but in our business model, the projected cash outlay for these costs will be offset by the additional revenue received from our increased billings to wholesale customers. We also project that the cash collected from

revenue growth will be sufficient to allow us to expand our network equipment to support such growth due to the low facilities cost that we incur per subscriber.

Our retail customers consist of small businesses and residential users. These customers buy our VoIP services, our landline services or both. Our VoIP services are available nationwide, while our landline services are limited to the states of New Jersey, New York and Pennsylvania. We primarily market our services through two distribution channels. We use third-party telemarketers to attract small business and residential accounts (typically less than three telephone lines for each account), and we use agents and direct marketing to attract small business and residential accounts (typically one to 10 lines in size for each account). To further help our customers manage their phone service, and to differentiate ourselves from other service providers, we provide a secure customer web site with the tools to help our customers to manage their accounts. These tools include the following:

- o Billing management: we provide customers with Web-based access to billing records, invoices, payment history and individual call records;

- o Payment processing: we provide customers with the ability to process or change secure credit card information over the Web to make payments to us;

- o Account provisioning: we provide customers with Web pages through which they can order new services, new phone numbers, including virtual numbers, and advanced features;

- o Customer care: we provide customers with first tier customer care to explain how to use features, to perform simple diagnostic checks and repairs and to contact us via email.

The pricing and robust nature of our feature packages also help to differentiate us from our competitors. For landline customers, we offer the same calling features offered by the Incumbent Local Exchange Carrier ("ILEC") from which we are buying and reselling services, but we charge less for each of the features. We also bundle certain key features, such as Caller ID and Call Waiting, in an unlimited monthly calling plan. For our VoIP customers, we offer differentiating features, such as fax lines and toll free numbers. The following features are offered to our VoIP customer, at no extra charge:

- o 911 Dialing

- Voicemail
- Caller ID
- Call Waiting
- Call Forwarding
- Three Way Calling
- Free In-Network Calls
- Call Return
- Caller ID Block
- International Call Blocking
- Directory Assistance Blocking
- Do Not Disturb
- Speed Dial
- Online Account Management

For an additional competitive charge, our VoIP customers can receive additional premium features, such as:

- 411 Directory Assistance

- Virtual numbers
- Local number portability

Our Network

We operate a sophisticated VoIP network to deliver our VoIP services. We carefully monitor the network as it automatically minimizes the route taken by packets carrying a voice conversation, and self-regulates traffic volumes to directly control the quality of service from the origination to the termination of a call. Calls are connected on our network with minimal post dial delay and our G.729 compression yields virtually no jitter. When compared to other VoIP carriers, or wireline connections, we deliver a high quality call. Our softswitch utilizes advanced SIP infrastructure on a cluster of SIP servers and has the ability to scale at a low cost. The collective thought process of our SIP servers makes us unique, as they are capable of "thinking" about what they are doing and will perform self-healing functions when necessary to ensure a call is not dropped. Unlike many of our competitors, we do not rely on Microsoft to power our softswitch. By using our own open-source software platform, we have been able to create a neurological network and to avoid the delays of waiting for software upgrades from Microsoft and the problems associated with having too much reliance on one vendor in order to run our network.

We consider VoIP to be an application on an IP transport. Our network does not use the mainframe technology approach that Sonus Networks, Inc. or BroadSoft, Inc. promotes. Instead, we have a fully scalable, redundant, power-backed stable platform with a server farm that contains no specifically designed telecom equipment. By not relying on the telecom equipment and related software of the larger equipment vendors, we are able to own and control our own proprietary source code and to scale without the limitations of delays, equipment financing, installation and integration and source code updates that equipment vendors impose on the VoIP carriers. Our approach is very similar to the server cluster type of approach that has provided Google, Inc. substantial computing resources at a low cost.

Business Strategy

Our objective is to build a profitable telephone company on a stable and scalable platform with minimal network costs. We want to be known for our high quality of service, robust features and ability to deliver any new product to a wholesale customer or a web store without delay. We believe that to achieve our objective we need to have "cradle to grave" automation of our back-office web and billing systems. We have written our software for maximum automation, flexibility and changeability.

We know from experience in provisioning complex telecom orders that back-office automation is a key factor in keeping overhead costs low. Technology continues to work for 24 hours a day and we believe that the fewer people a company has in the back office, the more efficiently it can run, which should drive down the cost per order.

When an order is entered into our web based order entry system more than 50 database tables are populated. No extra back-office employees are needed to guide the order though our systems. Some of the high-level, completely automated steps that occur when a customer enters an order are as follows:

o Telephone number is assigned if in stock, or ordered if not in stock

o Customer's credit card is charged

o E911 address is formatted and sent to the Automatic Location Identification database

o The configuration file for an integrated access device ("IAD") is sent to the provisioning server

o The web portal database is populated so the subscriber can view his account

o Provisioning status emails are generated and sent to the subscriber

o The appropriate entries are made into the billing system for the chosen plan

o Federal Express is contacted and a shipping label is printed to ship the IAD

o A welcome letter is generated

Given our current level of automation, we believe we can handle between 500 and 1,000 orders a day. The order processing and auto-provisioning of the IAD into the back office provisioning system and billing systems is seamless and integrated and is designed to handle a single order entered on our web site or many thousands of orders flowing through an Extensible Markup Language, or XML, bulk entry portal.

A very complex part of the web process that we created with our own software is the ability to deliver a new product into the web provisioning systems without any software code additions or changes. The products, provisioning and interface to the back-office and billing systems have been "soft coded," which means they are data driven. We can simply key new parameters pertaining to a particular product into our database, and a new product is automatically created and available for purchase in the web store. We also have the ability to load a variable set of products in the web store depending on a specific sales campaign or agent.

Our automation strategy and soft code approach is further leveraged for our wholesale customers. We are able to set up a new wholesale account with a custom web store, logo, terms and conditions, privacy policy, products and anything else the wholesaler requires with no additional code being developed. Everything is uploadable or configurable so that we can scale.

We believe our "cradle to grave" automation strategy in a wholesale environment, in which we are able to sell our VoIP services to other carriers, such as cable companies, CLECs and Internet service providers, will be an important factor that differentiates us from other VoIP service providers. Many VoIP service providers are primarily selling a retail product and are incurring substantial customer acquisition costs in order to grow their subscriber base. These companies have access to significantly more capital than we have and are generating large operating losses because of the rapid growth rate they have achieved. Other VoIP service providers have a wholesale offering, but have not been able to implement a satisfactory billing platform or E911 functionality. Many of these carriers do not have the ability to implement custom programs on a zero code basis, and some do not even own their own code and are dependent upon a vendor to provide them with quarterly or semi-annual upgrades so they can keep up with the new products being offered in the industry. We believe these wholesale competitors will not have the same success in scaling their business as we plan to experience.

Furthermore, our strategy is to grow rapidly by leveraging the capital, customer base and marketing strength of our wholesale customers. Many of our targeted wholesale customers and some of our existing wholesale customers have ample capital to market a private-labeled VoIP product to their existing customer base or to new customers. We believe our strength is our technology-based platform. By providing our technology to cable companies, CLECs, Internet service providers, agents, affinity groups and any other entity that desires to offer a VoIP telephony product, we believe we will require significantly less cash resources than other VoIP providers will require to attract a similar number of subscribers.

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Sales and Marketing

In establishing our VoIP business, we initially do not plan to compete on price. We believe we have a stable, high-quality, feature-rich service so as to allow us to distinguish ourselves from lower-priced VoIP alternatives. Furthermore, a VoIP line offers substantial savings to any customer that is switching from a circuit-switched line. In addition to enjoying an unlimited local and national calling plan for approximately $20 less per month than the cost of Plain Old Telephone Service ("POTS") provided by an ILEC or CLEC, the VoIP consumer also can save approximately $10 a month in telecom taxes, as VoIP generally is considered data communications and is subject to substantially fewer taxes than a POTS line. If we need to lower our prices in the future to capture market share, we believe that option will be available to us.

We are taking the following actions to grow our VoIP business:

- Market VoIP Services to ILEC Customers. We have years of experience selling POTS lines one at a time. Similarly, we plan to sell VoIP lines one at a time to residential consumers, as there are many advantages in both speed and simplicity when we only have to provision one or two lines per location. We have instituted an outbound call program to sell to new customers, and a Google ad campaign to attract Internet users. We also are exploring direct response to an inbound call center.

- Offer VoIP on a Wholesale Basis. We believe our VoIP platform is scalable and stable. We designed and built our platform with the intention of carrying more than one million customers. We are allowing other entities that want to offer VoIP to an existing customer base access to our platform on a wholesale basis. An independent cable company, for example, may not have the technological expertise to build its own VoIP platform, or may realize that any efforts to do so would take more than a year to accomplish. We plan to continue to attract wholesale accounts by offering our platform on a private-label basis.

- Utilize our Technological Expertise in VoIP to Add New Products. We have developed a robust IP platform that we intend to use to develop further product enhancements. By adding new features and technologically innovative products, we believe we can continue to attract new customers and provide additional incentives for current customers to continue using our services. We currently support WiFi phones and have approximately 100 WiFi phones users on our network.

Competition

The communications industry is highly competitive and the market for enhanced Internet and IP communications services is new and rapidly evolving. We believe the primary competitive factors that will determine our success in the Internet and IP communications market are:

- Quality of service
- Responsive customer care services
- Ability to provide customers with a telephone number in their local calling area
- Pricing levels and policies

- Ability to provide 911 service
- Bundled service offerings
- Innovative features
- Ease of use
- Accurate billing
- Brand recognition
- Quality of IAD supported by us and used by our customer

Future competition could come from a variety of companies, both in the Internet and telecommunications industries. This includes major companies that have been in operation for many years and have greater resources and larger subscriber bases than we have, as well as companies operating in the growing market of discount telecommunications services, including calling cards and prepaid cards. In addition, some Internet service providers have begun to aggressively enhance their real time interactive communications, and are focusing initially on instant messaging, with the intent to progress toward providing PC-to-Phone services and VoIP services.

We anticipate that competition will also come from several traditional telecommunications companies, including industry leaders, such as AT&T Inc., Sprint Nextel Corporation, Deutsche Telekom AG, WorldCom Inc. and Qwest Communications International, Inc.,as well as established broadband services providers, such as Time Warner Inc., Comcast Corporation, and Cablevision Inc. These companies have all announced their intention to offer enhanced Internet and IP communications services in both the United States and internationally. All of these competitors are significantly larger than we are and have:

- substantially greater financial, technical and marketing resources;
- stronger name recognition and customer loyalty;
- well-established relationships with many of our target customers;
- larger networks; and
- large existing user base to cross sell new services.

These and other competitors may be able to bundle services and products that are not offered by us together with enhanced Internet and IP communications services, which could place us at a significant competitive disadvantage. Many of our competitors enjoy economies of scale that can result in lower cost structure for transmission and related costs, which could cause significant pricing pressures within the industry.

Government Regulation

United States regulatory environment

We believe that, under United States law, based on specific regulatory classifications and recent regulatory decisions, VoIP communications services will continue to constitute information services (as opposed to regulated telecommunications services). Therefore, such services are not currently regulated by the state public service agencies charged with regulating telecommunications carriers. Nevertheless, aspects of the VoIP services that we are providing are subject to regulation by the Federal Communications Commission ("FCC,") and there may be some

regulatory movement toward having VoIP providers collect and remit certain taxes that telecom providers currently collect and remit. We cannot assure you that such services will not be regulated in the future. Several efforts have been made or are currently being considered in the United States to enact federal legislation that would either regulate or exempt from regulation communications services provided over the Internet.

In addition, the FCC is currently considering reforms to universal service funding and may consider whether to impose various types of charges, other common carrier regulations and/or additional operational burdens upon some providers of Internet and IP telephony. On May 19, 2005, the FCC gave Internet phone companies four months to provide 911 service to their customers and ordered incumbent carriers to make emergency networks accessible to VoIP providers. The four-month period began from date of publication of the FCC's order in the federal register in July 2005. We were unable to meet this time frame and applied for a six-month waiver. We now are able to offer 911 service to our customers. The FCC also is considering reforms to law-enforcement agency regulations and may consider imposing various types of charges, other common carrier regulations and/or additional operational burdens upon some providers of Internet and IP telephony. The FCC has stated that the development of new technologies, such as IP telephony, may increase the strain on universal service funding and emergency services provisioning and hinder law enforcement agencies activities. In that regard, the FCC is currently reviewing whether to extend universal service, emergency services provisioning and/or law-enforcement agency assistance obligations to non-traditional providers, such as facilities-based and non-facilities-based providers of VoIP services.

Several carriers have asked the FCC to make definitive rulings regarding the classification of their IP telephony services. In response to one of those requests, the FCC determined that a particular free, peer-to-peer IP application is an interstate information service. The FCC's ruling applies only to that particular application and does not affect the regulatory classification of the services we offer. The FCC also has determined that IP-enabled services with certain characteristics are interstate services subject to federal jurisdiction, rather than state regulation. We cannot predict, however, that services we will make available to certain purchasers of our phones would be found by the FCC to meet the characteristics established by the FCC. In addition, the FCC has initiated a generic proceeding to investigate the legal and regulatory framework for all IP-enabled services, including IP telephony services. Thus, the regulatory classification issue is now before the FCC. Any ruling by the FCC on the regulatory considerations affecting Internet and IP telephony services will affect our operations and revenues.

If the FCC were to determine that certain services are subject to FCC regulations as telecommunications services, the FCC might require providers of Internet and IP telephony services to be subject to traditional common carrier regulation, make universal service contributions, implement new hardware and/or software to aid emergency services response and aid law enforcement agencies and/or pay access charges. It is also possible that the FCC may adopt a regulatory framework other than traditional common carrier regulation, which would apply to Internet and IP telephony providers. Despite the FCC's actions, state regulatory authorities may also retain jurisdiction to regulate the provision of, and impose charges on, intrastate Internet and IP telephony services. Several state regulatory authorities have initiated proceedings to examine the regulation of such. Many, but not all, of the states that have looked at the regulation of IP telephony services have deferred consideration of the issue pending the outcome of the FCC's proceedings.

International regulatory environment

The regulatory treatment of Internet and IP telephony outside of the United States varies widely from country to country. A number of countries that currently prohibit competition in the provision of voice telephony may also prohibit IP telephony. Other countries permit, but regulate, IP telephony. Some countries will evaluate proposed IP telephony service on a case-by-case basis and determine whether it should be regulated as a voice service or as another telecommunications service. Finally, in many countries IP telephony has not yet been addressed by legislation or regulatory action.

In 2003, the European Commission adopted directives for a new framework for electronic communications regulation that, in part, attempt to harmonize the regulations that apply to services regardless of the technology used by the provider. Under the New Regulatory Framework, there is no distinction in regulation made based upon technology between switched or packet-based networks. As a result, some types of IP telephony services may be regulated like traditional telephony services while others may remain free from regulation. The European Commission currently is reviewing how IP telephony services fit into the New Regulatory Framework. Although it has been suggested that a "light touch" to regulation be taken, we cannot predict what future actions the European Commission and courts reviewing the New Regulatory Framework may take regarding IP telephony and related matters, or what impact, if any, such actions may have on our business.

Employees

As of February 15, 2006, we employed 42 employees, of whom 39 were employed on a full-time basis and three were employed on a part-time basis. We are not subject to any collective bargaining agreement and we believe our relationship with our employees is good.

Item 1A. Risk Factors

Risks Relating to Our Business

We have incurred losses since inception of our telephone business and we may be unable to achieve profitability or generate positive cash flow.

We have not generated operating profits since fiscal 1996. While we reported net income of $170,253 and $8,323,211 in fiscal 2004 and 2003, respectively, we reported losses from our telecommunications operations. Furthermore, in fiscal 2005, we reported losses of approximately $2,266,000. In fiscal 2004, net income of $170,253 resulted primarily from the gain of approximately $743,000 resulting from a settlement with creditors in the bankruptcy proceedings of a subsidiary. In fiscal 2003, net income of $8,323,211 resulted primarily from the gain on the disposition of a subsidiary and the disposition of property of approximately $11,306,000. In fiscal 2005, fiscal 2004 and fiscal 2003, we generated operating losses of approximately ($2,402,000), ($642,000) and ($2,948,000), respectively, from our telecommunications operations. We expect to continue to incur operating losses until we develop our telecommunications operations to a level at which it generates sufficient revenues to cover operating expenses.

We have an unproven business model and can give no assurance that our business model and strategy will be successful.

Our business strategy is unproven and we do not know whether our business model and strategy will be successful. We intend to sell wholesale and retail VoIP services to residential consumers and small businesses and de-emphasize the wireline business that we have utilized for the majority of our revenues since fiscal 2000. We have developed our own proprietary IP platform and for the first time in our operating history, we are a facilities-based carrier. We believe our network is robust and efficient, but it has not carried the hundreds of millions of minutes that we anticipate will eventually use our network. Our inability to scale our VoIP network and execute effectively as a VoIP provider, if that occurs, would significantly diminish our ability to generate sufficient VoIP revenue to achieve profitability.

We have a need for additional financing.

Due to our recent operating losses and our additional requirements for working capital to establish and grow our business, over the past several months we have sold debt and additional shares of capital stock to fund our working capital needs. We expect that we will continue to sell our capital stock, incur additional indebtedness or sell other assets we currently own to fund the anticipated growth of our telecommunications business and implement our business objectives. There can be no assurance that we will be able to obtain additional funding when needed, or that such funding, if available, will be available on terms we find acceptable. If we cannot obtain additional funds when needed, we may be forced to curtail or cease our activities, which may result in the loss of all or a substantial portion of your investment.

We depend on incumbent carriers as a key component for our business.

To limit our capital expenditures and support staff, we rely extensively on third parties. We lease our local exchange network and our long distance network. As a result, we depend entirely on incumbent carriers for the transmission of customer telephone calls for our CLEC subsidiaries. The risk factors inherent in this approach include, but are not limited to, the following:

- the inability to negotiate and renew favorable wholesale agreements;
- lack of timeliness of the ILEC in processing our orders for customers seeking to utilize our services;
- dependence on the effectiveness of internal and external telemarketing services to attract new customers;
- dependence on third-party contractors to install necessary equipment and wiring at our customers facilities; and
- dependence on a facilities-based carrier to provide our customers with repair services and new installation services.

We depend on a third-party billing system to bill our customers.

The accurate and prompt billing of our customers is essential to our operations and future profitability. We utilize a third-party system for billing, tracking and customer service. Our former Chairman, who also owns stock in our company, is the Chairman and CEO of our billing company, and we believe all transactions with this company are at arms-length. The system is designed to provide us with a high degree of flexibility to handle custom rate plans that provide consumers discounts from the incumbent local carriers' rate plans or bundled plans that include various features and long distance services. Although we believe the system is very functional, it is currently set up to support approximately 500,000 local lines in six states, and its ability to handle substantially more customers is not fully tested. In addition, the billing company we utilize competes with us as a CLEC and may terminate its billing services at any time. Furthermore, in the most recent audited financial statements of the billing company we utilize, the report of the independent public accountants expressed substantial doubt about its ability to continue as a going concern. This strategy exposes us to various risks that include, but are not limited to, the following:

- the inability to adapt the billing system to process the number of customers we are targeting in our marketing plans;

- the failure of the system to provide all of the billing services that we require;

- the possibility that we may want to provide services in a state that our billing company has difficulty rating calls and processing data for us; and

- the possibility that we may need to quickly engage a new billing company to process our invoices to our customers, and devote a large amount of internal res ources at one time to work on this transition.

Our business is dependent upon our ability to resell long distance services, for which we currently rely on only one third-party carrier.

We offer long distance telephone services as part of our service package. We currently have a wholesale agreement with only one long distance carrier to provide transmission and termination services for all of our long distance traffic. Recently, several long distance carriers have encountered financial difficulties, including the carrier utilized by us. Financial difficulties encountered by our current carrier or any other carrier with which we are negotiating could cause disruption to our operations and loss of customers and revenues.

We could be liable for breaches of security on our web site, fraudulent activities of our users, or the failure of third-party vendors to deliver credit card transaction processing services.

A fundamental requirement for operating a customer-friendly CLEC and an internet-based, worldwide voice service is the secure transmission of confidential information over public networks. Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches, failure to mitigate such fraud or breaches may adversely affect our operating results. The law relating to the liability of providers of online payment services is currently unsettled. We rely on third party providers to process and guarantee payments made by our customers up to certain limits, and we may be unable to prevent our users from fraudulently receiving goods and services. Any costs we incur as a result of fraudulent transactions could harm our business. In addition, the functionality of our current billing system relies on certain third-party vendors delivering services. If these vendors are unable or unwilling to provide services, we will not be able to charge for our services in a timely or scalable fashion.

We may face difficulties managing our anticipated rapid expansion.

We are attempting to grow our business rapidly in terms of the number of services we offer, the number of customers we serve and the regions we serve. In particular, we are expending substantial sums to expand our VoIP initiative. There can be no assurance that our marketing initiatives will proceed as expected or that they will be successful, particularly in light of the legal and regulatory and competitive

uncertainties described elsewhere in this report. Furthermore, there is no assurance that we will successfully manage our efforts to:

- o expand, train, manage and retain our employee base;
- o expand and improve our customer service and support systems;
- o introduce and market new VoIP products and services and new pricing plans;
- o capitalize on new opportunities in the competitive marketplace; or
- o control our expenses.

The strains posed by these new demands are magnified by the emerging nature of our operations. If we cannot manage our growth effectively, our results of operations could be adversely affected.

The failure of our customers to pay their bills on a timely basis could adversely affect our cash flow.

Our target customers consist of residences and small businesses. We anticipate having to bill and collect numerous relatively small customer accounts. We may experience difficulty in collecting amounts due on a timely basis. We have experienced difficulty with residential wireline accounts in the past and have incurred significant bad debt write offs. Our failure to collect accounts receivable owed to us by our residential wireline or wholesale VoIP customers on a timely basis could have a material adverse effect on our business, financial condition, results of operations and cash flow.

Acquisitions could divert management's time and attention, dilute the voting power of existing shareholders and have a material adverse effect on our business.

As part of our growth strategy, we may continue to acquire complementary businesses and assets. Acquisitions that we may make in the future could result in the diversion of time and personnel from our business. We also may issue shares of common stock or other securities in connection with acquisitions, which could result in the dilution of the voting power of existing shareholders and could dilute earnings per share. Any acquisitions would be accompanied by other risks commonly encountered in such transactions, including the following:

- o difficulties integrating the operations and personnel of acquired companies;
- o the additional financial resources required to fund the operations of acquired companies;
- o the potential disruption of our business;
- o our ability to maximize our financial and strategic position by the incorporation of acquired technology or businesses with our product and service offerings;

- the difficulty of maintaining uniform standards, controls, procedures and policies;

- the potential loss of key employees of acquired companies;

- the impairment of employee and customer relationships as a result of changes in management; and

- significant expenditures to consummate acquisitions.

As a part of our acquisition strategy, we may engage in discussions with various businesses respecting their potential acquisition. In connection with these discussions, we and each potential acquired business may exchange confidential operational and financial information, conduct due diligence inquiries, and consider the structure, terms and conditions of the potential acquisition. In certain cases, the prospective acquired business may agree not to discuss a potential acquisition with any other party for a specific period of time, may grant us certain rights in the event the acquisition is not completed, and may agree to take other actions designed to enhance the possibility of the acquisition. Potential acquisition discussions may take place over a long period of time, may involve difficult business integration and other issues, and may require solutions for numerous family relationship, management succession and related matters. As a result of these and other factors, potential acquisitions that from time to time appear likely to occur may not result in binding legal agreements and may not be consummated. Our acquisition agreements may contain purchase price adjustments, rights of set-off and other remedies in the event that certain unforeseen liabilities or issues arise in connection with an acquisition. These remedies, however, may not be sufficient to compensate us in the event that any unforeseen liabilities or other issues arise.

We need to retain key management personnel and hire additional qualified personnel. We are dependent on the efforts of our executive officers and senior management and on our ability to hire and retain qualified management personnel.

A small number of key management and operating employees and consultants manage our telecommunications business. Our loss of such employees or consultants or their failure to work effectively as a team could materially adversely impact our telecommunications business. Competition for qualified executives in the telecommunications and data communication industries is intense and there are a limited number of persons with applicable experience. We believe that our future success in the telecommunications business significantly depends on our ability to attract and retain highly skilled and qualified telecommunications personnel. We have not entered into employment agreements with any of our senior officers. The loss of any of Paul H. Riss, our Chief Executive Officer, Michael Khalilian, our Chief Technology Officer, or Mark Richards, our Chief Information Officer and the President of our Vox Communications subsidiary, could adversely affect our business.

We may be unable to adapt to rapid technology trends and evolving industry standards.

The communications industry is subject to rapid and significant changes due to technology innovation, evolving industry standards, and frequent new service and product introductions. New services and products based on new technologies or new industry standards expose us to risks of technical or product obsolescence. We will need to use technologies effectively, continue to develop our technical expertise and enhance our existing products and services in a timely manner to compete successfully in this industry. We may not be successful in using new technologies effectively, developing new products or enhancing existing products and services in a timely manner or that any new technologies or enhancements used by us or offered to our customers will achieve market acceptance.

The telecommunications industry is highly regulated and amendments to or repeals of existing regulations or the adoption of new regulations could adversely affect our business, financial condition or results of operations.

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Federal, state and local regulation may affect our telecommunications business. Since regulation of the telecommunications industry is frequently changing, we cannot predict whether, when and to what extent new regulations will affect us. The following factors, among others, may adversely affect our business, financial condition and results of operations:

- delays in obtaining required regulatory approvals;
- new court decisions;
- the enactment of new adverse regulations; and
- the establishment of strict regulatory requirements.

The communications services industry is highly competitive and we may be unable to compete effectively.

The communications industry, including Internet and data services, is highly competitive, rapidly evolving and subject to constant technological change and intense marketing by providers with similar products and services. We expect that new competitors are likely to join existing competitors in the communications industry, including the market for VoIP, Internet and data services. Many of our current competitors are significantly larger and have substantially greater market presence, as well as greater financial, technical, operational, marketing and other resources and experience, than we do. In the event that such a competitor expends significant sales and marketing resources in one or several markets, we may not be able to compete successfully in such markets. We believe that competition will continue to increase, placing downward pressure on prices. Such pressure could adversely affect our gross margins if we are not able to reduce our costs commensurate with such price reductions. In addition, the pace of technological change makes it impossible for us to predict whether we will face new competitors using different technologies to provide the same or similar services offered or proposed to be offered by us. If our competitors were to provide better and more cost effective services than ours, our business initiatives could be materially and adversely affected.

Industry consolidation could make it more difficult for us to compete.

Companies offering Internet, data and communications services are, in some circumstances, consolidating. We may not be able to compete successfully with businesses that have combined, or will combine, to produce companies with substantially greater financial, sales and marketing resources, larger client bases, extended networks and infra-structures and more established relationships with vendors, distributors and partners than we have. With these heightened competitive pressures, there is a risk that our financial performance could be adversely impacted and the value of our common stock could decline.

Risks Relating to Our VoIP Business

Part of our long-term strategy in building a profitable telephone company includes the marketing of our technology for VoIP-based telephony applications through our wholly-owned subsidiary, VoX. VoIP is a new technology that involves many unique risks, including those set forth below.

The VoIP telephony market is subject to rapid technological change and we depend on new product introductions in order to grow our VoIP business.

VoIP telephony is an emerging market that is characterized by rapid changes in customer

requirements, frequent introductions of new and enhanced products, and continuing and rapid technological advancement. To compete successfully in this emerging market, we must continue to design, develop and sell new and enhanced VoIP telephony software products and services that provide increasingly higher levels of performance and reliability at lower cost. These new and enhanced products must take advantage of technological advancements and changes, and respond to new customer requirements. Our success in designing, developing and selling such products and services will depend on a variety of factors, including:

- the identification of market demand for new products;
- the scalability of our VoIP telephony software products;
- product and feature selection;
- timely implementation of product design and development;
- product performance;
- cost-effectiveness of products under development;
- effective distribution processes; and
- success of promotional efforts.

Additionally, we may also be required to collaborate with third parties to develop our products and may not be able to do so on a timely and cost-effective basis, if at all. We have in the past experienced delays in the development of new products and the enhancement of existing products, and such delays will likely occur in the future. If we are unable, due to resource constraints or technological or other reasons, to develop and introduce new or enhanced products in a timely manner, if such new or enhanced products do not achieve sufficient market acceptance, or if such new product introductions decrease demand for existing products, our operating results would decline and our business would not grow.

We may not be successful if the Internet is not adopted by a significant number of users as a means of communications.

If the market for IP-based communications and the related services that we will make available does not grow at the rate we anticipate or at all, we will not be able to realize our anticipated revenues with respect to our broadband phone service. To be successful, IP-based communications require validation as an effective means of communication and as a viable alternative to traditional phone service. Demand and market acceptance for newly introduced services are subject to a high level of uncertainty. The Internet may not prove to be a viable alternative to traditional phone service for reasons including:

- inconsistent quality or speed of service;
- traffic congestion on the Internet;
- potentially inadequate development of the necessary infrastructure;
- lack of acceptable security technologies;
- lack of timely development and commercialization of performance improvements; and

- unavailability of cost-effective, high-speed access to the Internet.

Future legislation or regulation of the Internet and/or VoIP services could restrict our business, prevent us from offering service or increase our cost of doing business.

At present there are few laws, regulations or rulings that specifically address access to or commerce on the Internet, including VoIP services. We are unable to predict the impact, if any, that future legislation, legal decisions or regulations concerning the Internet may have on our business, financial condition or results of operations. Regulation may be targeted toward, among other things, assessing access or settlement charges, imposing taxes related to Internet communications, imposing tariffs or regulations based on encryption concerns or the characteristics and quality of products and services, imposing additional regulations and requirements related to the handling of emergency 911 services, any of which could restrict our business or increase our cost of doing business. The increasing growth of the VoIP market and popularity of VoIP products and services heighten the risk that governments or other legislative bodies will seek to regulate VoIP and the Internet. In addition, large, established telecommunication companies may devote substantial lobbying efforts to influence the regulation of the broadband IP telephony market, which may be contrary to our interests.

Many regulatory actions are underway or are being contemplated by federal and state authorities, including the FCC and other state regulatory agencies. There is risk that a regulatory agency may require us to conform to rules that are unsuitable for VoIP communications technologies or rules that cannot be complied with due to the nature and efficiencies of IP routing, or are unnecessary or unreasonable in light of the manner in which we offer service to our customers. It is not possible to separate the Internet, or any service offered over it, into intrastate and interstate components. While suitable alternatives may be developed in the future, the current IP network does not enable us to identify the geographic nature of the traffic traversing the Internet.

Our emergency calling services are different from those offered by traditional wireline telephone companies and may expose us to significant liability.

Our 911 calling service is more limited, in certain areas, than the emergency calling services offered by traditional wireline telephone companies. In each case, those differences may cause significant delays, or even failure, in a caller's receipt of the emergency assistance he or she needs.

Traditional wireline telephone companies route emergency calls over a dedicated infrastructure directly to an emergency services dispatcher at the public safety answering point, or PSAP, in the caller's area. Generally, the dispatcher automatically receives the caller's phone number and actual location information. While our 911 service being deployed in the United States is designed to route calls in a fashion similar to traditional wireline services, our 911 capabilities may not reach the intended PSAP, although we do have procedures in place to ensure that a dispatcher somewhere is reached. In addition, the only location information that our E911 service can transmit to a dispatcher at a PSAP is the information that our customers have registered with us. A customer's registered location may be different from the customer's actual location at the time of the call because customers can use their enabled VoIP device to make calls almost anywhere a broadband connection is available. In such cases, as described below, we offer customers alternative access to emergency services.

We are also providing E911 service that is comparable to the emergency calling services obtained by customers of traditional wireline telephone companies in the same area. For those customers, emergency

calls are routed, subject to the limitations discussed below, directly to an emergency services dispatcher at the PSAP in the area of the customer's registered location. The dispatcher will have automatic access to the customer's telephone number and registered location information. However, if a customer places an emergency call using the customer's enabled VoIP device and the device is in a location different from the one registered with us, the E911 system will still route the call to a dispatcher in the registered location, not the customer's actual location at the time of the call. Every time a customer moves his or her enabled VoIP device to a new location, the customer's registered location information must be updated and verified. Until that takes place, the customer will have to verbally advise the emergency dispatcher of his or her actual location at the time of the call and wait for the call to be transferred, if possible, to the appropriate local emergency response center before emergency assistance can be dispatched.

In some cases, even under our E911 service, emergency calls may be routed to a local PSAP, designated statewide default answering point or appropriate local emergency authority that is not capable of receiving our transmission of the caller's registered location information and, in some cases, the caller's phone number. Where the emergency call center is unable to process the information, the caller is provided a service that is similar to the basic 911 services offered to some wireline telephone customers. In these instances, the emergency caller may be required to verbally advise the operator of his or her location at the time of the call and, in some cases, a call back number so that the call can be handled or forwarded to an appropriate emergency dispatcher. We are continuing our efforts to deploy our E911 service such that all relevant information is displayed and will be routed to the appropriate PSAP in the first instance.

Customers who are located in areas in which we are currently unable to provide either E911 or the basic 911 described above, as well as WiFi telephone and SoftPhone users, are supported by a national call center that is run by a third-party provider and operates 24 hours a day, seven days a week. When reaching the call center, a caller must provide his or her physical location and call back number, after which an operator will coordinate connecting the caller to the appropriate PSAP or emergency services provider.

Our softswitching platform and back office systems are technologically advanced and the essential service delivery of providing emergency call handling is of paramount importance to us. We have developed a web portal where subscribers can maintain the flexibility of providing us with a currently correct physical location should they take the VoIP device away from the registered location. We cannot guarantee they will actually remember to enter this information in the web portal when they move their VoIP device, and if they do not make this update, the emergency call will be routed to the address that was previously notified. This flexibility, along with the ability to call into our customer support call center to update the address, is compliant with the current requirements of the FCC regarding emergency calling.

If one of our customers experiences a broadband or power outage, or if a network failure were to occur, the customer will not be able to reach an emergency services provider.

Delays our customers encounter when making E911 or basic 911 calls and any inability of the answering point to automatically recognize the caller's location or telephone number can have devastating consequences. Customers may in the future attempt to hold us responsible for any loss, damage, personal injury or death suffered as a result. Some traditional telephone companies also may be unable to provide the precise location or the caller's telephone number when their customers place emergency calls. However, while we are not covered by legislation exempting us from liability for failures of our emergency calling services, traditional telephone companies are covered. This liability could be significant. In addition, we have lost, and may in the future lose, existing and prospective customers

because of the limitations inherent in our emergency calling services. Any of these factors could cause us to lose revenues, incur greater expenses or cause our reputation or financial results to suffer.

The success of our planned expansion is dependent upon market developments and usage patterns.

Our purchase of network equipment and placement of our VoIP software will be based in part on our expectations concerning future revenue growth and market developments. As we expand our network, we will be required to make capital expenditures, in addition to making financial commitments for DS-3 circuits and colocation space, and to add additional employees. If our traffic volume were to decrease, or fail to increase to the extent expected or necessary to make efficient use of our network, our costs as a percentage of revenues would increase significantly, which would have a materially adverse effect on our financial condition and results of operations.

Potential regulation of Internet service providers could adversely affect our operations.

To date, the FCC has treated Internet service providers as information service providers. Information service providers are currently exempt from federal and state regulations governing common carriers, including the obligation to pay access charges and contribute to the universal service fund. The FCC is currently examining the status of Internet service providers and the services they provide. If the FCC were to determine that Internet service providers, or the services they provide, are subject to FCC regulation, including the payment of access charges and contribution to the universal service funds, it could have a material adverse effect on our business, financial condition and operating results.

Our success depends on our ability to handle a large number of simultaneous calls, which our network may not be able to accommodate.

We expect the volume of simultaneous calls to increase significantly as our VoIP subscriber base grows. Our network hardware and software may not be able to accommodate this additional volume. If we fail to maintain an appropriate level of operating performance, or if our VoIP service is disrupted, our reputation could be hurt and we could lose customers, which could have a material adverse effect on our business, financial condition and results of operations.

Our growth in our VoIP business is dependent upon our ability to build new relationships with VoIP carriers and to bring on new customers.

Our ability to grow through quick and cost effective deployment of our VoIP services is due, in part, to our ability to create new interconnection agreements with VoIP carriers that can provide us with telephone numbers and termination service to sign contracts with new customers, and, in many cases, to enter into joint venture or strategic agreements with local partners, as well as to satisfy newly enacted regulatory requirements to operate in emerging markets. While we pursue several opportunities simultaneously, we might not be able to create the necessary partnerships and interconnections, expand our customer base, deploy networks and generate profitable traffic over these networks within the time frame envisioned.

We are pursuing new business lines, that require specialized skill sets. Our ability to effectuate our business plan is due, in part, to the roll out of new services.

Our ability to deploy new products and services may be hampered by technical and operational issues that could delay our ability to derive profitable revenue from these service offerings. These issues include

our ability to competitively price such products and services. In addition, certain VoIP service offerings are relatively new in our industry and their market potential is relatively untested. Additionally, our ability to market these products and service offerings may prove difficult. To date, our customers use approximately only 500,000 VoIP minutes per month. As a result we have derived extremely limited revenue from our VoIP service offerings and there can be no assurance that we will increase our current focus and/or derive significant revenue from such offerings.

We rely on third party equipment suppliers.

We are dependent on third party equipment suppliers for equipment, VoIP phones and adapter devices, including UTStarcom Inc., Cisco Systems, Inc. and Motorola, Inc. If these suppliers fail to continue product development or research and development or fail to deliver quality products or support services on a timely basis, or we are unable to develop alternative sources, if and as required, our financial condition or results of operations could be materially adversely impacted.

We may not be able to maintain adequate customer care during periods of growth or in connection with our addition of new and complex VoIP devices, which could adversely affect our ability to grow and cause our financial results to be negatively impacted.

Good customer care is important to acquiring and retaining customers. As we continue to grow our VoIP business, we will need to expand our customer care operations quickly enough to meet the needs of our increased customer base. We may face additional challenges in training our customer care staff. If we are unable to hire, train and retain sufficient personnel to provide adequate customer care, we may experience slower growth, increased costs and higher churn levels, which would cause our financial results to be negatively impacted.

If we are unable to improve our process for local number portability provisioning, our growth may be negatively impacted.

We support local number portability for our customers, which allows our customers to retain their existing telephone numbers when subscribing to our services. Transferring numbers is a manual process that in the past could have taken us 20 business days or longer, although we have taken steps to automate this process to reduce the delay. A new VoX customer must maintain both VoX service and the customer's existing telephone service during the transferring process. By comparison, transferring wireless telephone numbers among wireless service providers generally takes several hours, and transferring wireline telephone numbers among traditional wireline service providers generally takes a few days. The additional delay that we experience is due to our reliance on the telephone company from which the customer is transferring and to the lack of full automation in our process. Further, because VoX is not a regulated telecommunications provider, it must rely on the telephone companies, over whom we have no control, to transfer numbers. Local number portability is considered an important feature by many potential customers, and if we fail to reduce related delays, we may experience increased difficulty in acquiring new customers.

Risks Relating to Our Common Stock

Disappointing quarterly revenue or operating results could cause the price of our common stock to fall.

Our quarterly revenue and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. If our quarterly revenue or operating results fall below the expectations of investors or security analysts, the price of our common stock could fall substantially. Our quarterly revenue and operating results may fluctuate as a result of a variety of factors, many of which are outside our control, including:

- the amount and timing of expenditures relating to the rollout of our POTS and VoIP service offerings;
- our ability to obtain, and the timing of, necessary regulatory approvals;
- the rate at which we are able to attract customers within our target markets and our ability to retain these customers at sufficient aggregate revenue levels;
- our ability to deploy our network on a timely basis;
- the availability of financing to continue our expansion;
- technical difficulties or network downtime;
- the availability of incumbent carrier's wholesale service program for the establishment of our own full-service

platform and timing of the implementation of our VoIP platform; and

- the introduction of new services or technologies by our competitors and resulting pressures on the pricing of our service.

We do not intend to pay dividends on our common stock in the foreseeable future, which could cause the market price of our common stock and the value of your investment to decline.

We expect to retain earnings, if any, to finance the expansion and development of our business. Our Board of Directors will decide whether to make future cash dividend payments. Such decision will depend on, among other things, the following factors:

- our earnings;
- our capital requirements;
- our operating condition;
- our financial condition; and
- our compliance with various financing covenants to which we are or may become a party. Our agreement with our primary lender currently precludes the payment of dividends.

The market for our common stock is thinly traded, which could result in fluctuations in the value of our common stock.

Although there is a public market for our common stock, the market for our common stock is thinly traded. The trading prices of our common stock could be subject to wide fluctuations in response to, among other events and factors, the following:

- variations in our operating results;
- sales of a large number of shares by our existing shareholders;
- announcements by us or others;
- developments affecting us or our competitors; and
- extreme price and volume fluctuations in the stock market.

Our common stock price is likely to be highly volatile, which could cause the value of your investment to decline.

The market price of our common stock is likely to be highly volatile as the stock market in general, and the market for small cap and micro cap technology companies in particular, has been highly volatile. For example, during the last 12 months our common stock has traded at prices ranging from $0.32 to $0.72 per share. Investors may not be able to resell their shares of our common stock following periods of volatility because of the market's adverse reaction to volatility. We cannot assure you that our common stock will trade at the same levels of our stocks in our industry or that our industry stocks in general will sustain their current market prices. Factors that could cause such volatility may include, among other things:

- actual or anticipated fluctuations in our quarterly operating results;
- large purchases or sales or our common stock;
- announcements of technological innovations;
- changes in financial estimates by securities analysts;
- investor perception of our business prospects;
- conditions or trends in the telecommunications industry;
- changes in the market valuations of other industry-related companies;
- the acceptance of market makers and institutional investors of our business model and our common stock; and
- worldwide economic or financial conditions.

Effect of certain charter provisions.

Authority of Board of Directors to Issue Preferred Stock. Pursuant to the terms of our charter, our Board of Directors has the authority to issue up to 1,000,000 shares of preferred stock in one or more series. Our Board of Directors may also determine the prices, rights, preferences, privileges and restrictions, including voting rights, of the shares within each series without any further shareholder vote or action. The rights of the holders of our preferred stock may adversely affect the rights of the holders of common stock. While the issuance of such preferred stock could facilitate possible acquisitions and other corporate activities, it could also impede a third party's ability to acquire control of our company.

Limitation of Liability of Directors. Pursuant to the terms of our charter and to the extent New York law permits, we and our shareholders may not hold our directors personally liable for monetary damages in the event of a breach of fiduciary duty.

Provisions of New York law may discourage a takeover attempt even if doing so may be beneficial to our shareholders.

Certain anti-takeover provisions of New York law could delay or hinder a change of control of our company. While such provisions generally facilitate our Board of Directors' ability to maximize shareholder value, they may discourage takeovers that could be in the best interest of certain shareholders. Such provisions could adversely affect the market value of our stock in the future.

We are exposed to potential risks from recent legislation requiring companies to evaluate internal controls under Section 404 of the Sarbanes Oxley Act of 2002.

We are evaluating and documenting our internal controls systems so that when we are required to do so, our management will be able to report on, and our independent auditors to attest to, our internal controls, as required by this legislation. We will be performing the system and process evaluation and testing (and any necessary remediation) required in an effort to comply with the management certification and auditor attestation requirements of Section 404 of the Sarbanes Oxley Act. As a result, we expect to incur additional expenses and diversion of management's time. We have reported material weaknesses and significant deficiencies in our disclosure controls and procedures and our internal control over financial reporting because of a deficiency in the number of qualified personnel in our accounting department. While we anticipate being able to rectify this weakness and to fully implement the requirements relating to internal controls and all other aspects of Section 404 in a timely fashion, we cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations. If we are not able to implement the requirements of Section 404 in a timely manner or with adequate compliance, we might be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission. Any such action could adversely affect our financial results and could cause our stock price to decline.

Item 1B. Unresolved Staff Comments

None.

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Item 2. - Properties

The following table sets forth pertinent facts concerning our office leases at February 15, 2006.

Location	Use	Approximate Square Feet	Annual Rent
75 South Broadway White Plains, NY 10601	Office	4,000	$77,000
118 Celebration Avenue Celebration, FL 34747	Office	2,000	$52,700

The lease for our office space in White Plains, New York is a five-year lease that began on December 1, 2003 and our lease for our office space in Celebration, Florida is a three-year lease that began on February 1, 2005. We also lease colocation space in two locations in Orlando that are subject to written agreements that are renewable each year. We believe we will need to lease additional office space of between 6,000 and 10,000 square feet to meet our operating needs in fiscal 2006. We have been considering leases in Orlando, Florida with annual rentals between approximately $100,000 and $150,000.

Item 3. - Legal Proceedings

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

Item 4. - Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. – Market for Common Equity, Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities

Our common stock currently trades on The OTC Bulletin Board(R) ("OTCBB") under the symbol ELEC. The high and low closing sales price for each quarterly period of our last two fiscal years are listed below:

	High	Low
Fiscal 2004		
1st Quarter	$0.25	$0.13
2nd Quarter	0.26	0.14
3rd Quarter	0.36	0.14
4th Quarter	0.40	0.21
Fiscal 2005		
1st Quarter	$0.74	$0.28
2nd Quarter	0.69	0.35
3rd Quarter	0.58	0.36
4th Quarter	0.53	0.35

The quotations set forth in the table above reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions. As of February 15, 2006, there were 195 holders of record of our common stock and approximately 3,000 beneficial holders.

We have never paid dividends on our common stock and do not expected to do so in the foreseeable future. Our loan agreements with Laurus Master Funds, Ltd. ("Laurus") do not allow us to directly or indirectly declare or pay any dividends so long as certain amounts of our secured convertible term notes to Laurus remain outstanding.

The following table provides information as of November 30, 2005 with respect to shares of our common stock that are issuable under equity compensation plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	r s

Equity compensation plans approved by security holders:		
Employee Stock Option Plan (1)	1,555,000	$0.38
1996 Restricted Stock Plan (2)	--	
Subtotal	1,555,000	
Equity compensation plans not approved by security holders:		
Employee stock options	1,900,000	0.24
Employee Stock Option Plan (1)	734,000	0.39
Laurus Master Fund, Ltd. (3)	2,477,578	0.33
Source Capital Group, Inc. (3)	516,263	0.62
Kaufman Bros. Warrants (4)	250,000	1.63
Capital TT, LLC (5)	150,000	0.63
Subtotal	6,027,841	
Total	7,582,841	

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(1) Our Employee Stock Option Plan allows for the granting of share options to Board members, officers, non-officer employees and consultants.

(2) Our Restricted Stock Plan provides for the issuance of restricted share grants to officers and non-officer employees.

(3) Warrants were issued in conjunction with financings provided by Laurus Master Fund, Ltd..

(4) The Kaufman Bros. warrants were granted for investment banking services. These warrants expired unexercised on February 26, 2006.

(5) Warrants were issued for consulting services.

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Item 6. - Selected Financial Data

The following selected financial information has been taken from our consolidated financial statements. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements and related notes included elsewhere in this Report.

	2005	2004	2003	2002	2001
	(In thousands, except per share amounts)				
Selected Income Statement Data:					

Net Sales	$ 15,881	$ 9,558	$ 5,568	$ 14,242	$ 19,693
Gross Profit	7,279	4,820	2,802	5,266	7,153
Loss From Continuing Operations	(2,402)	(642)	(2,948)	(4,481)	(12,601)
(Loss) Income From Discontinued Operations	--	--	--	--	(4)
Earnings (Loss)	(2,266)	170	8,323	(3,319)	(12,374)
Earnings (Loss) From Continuing Operations per Common Share:					
Basic	(0.14)	0.01	0.53	(0.21)	(0.83)
Diluted	(0.14)	0.01	0.53	(0.21)	(0.83)
Cash Dividends	--	--	--	--	--
Selected Balance Sheet Data:					
Working Capital	$ (974)	$ (1,939)	$ (1,938)	$ (11,214)	$ (8,031)
Property, Plant, Equipment	594	192	25	1,827	2,168
Total Assets	4,385	1,904	1,637	4,885	7,281
Long-Term Debt (Less Current Maturities)	1,655	--	--	1,145	1,288
Stockholders' Equity	(2,364)	(1,696)	(1,864)	(10,162)	(6,626)

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Item 7. - Management's Discussion and Analysis or Plan of Operation

Certain statements set forth below under this caption constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Please refer to page 1 of this Report for additional factors relating to such statements.

Overview

We have operated as a telephone service provider since 1998. We built our telephony business by leasing lines from incumbent local exchange carriers and reselling their services, while maintaining the vision of becoming a carrier that provides Voice over Internet Protocol, or VoIP, to both carriers and end-users. We have succeeded in our efforts to transition to a facilities-based VoIP provider, and we currently offer telephony services over the Internet or over a wireline. We offer our VoIP services throughout the United States and in many foreign countries, whereas our wireline services are offered only in the States of Pennsylvania, New Jersey and New York. Our VoIP technology enables voice communications over the Internet through the conversion of voice signals into data packets. In order to use our VoIP service, customers must have access to a high-speed Internet connection. Our VoIP technology generally uses eight kilobits per second to transmit data packets over an Internet connection. This high compression of the packet allows us to provide a superior quality voice call without excessive bandwidth use, and gives us an advantage over other carriers that use approximately 64 kilobits per second to transmit the data packets that carry a voice conversation.

The roll-out of our VoIP product has taken significantly longer than we anticipated. A key reason for the delay was our concern over a June 3, 2005 order released by the FCC regarding proposed rulemaking for VoIP emergency services. Among other things, the order required VoIP carriers, like us, to provide enhanced emergency dialing capabilities, or E911, to all customers by November 28, 2005. Furthermore, on November 7, 2005, the FCC issued a Public Notice indicating that VoIP providers that have not fully complied with the enhanced emergency dialing capabilities requirement by November 28, 2005 should discontinue marketing their services and accepting new customers. Although we filed a petition for an extension of time and limited waiver of certain of the enhanced emergency service requirements, our existing wholesale customers and potential new customers were reluctant to move forward selling our VoIP product. While we had been able to acquire emergency dialing services for certain telephone numbers that we leased from a CLEC, we believed the geographical footprint of numbers was not extensive enough to entice new accounts to sign up for our services.

In February 2006, we first became capable of providing emergency dialing service for every VoIP line on our service platform. In the first two weeks of February 2006, 14 potential wholesale customers signed nondisclosure agreements with us and began negotiating wholesale VoIP contracts. By February 17, 2006, three of those customers had signed a wholesale service agreement and sent us a deposit. Although we cannot control when our wholesale customers send us orders, we anticipate being able to sign up several significant wholesale accounts in fiscal 2006. We believe the functionality and changeability of our back-office systems provide us with a unique flexibility of being able to adapt VoIP programs to the needs of various wholesale customers without us having to write new code. We believe our ability to implement custom programs on a zero code basis, combined with our emergency services offering and our ability to port local telephone numbers from other carriers, including wireless and VoIP carriers, will help differentiate us from other VoIP wholesale providers, and generate rapid sale growth in VoIP services in 2006.

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Revenues

Revenues consist of telephony services revenue and customer equipment revenue.

Telephony services revenue. Substantially all of our operating revenues are telephony services revenue. We offer several bundled plans, unlimited plans and basic plans for residential and business customers. Each of our unlimited plans offers unlimited domestic calling, subject to certain restrictions, and each of our basic plans offers a limited number of calling minutes per month. Under our basic plans, we charge on a per minute basis when the number of calling minutes included in the plan is exceeded for a particular month. For all of our U.S. plans, we charge on a per minute basis for international calls to destinations other than Canada. These per minute fees are not included in our monthly subscription fees. Any plan we offer to individual end-users is also available to our wholesale customers at a reduced rate. VoIP revenues have not been significant to date.

We derive most of our telephony services revenue from monthly subscription fees we charge our customers under our service plans. We also offer a VoIP fax service, virtual phone numbers, toll free numbers and other services, for each of which we may charge an additional monthly fee. We automatically charge service fees monthly in advance to the credit cards of all of our VoIP retail customers and approximately 10% of our wireline customers. We automatically charge the per minute fees not included in our monthly subscription fees to our customers' credit cards monthly in arrears unless they exceed a certain dollar threshold, in which case they are charged immediately.

By collecting monthly subscription fees in advance and certain other charges immediately after they are incurred, we are able to reduce the amount of accounts receivable we have outstanding, which lowers our working capital requirements. Collecting fees and charges in this manner also helps us mitigate bad debt exposure and is one of the industry-accepted practices for VoIP carriers. Approximately 90% of our leased wireline customers do not pay by credit card and are mailed an invoice that is due within 25 days. We have experienced growth periods with significant bad debts from wireline customers. We do not anticipate the same level of bad debt exposure in our VoIP service offerings, as our wholesale customers are required to place a one month deposit and our retail customers are required to pay by credit card. If a customer's credit card is declined, we generally suspend international calling capabilities as well as the customer's ability to incur domestic usage charges in excess of its plan minutes. Historically, in most cases, we are able to correct the problem with the customer within the current monthly billing cycle. If a customer's credit card cannot be successfully processed during the current month's billing cycle, we generally terminate the account.

We also generate revenue by charging a fee for activating service. Further, we generally charge a disconnect fee to customers who do not return their IAD to us upon termination of service, if the length of time between activation and termination is less than one year. Disconnect fees are recorded as revenue and are recognized at the time the customer terminates service. These revenues were nominal in fiscal 2005.

Telephony services revenue is offset by the cost of certain customer acquisition activities, such as rebates and promotions.

Customer equipment revenue. Customer equipment revenue consists of revenue from sales of customer equipment to our wholesalers or directly to customers. In addition,

customer equipment revenue includes the fees we charge our customers for shipping any equipment to them. These revenues were nominal in fiscal 2005.

Cost of Revenues

Direct cost of telephony services. Direct cost of telephony services primarily consists of fees that we pay to third parties on an ongoing basis in order to provide our services. These fees include:

o Usage charges and line and port costs from reselling wireline service of incumbent carriers.

o Access charges we pay to other telephone companies to terminate VoIP calls on the public switched telephone network ("PSTN"). When a VoX subscriber calls another VoX subscriber, we do not pay an access charge, as the call routes through our network without touching the PSTN.

o The cost of leasing interconnections to route calls over the Internet and transfer calls between the Internet and the PSTN of various long distance carriers.

o The cost of leasing from other telephone companies the telephone numbers we provide to our customers. We lease these telephone numbers on a monthly basis.

o The cost of co-locating our connection point equipment in third-party facilities owned by other telephone companies.

o The cost of providing local number portability, which allows customers to move their existing telephone numbers from another provider to our service. Only regulated telecommunications providers have access to the centralized number databases that facilitate this process. Because VoX is not a regulated telecommunications provider, we must pay other telecommunications providers to process our local number portability requests.

o The cost of complying with the new FCC regulations regarding VoIP emergency services, which require us to provide enhanced emergency dialing capabilities to transmit 911 calls for all of our customers. This cost may increase in future periods.

o Taxes we pay on our purchases of telecommunications services from our suppliers.

Direct cost of customer equipment and shipping. Direct cost of goods sold primarily consists of costs we incur when a customer first subscribes to our service. These costs include:

o The cost of the equipment we provide to customers who subscribe to our service through our direct sales channel, in each case in excess of activation fees.

o The cost of shipping and handling for customer equipment, together with the installation manual, we ship to customers.

Results of Operations

Fiscal Year 2005 Compared to Fiscal Year 2004

Our revenues for fiscal 2005 increased by approximately $6,323,000, or approximately 66%, to approximately $15,881,000 as compared to approximately $9,558,000 reported for fiscal 2004. The growth in revenues was directly related to the increased number of leased local access lines we served in fiscal 2005. In fiscal 2006, we want more of our telephony service revenues to come from VoIP services than from wireline services. Consequently, almost all of our marketing efforts are focused on obtaining additional VoIP lines. We anticipate the continuation of normal customer churn in our leased line business in fiscal 2006, and expect that the bulk of our revenues during fiscal 2006 will come from our provision of VoIP services. We anticipate that many of these lines will be from wholesale customers.

We have certain wholesale customers that have the financial resources and marketing capability to reach out to their existing customers and sell more than 100,000 VoIP lines in fiscal 2006. However, we do not control the marketing dollars of our wholesale customers or the timing of their marketing efforts. We continue to sign up wholesale customers because we are confident they will eventually provide us significant numbers of new VoIP lines. However, we are currently unable to model or predict such sales activity. In order to better control our anticipated future sales, we are testing various retail marketing channels, and in February 2006, we obtained a non-binding term sheet to purchase a telephony company that has a successful inbound marketing program that is anchored by direct response advertising. We believe this company will be able to acquire for us up to 3,000 retail VoIP lines per month, but we cannot be certain that our purchase will be completed, as we have not finished our due diligence efforts or finalized a definitive purchase agreement.

Our gross profit for fiscal 2005 increased by approximately $2,459,000 to approximately $7,279,000 from approximately $4,820,000 reported in fiscal 2004, while our gross profit percentage of 45.8% in fiscal 2005, as compared to 50.4% in fiscal 2004, decreased by 4.6 percentage points primarily due to the higher fees we were charged for leasing lines and ports from Verizon Services Corp. ("Verizon"). The increase in our dollars of gross profit resulted from the increase in our customer base in fiscal 2005 over fiscal 2004. Our gross profit percentage of approximately 45.8% reflected our sales strategy of selling only in those states in which we believe we will be able to achieve a gross margin of over 40%. Our selling strategy in fiscal 2006 is to continue to sell leased wirelines in states in which we are offered the opportunity to achieve higher margins. However, we anticipate selling substantially more new VoIP lines in fiscal 2006 than leased lines. It is difficult for us to predict the gross margins we will achieve on our VoIP lines because we are offering both a wholesale and a retail product and the gross margin will be impacted by the product mix.

Selling, general and administrative expenses ("SG&A") increased by approximately $4,038,000, or approximately 74.1%, to approximately $9,485,000 for fiscal 2005 from approximately $5,447,000 reported in the prior year fiscal period. Of this increase, approximately $2,563,000 was for bad debt expense, approximately $816,000 was for increased personnel costs, of which approximately $403,000 was related to VoX, approximately $230,000 was for billing costs, approximately $144,000 was for non-employee option costs and approximately $187,000 was for other VoX operating costs. From January 2005 until mid-April 2005, our CLECs attracted an unusually high number of residential consumers that did not pay our invoices, and for which we subsequently terminated services, even though such customers had qualifying credit scores. Going forward, we do not anticipate the continuation of this high percentage of bad debt expense with our CLEC customers, as we have decreased our marketing efforts to acquire new customers

in favor of marketing to acquire new VoIP customers. With our VoIP customers, we anticipate minimal bad debt expense, as we require credit card payment from our residential VoIP users, and all of our wholesale accounts are credit checked and required to pay us a deposit for future services. We also believe VoIP customers will generate a significantly lower bad debt percentage because they tend to be more sophisticated Internet users that are already paying for a broadband connection.

Depreciation and amortization expense increased by approximately $182,000 to approximately $196,000 for fiscal 2005 as compared to approximately $14,000 for the prior fiscal year. Approximately $143,000 of the increase was for deferred financing costs related to the Laurus financing (See Note 8) and approximately $40,000 related to our VoIP platform.

Interest expense increased by approximately $679,000 to approximately $682,000 for the year ended November 30, 2005 as compared to approximately $3,000 for the prior fiscal year, as a result of increased borrowings under our financing agreements (See Note 8). We anticipate that interest expense will increase due to the interest that we project we will pay on the debt we incurred on November 30, 2005.

Other income amounted to approximately $66,000 for the year ended November 30, 2005 as compared to $46,000 for the prior fiscal year. For fiscal 2005, other income of approximately $66,000 resulted primarily from commission income. For fiscal 2004, other income of approximately $46,000 resulted primarily from commission income of approximately $91,000, which was partially offset by approximately $45,000 in additional costs associated with the sale of our headquarters building in the fourth quarter of fiscal 2003.

For the year ended November 30, 2005, we recorded income of approximately

$177,000, which resulted from the change in the market value of the warrants issued to Laurus as part of the Laurus financing (See Note 8). No such income was recorded in fiscal 2004.

For the fiscal years ended November 30, 2005 and 2004, we recorded gain on the sale of investment securities and other investments of approximately $378,000 and $1,000, respectively. In fiscal 2005, the gain resulted from the sale of shares of Cordia Corporation of approximately $160,000 and Talk America Holding, Inc. warrants of approximately $218,000.

In fiscal 2005 we reversed liabilities related to our discontinued luggage business in the amount of approximately $198,000. No such adjustment was made in fiscal 2004.

For the fiscal year ended November 30, 2004, we reported a gain on settlement with creditors of approximately $904,000, which was offset in part by approximately $161,000 in professional fees. No such gain was recorded in the fiscal year ended November 30, 2005 (See Note 10).

For the fiscal year ended November 30, 2004, we recorded a tax benefit of $26,000 that resulted from the reduction of an estimated accrual of corporate tax expense for fiscal 2003. No such benefit was recorded in the fiscal year ended November 30, 2005.

Fiscal Year 2004 Compared to Fiscal Year 2003

Our revenues for fiscal 2004 increased by approximately $3,990,000, or approximately 72%, to approximately $9,558,000 as compared to approximately $5,568,000 reported for fiscal 2003. The growth in revenues is directly related to the growth in our customer base or number of local access lines that we served. We ended fiscal 2004 with 24,034 billed lines, as compared to 10,835 billed lines at November 30, 2003. Although the line count increased by 13,199 lines, or 122%, in fiscal 2004, due to insufficient cash flow to support our telemarketing costs in the first half of fiscal 2004, most of the increase came in the second half of our fiscal year. Therefore, annual revenues did not increase by the same percentage as the percentage increase in our line count.

Our gross profit for fiscal 2004 increased by approximately $2,018,000 to approximately $4,820,000 from approximately $2,802,000 reported in fiscal 2003, while our gross profit percentage of 50.4% in fiscal 2004 as compared to 50.3% in fiscal 2003 essentially remained the same from fiscal period to fiscal period. The increase in our dollars of gross profit resulted from the increase in our customer base in fiscal 2004 over fiscal 2003. Our gross profit percentage of approximately 50.4% reflected our sales strategy to sell only in those states in which we believe we will be able to achieve a gross margin of over 40

Selling, general and administrative expenses ("SG&A") decreased by approximately $215,000, or approximately 3.8%, to approximately $5,447,000 for fiscal 2004 from approximately $5,662,000 reported in the prior fiscal year period. Although we grew our revenues significantly in fiscal 2004, we were able to limit our SG&A. Our occupancy costs were substantially lower in fiscal 2004, as we incurred rental expense of approximately $6,000 per month under our existing headquarters lease as compared to the occupancy costs of approximately $22,000 per month we incurred in operating our former headquarters building, which we sold in the fourth quarter of fiscal 2003.

Depreciation expense decreased by approximately $74,000, to approximately

$14,000 for fiscal 2004 as compared to approximately $88,000 for fiscal 2003. The decline in depreciation expense was primarily attributable to the sale of our headquarters building in the fourth quarter of fiscal 2003 and to the sale of certain assets to EAC in the first quarter of fiscal 2003.

Interest expense decreased by approximately $172,000, to approximately $3,000 for fiscal 2004 as compared to approximately $175,000 for fiscal 2003. The decrease in interest expense was primarily attributable to the repayment of a mortgage note in conjunction with the sale of our headquarters building in the fourth quarter of fiscal 2003.

Other income, net for fiscal 2004 was approximately $46,000 as compared to approximately $164,000 for fiscal 2003. The income for fiscal 2004 resulted primarily from commission income of approximately $88,000, which was partially offset by charges for environmental costs of approximately $45,000 directly related to the sale of our headquarters building in the fourth quarter of fiscal 2003. The income for fiscal 2003 resulted primarily from rental and commission income of approximately $210,000, which was partially offset by the write-down of our investment in Cordia Corporation of approximately $71,000.

In fiscal 2004, we reported income of approximately $904,000 from debt reduction related to the TSI bankruptcy. No such income was reported in fiscal 2003. Bankruptcy reorganization costs for fiscal

years 2004 and 2003 of approximately $161,000 and $70,000, respectively, represented legal cost associated with the TSI bankruptcy.

In fiscal 2003, we sold Essex assets, Essex stock and our headquarters building. The sales netted a gain of approximately $11,306,000. We had no such asset sales in fiscal 2004.

In fiscal 2004, gain on the sale of investment securities and other investments of approximately $1,000, resulted from the sale of Cordia Corporation ("Cordia") shares as compared to the gain of approximately $122,000 in fiscal 2003, which resulted from the sale of shares of Cordia and Talk America Holdings Inc.

In fiscal 2004, we recorded a net tax benefit of approximately $48,000 offset by a current year provision of $22,000, which resulted from the reduction of an estimated accrual of corporate tax expense for fiscal 2003. In fiscal 2003, we recorded estimated corporate tax expense of approximately $75,000.

Liquidity and Capital Resources

At November 30, 2005, we had cash and cash equivalents of approximately $206,000 and negative working capital of approximately $974,000 as compared to cash and cash equivalents of approximately $372,000 and negative working capital of approximately $1,939,000 at November 30, 2004. At November 30, 2005, we had loan proceeds receivable of approximately $1,753,000 in conjunction with our November 2005 financing (See Note 8).

Net cash used in operating activities aggregated approximately $2,165,000, $80,000 and $1,636,000 in fiscal 2005, 2004 and 2003, respectively. The principal use of cash from operating activities in fiscal 2005 was the loss for the year of approximately $2,266,000. The principal use of cash from operating activities in fiscal 2004 was the increase in accounts receivable of approximately $1,590,000, which was offset by a non-cash item, an increase in the provision for doubtful accounts of approximately $1,049,000. The principal use of cash from operating activities in fiscal 2003 was net income of approximately $8,323,000, which was o