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

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

FORM 10-QSB/A #2

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

For the quarterly period ended June 30, 2002

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

For the transition period from ___________ to _____________

Commission File Number 0-24217

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

Nevada	85-0206668
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

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

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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

The number of shares of the issuer's common equity outstanding as of JUNE 30, 2002 was 43,813,680 shares of common stock, par value $.001.

Transitional Small Business Disclosure Format (check one):

Yes ___ No X

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YP.NET, INC.
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FOR THE QUARTER ENDED JUNE 30, 2002

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

UNAUDITED CONSOLIDATED BALANCE SHEET
AS OF JUNE 30, 2002

ASSETS:	
CURRENT ASSETS	
Cash	$ 321,469
Accounts receivable	3,528,538
Customer acquisition costs	1,207,772
Prepaid expenses and other assets	227,880
Deferred income taxes	744,398
Total current assets	6,030,057
PROPERTY AND EQUIPMENT, net	353,751

DEPOSITS	28,287
INTELLECTUAL PROPERTY- URL	3,657,592
NOTES RECEIVABLE - affiliates	289,862
TOTAL ASSETS	$10,359,549
LIABILITIES AND STOCKHOLDERS' EQUITY:	
CURRENT LIABILITIES:	
Accounts payable	$ 95,835
Notes payable and accrued interest- current portion	342,666
Income taxes payable	2,523,645
Total current liabilities	2,962,146
NOTES PAYABLE - long term portion	119,586
DEFERRED INCOME TAXES	120,868
Total liabilities	3,202,600
STOCKHOLDERS' EQUITY:	
Common stock, $.001 par value, 50,000,000 shares authorized, 43,563,680 issued and outstanding	43,564
Paid in capital	4,289,381
Treasury stock at cost	(171,422)
Retained earnings	2,995,426
Total stockholders' equity	7,156,949
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$10,359,549

See the accompanying notes to these unaudited financial statements

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YP.NET, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE-MONTH PERIOD AND NINE-MONTH PERIOD ENDED JUNE 30, 2002 AND JUNE 30, 2001

	Three Months Ended June 30, 2002	Nine Months Ended June 30, 2002	Three Months Ended June 30, 2001
NET REVENUES	$ 3,416,953	$ 9,249,792	$ 3,466,635
OPERATING EXPENSES:			

Cost of services	1,168,396	3,086,075	1,918,532
General and administrative expenses	1,186,777	3,075,448	667,216
Sales and marketing expenses	16,330	155,663	14,623
Depreciation and amortization	156,487	456,587	151,536
Total operating expenses	2,527,990	6,773,773	2,751,907
OPERATING INCOME	888,963	2,476,019	714,728
OTHER (INCOME) AND EXPENSES			
Interest (income) expense	33,808	70,802	(96,418
Other Income	(392,482)	(398,052)	57
Total other (income)expense	(358,674)	(327,250)	(96,361
INCOME BEFORE INCOME TAXES	1,247,637	2,803,269	618,367
INCOME TAX PROVISION (BENEFIT)	448,895	1,077,182	189,515
NET INCOME	$ 798,742	$ 1,726,087	$ 428,852
NET INCOME PER SHARE:			
Basic	$ 0.02	$ 0.04	$ 0.01
Diluted	$ 0.02	$ 0.04	$ 0.01
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:			
Basic	43,810,933	43,812,299	40,615,464
Diluted	43,810,933	43,812,299	40,615,464

See the accompanying notes to these unaudited financial statements

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YP.NET, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE-MONTH PERIOD ENDED JUNE 30, 2002 AND JUNE 30, 2001

CASH FLOWS FROM OPERATING ACTIVITIES:	NINE MONTHS ENDED JUNE 30, 2002	NINE MONTHS ENDED JUNE 30, 2001
Net income	$ 1,726,087	$ 1,521,682
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		

Depreciation and amortization	456,609	456,113
Loss on disposal of equipment	7,715	-
Non-cash income recognized on recapture of common stock	(267,675)	-
Receivable of legal settlement	(126,466)	-
Allowance on related party notes receivable	131,690	-
Deferred income taxes	(226,572)	-
Officers & consultants paid common stock	-	59,700
Common stock surrendered	-	(494,310)
Changes in assets and liabilities:		
Trade and other accounts receivable	(658,429)	624,805
Customer acquisition costs	(1,014,528)	(71,320)
Prepaid and other current assets	(81,245)	98,053
Other assets	(5,000)	(26,777)
Accounts payable	(219,069)	15,508
Accrued liabilities	(76,234)	(328,201)
Income taxes payable	1,301,327	705,345
Deferred revenue	-	
Net cash provided by operating activities	948,210	2,560,598
CASH FLOWS FROM INVESTING ACTIVITIES:		
Advances made to affiliates and related parties	(458,987)	-
Repayment of advances to affiliates and related parties	153,750	-
Purchases of intellectual property	(49,719)	-
Purchases of equipment	(118,979)	(15,138)
Net cash (used in) investing activities	(473,935)	(15,138)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal repayments on notes payable	(836,653)	(2,713,986)
Net cash (used)/provided by financing activities	(836,653)	(2,713,986)
(DECREASE)/INCREASE IN CASH	(362,378)	(168,526)
CASH, BEGINNING OF PERIOD	683,847	219,613
CASH, END OF PERIOD	$ 321,469	$ 51,087

See the accompanying notes to these unaudited financial statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE-MONTH PERIOD AND NINE-MONTH PERIOD ENDED JUNE 30, 2002 AND JUNE 30, 2001

1. Basis of Presentation

The accompanying unaudited financial statements represent the consolidated financial position of YP.Net, Inc. ("the Company" or "YP.Net") for the three and nine-month periods ended June 30, 2002, and June 30, 2001, which includes results of operations of the Company and Telco Billing, Inc. ("Telco"), its wholly owned subsidiary, and statement of cash flows for the three and nine-month periods ended June 30, 2002 and June 30, 2001. These statements have

been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments to these unaudited financial statements necessary for a fair presentation of the results for the interim period presented have been made. The results for the three and nine-month periods ended June 30, 2002, and June 30, 2001, may not necessarily be indicative of the results for the entire fiscal year. These financial statements should be read in conjunction with the Company's Form 10-KSB for the years ended September 30, 2001, and 2000, and Form 10-QSB for quarter ended December 31, 2001, and March 31, 2002 including specifically the financial statements and notes to such financial statements contained therein.

2. Summary of Significant Accounting Policies

The accounting policies followed by the Company, and the methods of applying those policies, which affect the determination of its financial position, results of operations and cash flows are summarized below:

Cash and Cash Equivalents

Cash and cash equivalents include all short-term liquid investments that are readily convertible to known amounts of cash and have original maturities of six months or less. At times cash deposits may exceed government insured limits.

Principles of Consolidation

The consolidated financial statements include the Company and its wholly owned subsidiary, Telco. All intercompany accounts in consolidation have been eliminated.

Revenue Recognition

The Company's revenue is generated by customer subscription of directory and advertising services. Revenue is recognized monthly for services subscribed in that specific month. The Company utilizes outside billing companies to transmit billing data that is forwarded to Local Exchange Carriers ("LECs"). Monthly subscription fees are included on the telephone bills of the LEC customers. The Company recognizes revenue based on net billings accepted by the LECs. Net

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billings result from gross submittals reduced by billing records rejected by the LEC's and adjusted for resubmittals. Revenue is reported gross of fees charged by the billing company and the LEC's.

Fair Value of Financial Instruments

The carrying amounts for investments in marketable securities, trade accounts receivable, trade accounts payable, accrued liabilities and notes payable, approximate their fair value due to the short maturity of these instruments. The Company has determined that the recorded amounts approximate fair value.

Net Earnings Per Share

Net earnings per share are calculated using the weighted average number of shares of common stock outstanding during the year. The Company has adopted the provisions of Statement of Financial Accounting Standards No. 128, Earnings Per Share.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. This may affect the reported amounts of assets and liabilities and disclosure of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Stock-Based Compensation

Statements of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123"), established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation. In accordance with SFAS 123, the Company has elected to continue accounting for stock based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25.

3. Intangible Asset

In connection with the Company's acquisition of Telco, the Company is required to provide payment of licensing fees for the use of the Internet domain name or Universal Resource Locator ("URL") Yellow-Page.Net. The URL is recorded at its cost net of accumulated amortization. The Company's management believes that the Company's business is dependent on its ability to utilize this URL given the recognition of the "yellow page" term. The Company's management believes that the current revenue and cash flow generated using the URL Yellow-Page.Net substantiates the net book value of the asset. The Company will periodically analyze the net book value of this asset and determine if impairment has incurred. The URL is amortized on an accelerated basis over the twenty-year term of the licensing agreement.

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4. Notes Payable and Line of Credit

Notes payables are recorded and interest is accrued in accordance with the individual terms of each note. Notes payable at June 30, 2002, were as follows:

Note 1: The Company entered into a loan agreement with Mr. Joseph Van Sickle in connection with the acquisition of Telco pursuant to which Mr. Van Sickle lent $2,000,000 to the Company. As of June 30, 2002, this note had an outstanding balance of $327,932 plus accrued interest of $14,734. In June 2002, Mr. Van Sickle filed suit against the Company alleging that the Company defaulted on its obligations under the loan agreement. The Company responded to this claim and is currently negotiating with Mr. Van Sickle concerning a resolution of the claim. Mr. Van Sickle is a less than one percent (1%) shareholder of the Company and Mr. Van Sickle is not a member of management and currently has no position on the Board of Directors of the Company.

Note 2: The Company entered into an agreement with Matthew & Markson, Ltd., an

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Antigua corporation ("M&M"), in connection with the acquisition of Telco for the license of the URL Yellow-Page.Net. The Company agreed to pay M&M $5,000,000 to license URL Yellow-Page.Net. At June 30, 2002, the M&M note payable had an outstanding balance of $119,586. M&M is not a member of management and currently has no position on the Board of Directors for the Company. M&M owns approximately 27% of the Company's issued and outstanding stock.

M&M, as the licensor to the Company of the Yellow-Page.net URL, made a claim against the Company during the year ended September 30, 2001asserting that the Company owed M&M $2,000,000, as a fee for a loan extension given to the Company in 1999. The Company entered into a settlement agreement with M&M resolving this claim. The settlement agreement required the Company to pay M&M $550,000, and issue 4,000,000 shares of the Company's common stock and warrants to purchase an additional 500,000 shares of the Company's common stock. The value of the common stock was determined on the basis of the quoted trading price of the shares on the date of this settlement agreement. The stock has a two-year restrictive stock legend. The outstanding balance owed to M&M was $119,586 as of June 30, 2002. The Company accelerated payments to M&M on this note to prepay principal at a more rapid rate than is required under the note agreement.

5. Common Stock

Transactions in the Company's common stock issued for the acquisition of assets, products, or services are accounted for at fair value. Fair value is determined based on the bid and ask price at the date of the transactions of the Company's common stock, or the fair value of the asset, product, or service received.

6. Income Taxes

The Company provides for income taxes based on the provisions of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, which among other things, requires that recognition of deferred income taxes be measured by the provisions of enacted tax laws in effect at the date of financial statements. The provision for income taxes for interim periods is calculated on the basis of the expected effective rate for the full year.

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7. Advances to Affiliates

Officers' Loans

The Company has made loans to affiliates in the form of promissory notes to two officers as part of their respective compensation packages. The board of directors has approved the advance of these funds to the officers or companies they control. The advances are subject to repayment by the officers and are evidenced by the notes that are collateralized by the officers' common stock valued at a floor price of $1.00 per share or current market price, whichever is greater. Presently, the maximum loan amount under these notes is limited to $200,000 to Sunbelt Financial Concepts, in the case of Angelo Tullo, and $70,000 to The Thompson Group P.C., in the case of Pamela J. Thompson, the Company's former Chief Financial Officer. Advances are being amortized over a 12-month period and carry an annual interest rate of 8%. The Board of Directors has not made any decision whether to bonus as compensation these advances now or in the future, but will review on a quarterly basis any recommendations made by the Compensation Committee of the Board of Directors with respect to the treatment

of these amounts.

The Company has elected to provide in the financial statements a reserve based on a 12-month amortization schedule to allow for the potential bonus' that may be added to officer compensation and to insulate the Company from fluctuations in the value of the collateral stock.

Ms. Pamela Thompson resigned as Chief Financial Officer of the Company effective May 24, 2002. (See Item 1) The Company does not expect the loan made to the Thompson Group, P.C. to be voluntarily repaid. Any loss the Company may incur should be reduced by the value of the collateral stock and the reserve established for that loan. The Company does not expect to voluntarily recover any deficiency that may exist if the value of the collateral is not sufficient to cover the full amount of the Thompson Group's liability to the Company. The Company does not believe that the non-payment of the loan will have a materially adverse affect on the Company.

Matthew & Markson, Ltd. Advance Agreement

The Company has made advances to Matthew & Markson, Ltd. (M&M) that are also collateralized by the Company's common stock owned by M&M. This loan agreement resulted from a settlement reached in September 2000 with M&M whereby the "put" agreement originated as part of the purchase of Telco billing was terminated. The "put" agreement would have allowed M&M to "put" back to the Company up to 10 million shares of common stock at a price of $1.00 per share. Management negotiated a loan agreement with M&M in exchange for the termination of "put" agreement rights whereby M&M can borrow up to $10 million dollars from the Company collateralized by M&M's YP.Net stock valued at a floor of $1.00 per share or 80% of the last trade of the stock prior to the advance request, whichever is greater. The interest rate charged on these advances is either an 8% annual rate or % higher than the Company's average borrowing cost from an institutional lender, whichever is greater. Currently M&M is charged an interest rate of 8% calculated as an annual rate as the Company has paid off its institutional lender. There are restrictions in the loan agreement that allow management to reject an advance request by M&M if the Company has insufficient cash, cash reserves and anticipated cash receipts and or borrowing availability to cover operating expenses over the next 30-day period. M& M is a 27% shareholder of the Company.

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The following schedule sets forth the balances of the Company's advances made on behalf of it's officers and as part of the settlement with Matthew & Markson, Ltd. as of June 30, 2002:

Sunbelt Financial Concepts	$177,358	
The Thompson Group PC	16,899*	See Item 1, below
Matthew & Markson	227,296	
Allowance for Advances	(131,691)	
Total Advances to Affiliates	$289,862	

8. Related Party Transactions

Simple. Net. ("SN")

The Company has entered into mutual service agreements with Simple. Net ("SN"). Mr. DeVal Johnson, a director of YP.Net, Inc., is the beneficial owner of SN. SN is a national internet service provider that has from time to time sold those

services to the Company at below market rate prices.

On May 1, 2002, the Company assigned its Level 3 contract to SN in exchange for a new contract from SN that would provide dial-up services for the Company's customers at a reduced rate of $2.50 per user, per month. The Company determined that it did not have a sufficient amount of internet service dialup customers to benefit from its Level 3 contract, while SN, as an internet service provider, had a sufficient number of customers to support the base payment structure agreed to in the Level 3 contract. As a result, during this period the Company paid $19,218 to SN instead of the $50,000 that would have been paid to Level 3 under the old arrangement. If the Company's internet dial-up customers should increase, the Level 3 contract would be less expensive for us than our agreement with SN. The Level 3 contract is not assignable without the consent of Level 3, which the Company has not yet obtained. Consequently, the Company is still liable to Level 3 under the terms of the contract. SN has agreed to assume and perform the terms of the Level 3 contract. Since The Company provides billing services to SN it would have the right of offset against SN in the event that SN does not perform under the arrangement with Level 3 that SN has agreed to accept assignment from the Company. The assignment of the Level 3 contract to SN resulted in savings to the Company of approximately $30,782. In addition, SN has contracts with other National providers such as Broadwing Communications and through the Company's contract with SN The Company has obtained access numbers under those contracts as well for the benefit of the Company's customers.

By being able to provide Internet access to its customers the Company benefits two ways. First it has an additional product to sell to its customers, which enhances their retention. And second it has allowed the Company to bill customers on their phone bill (LEC Bill) for both services and is especially beneficial to the Company in areas where the Company can not LEC bill for the Company's core product

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SN pays a monthly fee to the Company to provide technical support and provide quality customer service while utilizing the Company's own customer service personnel as well as management and accounting services according to a pricing formula based on a price per customers as follows:

Customer Service & Management Agreement fees are calculated by number of customer records of SN multiplied by a base cost of $1.02.

Technical Support fees are calculated by number of customer records of SN multiplied by a base cost of 60 cents.

Previously the Company's staff performed the accounting functions for SN since SN utilizes a compatible accounting and billing process. SN paid us $2,500 a month for these accounting services. As of July 1, 2002, the Company no longer provides accounting services to SN as this arrangement has been canceled.

Matthew & Markson and Morris & Miller have provided the primary financing for SN in the principal amount of $1,025,000 and $610,000 respectively, in the form of promissory notes; interest is being calculated at a rate of 15% for both notes. Matthew & Markson is a 27% and Morris & Miller is a 22% of shareholder the Company. Neither Matthew & Markson, nor Morris & Miller is a part of management or on the Board of Directors of the Company or SN.

Commercial Finance Services d/b/a/ HR Management ("CFS")

The Company has entered into an employee leasing arrangement with Commercial

Finance Services, Inc. d/b/a HR Management, Inc. (CFS). See the Company's Form 10-KSB for the fiscal year ended September 30, 2001. CFS provides factoring and financing as well as the services of a professional employer organization ("PEO") for small to mid-sized companies. CFS does not provide any services to the Company, other than those of a PEO through HR Management, Inc. The Company pays CFS a monthly amount of approximately $128,000. This amount includes employee wages, payroll taxes, employee benefits and a below market administration fee of 2.5% per month. This arrangement allows the Company to offer additional benefits to its employees by sharing those costs with other clients of CFS. The Company pays CFS fees for payroll and benefit administration of approximately $2,800 per month, which represents the cost of a payroll clerk

Central Account Services, Inc. is the majority owner of CFS, holding over 85% of the stock. Central Account Services, Inc. and is unrelated to the Company. Mr. Joseph McDaniel, who owns 3% of CFS and also serves as counsel for the Company, and Matthew & Markson which has provided funding to CFS in the principal amount of $1,525,821, are the only related parties. Matthew & Markson is not a part of management or on the Board of Directors of the Company or CFS.

Matthew Markson, Ltd.

The Company has a note payable to Mathew Markson, Ltd. ("M&M"), which at the beginning of the fiscal year had a principal balance of $550,000. The outstanding balance on this note as of June 30, 2002, was $119,586 . In accordance with instructions that the Company has received from M&M, the Company has made payments to third parties on behalf of M&M, and applied those payments

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as reductions to this note, thereby reducing the outstanding balance on our books and records. Matthew & Markson is not a part of management or on the Board of Directors of the Company.

Business Executive Services, Inc.

Business Executive Services, Inc. ("BESI"), as the nominal rent sub-lessee, leases portions of the Company's Mesa facility to other businesses associated with other third parties (provides executive suites).

In addition to providing Executive Suites to a variety of companies, BESI's personnel have expertise in the processing and managing of large direct mail marketing campaigns. Because of this expertise, the Company has decided to outsource its direct mail marketing services to BESI.

Pursuant to an agreement the Company has with BESI, BESI processes all of the direct mail solicitation pieces, welcome letters and other communications with customers and prospective customers.

We pay a base fee of $10,000.00 per month and then a monthly fee to BESI based on a price of .015 cents per mail piece, based on the number of mail pieces prepared and sent, and not less than a floor of $15,000 per month. The floor amount is reviewed for possible adjustment quarterly.

Mr. Crane, a director of the Company, is employed by BESI and receives a salary of approximately $2,000 per month from BESI and bonuses in an undetermined amount. BESI has no related party ownership in the Company.

Advertising Management &Consulting Services , Inc.

Advertising Management & Consulting Services, Inc. ("AMCS"), is a marketing and advertising company that rents executive suites from BESI. AMCS' staff is experienced in designing direct marketing pieces, insuring compliance with regulatory authorities for those pieces and designing new products that can be mass marketed through the mail. The Company out sources the design and testing of its many direct mail pieces to AMCS for a fee of $20,000 per month. AMCS is also responsible for the new products that have been added to our website and is working on new mass- market products to offer our customers. Mr. Crane, a Director of the Company, is also the President of AMCS.

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

YP.Net, Inc., a Nevada corporation ("we," "our," "us" or the "Company") is in the business of providing to subscribers an Internet-based yellow page listing services on our Yellow-Page.Net and YP.Net Web sites. After acquiring Telco Billing ("Telco") in June 1999, we changed our primary business focus to become an Internet-based yellow page listing service. Our websites serve as a search engine for yellow page listings in the United States and Canada. We charge our customers a monthly fee (currently $17.95) for a "preferred" listing of their businesses on searches conducted by Internet consumers on our websites.

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

We currently derive virtually all of our revenues from selling to subscribers preferred listings for the search results on our websites. A preferred listing is displayed at the beginning of search results in response to a user's specific questions. A preferred listing is enhanced on the display of search results and includes a "mini-Web-page" listing where the preferred lister can use up to 40 words to advertise and provide additional information regarding its business. A preferred listing customer can also link its own web page to the search results. We are developing banner advertisements and outside marketing efforts as an additional source of revenue. We are also attempting to develop additional revenue sources and expand services to our customers through logo advertisements on our direct mailer.

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We have experienced continued increases in competition in the Internet yellow page market, and continue to seek joint venture and investment acquisition opportunities to potentially mitigate the effects of competition in the electronic yellow page markets.

We utilize direct mailings as our primary marketing program and the resultant customers from this program are the principal source of our revenue.

Our Customer Counts generally increase when the Company markets in this fashion. For example our customer counts increased from 114,409 in December 1999 to 129,457 by March 31st, 2000, and to 143,292 as of June 2000.

The Company voluntarily ceased its marketing activities while it negotiated a resolution of the suit with the Federal Trade Commission. This matter has been resolved with no findings of wrong doing on the part of the Company or its officers. During these periods of little or no marketing (some tests were done from November 2001 to February 2002) the Customer counts declined.

As of September 30th 2000 the customer count declined to 130,592, and as of December 31, 2000 the customer count was 123,408, as of March 2001 the customer count was 103,187, as of June 30th 2001 it was 99,862, as of September 30th, 2001 it was 91,348, as of December 31, 2001 it was 88,799 customers and finally as of March 31st 2002 we had 86,000 customers.

In February 2002 after resolution of the matter with the Federal Trade Commission and after conducting tests using the guidelines that had been agreed to the Company resumed its direct mail marketing.

Consequently, for the first time since June of 2000 the Company's customer counts actually increased to 112,330 customers for the period ended June 30th, 2002. In July 2002, we mailed one million solicitations to potential new customers and we expect to continue mailing one million mailers per month in the next quarter

Additionally our customer counts declined as we monitored our collection percentage of our direct-billed customers. These are customers that are directly invoiced through regular mail instead of being billed through the use of a Local Exchange Carrier ("LEC"). Because of this low collection percentage, we have initiated a contact campaign to determine if these customers are still in business and if they want to continue to advertise on our websites. This resulted in customer cancellations exceeding our acquisitions of new customers. Some of this decline may be mitigated by the acquisition of new paying customers. However, for the three-month period ended June 30, 2002, our collection percentages have increased due to our contact program, and we expect that to continue as more customers are contacted.

The increase in our customer count for the three-month period ending June 30, 2002, is a direct result of reinstituting our direct mail marketing program and continued efforts to increase customer satisfaction. We have contacted many of our customers in order to update each customer's account information. Our updated information has led to increased collections on outstanding invoices.

RESULTS OF OPERATIONS

Internet yellow page services business is currently our sole source of revenue. Revenue for the three and nine-month periods ended June 30, 2002, was $3,416,953 and $9,249,792, respectively, compared to $3,466,635 and $11,932,345 for the three and nine-month periods ended June 30, 2001, respectively. The decline in revenue Is due substantially to the suspension of our direct mail marketing from June 2000 to October 2001. As this is the sole source of new subscribers, the Company experienced its normal attrition of subscribers without replacing them with new subscribers. The Company intends to implement new processes to reduce the attrition of subscribers and also intends to increase its marketing efforts During the 3-month period ended June 30 2002 we experienced an increase in paying customers of 26,330 above the prior 3 month

period ended March 31, 2002. In November 2001, we resumed our direct mail marketing campaign that was voluntarily suspended in June 2000 while we negotiated a settlement with the FTC. Our increased marketing resulted in an increase in customers and revenues. With the continuation and expansion of our marketing program we hope to see an increase in our revenue and customer base in the future. Management has budgeted funds to mail one million mailers per month during the next quarter.

Cost of services for the three and nine-month periods ended June 30, 2002, was $1,168,396 and $3,086,075, respectively, compared to $1,918,532 and $6,645,440, respectively, for the three and nine month periods ended June 30, 2001. Cost of services is comprised of dilution expenses, direct mailer marketing costs, allowances for bad debt and our billing costs. Dilution expenses include customer credits and any other receivable write-downs. The primary reason our cost of services has continued to decline as of June 30, 2002, compared to June 30, 2001, is that we have implemented new filtering procedures that assure the proper filtering of our customer base to the correct LEC for billing. Further, our customer contact program has allowed the Company to obtain current information on its customers who have moved or changed the names of their businesses further reducing dilution. Further reductions in manpower and improvements in efficiencies have reduced our cost of services.

Selling expenses, primarily the costs associated with general advertising and market testing of other revenue sources, for the three and nine-month periods ended June 30, 2002, were $16,330 and $155,663, respectively, compared to $14,623 and $50,095, respectively, for the three and nine-month periods ended June 30, 2001. The primary reason for the increase in marketing is due to the implementation of new market strategies and modification of direct mail marketing pieces, as well as the increase in the number of pieces mailed. We capitalize certain direct marketing expenses and amortizes those costs over an 18 month period based on the customer attrition rates analyzed by the Company.

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General and administrative expense for the three and nine-month periods ended June 30, 2002, was $1,186,777 and $3,075,448, respectively, compared to $667,216 and $2,188,773, respectively, for the three and nine-month periods ended June 30, 2001. Administrative expenses increased due to an increase in legal fees related to the preferred share conversion offering and fees resulting from a suit against our former Chief Financial Officer. See Item 1, Legal Proceedings, below. . Additionally, we wrote off certain legal expenses associated with the prospective acquisition of Western Promotions, Inc. that was not completed due to unfavorable results of our due diligence investigation. We have also experienced an increase in corporate costs for directors and officers liability insurance due to the increase in the policy amount from $2.5 million to $5.0 million and an increase in rates. Additionally, board of director compensation has increased with additional duties assigned to the directors to assist us in implementing an employee stock option plan, and managing litigation.

The cost of our <u>Yellow-Page.Net</u> URL license was capitalized at $5,000,000. The URL is amortized on an accelerated basis over the twenty-year term of the licensing agreement. Amortization expense on the URL was $108,756 and $324,211 for the three and nine-month periods ended June 30, 2002, respectively, compared to $118,803 and $304,715 for the three and nine-month periods ended June 30, 2001. Annual amortization expense in future years related to the URL is anticipated to be approximately $430,000.

Interest expense net of interest income for the three and nine-month

periods ended June 30, 2002, was $33,808 and $70,802, respectively, compared to $-96,361 and $-364,759 for the three and nine-month periods ended June 30, 2001. The decrease in interest expense was a result of the reduction of our debt from our acquisition of Telco and our URL Yellow-Page.Net license.

We recorded other income of $392,482 and $398,052, respectively, for the three and nine-month periods ended June 30, 2002. The primary components of other income result from two transactions. During the three month period ended June 30, 2002, we reached a settlement with an entity that previously provided billing services to us. We claimed that the billing company improperly withheld receipts from our customers that were due to us. The Company entered into a settlement and was paid $200,000 to resolve this claim. Additionally, during the three month period ended June 30, 2002, the Company settled a dispute with a former consultant. By court order the consulting agreement was rescinded and 250,000 shares of the Company's common stock granted to this consultant under this consulting agreement during the year ended September 30, 2000 were returned. The Company recorded a gain of $267,675 for that settlement, which represents the value of the shares when issued, and recorded a corresponding expense at the time of issuance.

Net income before taxes for the three and nine-month periods ended June 30, 2002, was $1,247,637 and $2,803,269, respectively, compared to $618,367 and $2,227,027 for the same three and nine-month periods in 2001. Net income for the three and six-month periods ended June 30, 2002, was $798,743, or $.02 per diluted share, and $1,726,087, or $.04 per diluted share, respectively, compared to $428,852, or $.01 per diluted share, and $1,521,682, or $.04 per diluted share for the three and nine-month periods ended June 30, 2001.

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LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities for the nine-month period ended June 30, 2002, was $948,210 compared to $2,560,598 for the nine-month period ended June 30, 2001. The decrease in cash generated from operations is primarily due to a significantly greater increase in the accounts receivable balance and funds expended for mailings related to the Company's marketing efforts. The increase in the accounts receivable balance for the three month period ended June 30, 2002, related to difficulties with collections due to billing problems with the Company's primary billing service provider. We believe that those problems have been largely resolved and that cash receipts from accounts receivable will increase and that the reduction in collections was a temporary situation that has been corrected. Revenue was generated primarily from providing electronic yellow page preferred listing advertising from Telco Billing, Inc., our wholly owned subsidiary. Revenues increased during the three month period ended June 30, 2002, to $3,416,953 from $2,839,438 for the three-month period March 31, 2002, although our revenue for the three and nine-month period ended June 30, 2002, was still lower than revenue for the three and nine-month period ended June 30, 2001. While our customer base is lower than reported during the same period in 2001, it has increased for the three-month period ended June 30, 2002, compared to the three-month period ended March 31, 2002. We believe this is indicative of the positive results of the direct mail marketing program.

The primary reason for the decline in revenue and the decline in our customer base is that we ceased marketing efforts from the period of June 26, 2000 until October of 2001 in order to negotiate a final settlement with the Federal Trade Commission regarding our direct mailer program, and have written off many non-paying customers that were previously counted as revenue as their collectability was offset by a large reserve. Since October 2001, we have

increased our marketing efforts and have implemented procedures to refilter and direct customers to the correct LEC. This has increased our collection percentages. Although our overall customer base and gross revenues declined for the first six months of our fiscal year, we experienced an increase of our customer base for the three month period ended June 30, 2002. Our customer base is now 112,330, compared to 86,000 as of March 31, 2002.

Our billing for the month of February had been delayed through miscommunication with our main billing aggregator, IGT. Consequently we suffered a lower cash collection percentage in the month of May and a larger cash collection in the month of June 2002.

We anticipate that it will be obligated to pay federal and state income taxes for prior periods before the close of the fiscal year ending September 30, 2002. The final amount of tax due is not yet determined, however. The amount of taxes payable of $2,523,645 included in the accompanying balance sheet at June 30, 2002, is an estimate based on initial calculations. However, we are reevaluating its ability to use certain net operating loss carryforwards from the operations of RIGL. If it is determined that we have that ability, the income tax obligation will be reduced. To meet this obligation and all others anticipated by management, management is negotiating with Amerifund Capital, LLC, for a 3 million dollars standby funding agreement secured by the accounts receivable of our wholly owned subsidiary Telco Billing, Inc.

We had working capital of $3,067,911 as of June 30, 2002 compared to $1,680,074 as of June 30, 2001. The increase is due to increases in accounts receivable of $658,000 and capitalized direct marketing costs of $1,014,528.

The direct marketing costs will not result in cash but we anticipate future revenue and cash flow from customers obtained through these marketing efforts.

Cash used in investing activities was $473,935 for the nine-month period ended June 30, 2002. The cash used represents purchase of computer equipment of $118,979, net advances to affiliates of $305,237 and purchases of software licenses of $49,719, compared to the nine-month period ended June 30, 2001, where cash used of $15,138 represented the purchase of computer equipment.

Cash used by financing activities was $836,653 for the nine-month period ended June 30, 2002, compared to $2,713,986 for the nine-month period ended June 30, 2001. The cash used represents total payments made to reduce the principal balances of our outstanding notes payable to M & M and Mr. Joseph Van Sickle as well as loan advances to M&M and the Officers as part of agreements with them.

We have repaid a significant amount of our debt. We believe that we will continue to generate adequate cash flow from our operations to service our remaining debt. We have a commitment to provide up to $10,000,000 in loans to each of the M&M's (Morris & Miller, Ltd. and Matthew & Markson, Ltd.). Those funding commitments are contingent upon our cash flow. Any amounts advanced to the M&M's are to be repaid to the Company and can be offset against amounts owed to the M&M's. See Footnote 7 to the financial statements. We do not believe that the M&M's will make requests for funding under this commitment, if such advances would adversely affect our liquidity since the M&M's are our largest shareholders.

We are currently reviewing our loans and extensions of credit made to our officers and directors and other affiliated entities in order to comply with the recent enactment of the Sarbanes-Oxley Act of 2002, which, among other things,

generally prohibits (except in extraordinary circumstances) loans to officers and directors going forward from the date of its enactment.

CERTAIN RISK FACTORS

There are numerous factors that affect our business and the results of our operations. Sources of these factors include general economic and business conditions, federal and state regulation of our business activities, the level of demand for our services, the level and intensity of competition in the electronic yellow page industry and the pricing pressures that may result, our ability to develop new services based on new or evolving technology and the market's acceptance of those new services, our ability to timely and effectively manage periodic product transitions, the services, customer and geographic sales mix of any particular period, and our ability to continue to improve our infrastructure (including personnel and technology systems) to keep pace with the growth in our overall business activities. Our operations can be adversely affected if we are unable to increase our customer base and revenue through our direct marketing efforts. We are also subject to intense competition from other providers of Internet "yellow page" type services, Yahoo and Microsoft, as well as competition from large telephone companies. In addition, our Chief Executive Officer is involved in personal litigation, which may divert his attention from the management of the Company. See the Company's Form 10-QSB filed with the Securities and Exchange Commission for the period ended March 31, 2002.

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PREFERRED SHARED TENDER OFFER PENDING

There are currently 43,813,630 issued and outstanding shares of our Common Stock. We filed with the Securities and Exchange Commission a Schedule TO, pursuant to which the Company is making a preferred stock tender offer pursuant to Rule 13e-4, adopted under the Securities Exchange Act of 1934. We offered to the holders of its common stock, par value $.001 (the "Common Stock"), to exchange up to 10,000,000 shares of Common Stock for an equal amount of shares of Series E Preferred Stock. We paid all charges and expenses of Continental Stock Transfer & Trust Company, as Tendering Agent, in connection with the offer The offer terminated at 5:00 P.M., New York City time, on May 31, 2002. As a result of the offer, 113,000 shares of Common Stock were exchanged for an equal number of shares of Series E Preferred Stock.

Series E Preferred Stock is entitled to receive dividends at a rate of 5% per annum based upon the stated liquidation preference of $.30 per share ($0.015 per share per annum). From and after two years from the initial issuance of the Series E Preferred Stock until three years thereafter, preferred shareholders shall have the right to convert all or portions of their Series E Preferred Stock into shares of our Common Stock, at a rate of one for one, together with the payment by the holder of $0.45 per converted share.

Upon the sale of substantially all of the stock or assets of the Company in a non-public transaction or dissolution, liquidation, or winding up of the Corporation, whether voluntary or involuntary, the holders of the Series E Preferred Stock are entitled to receive out of the assets of the Company, before any distribution or payment is made upon the Common Stock or any other series of Preferred Stock, an amount in cash equal to $.30 per share, plus any accrued but unpaid dividends. The holders of the Series E Preferred Stock have no voting rights, except as required by law.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are party to ordinary routine litigation in the course of our operations. We have also been subject to certain state and federal regulatory proceedings. We recently settled a complaint filed against us by the Federal Trade Commission. See our Form 10-KSB for the year ended September 30, 2001, for a description of this matter.

We are named as defendant in material legal proceedings filed by Mr. Van Sickle wherein he alleges that we have defaulted on payment obligations under a $2,000,000 promissory note to Mr. Van Sickle. We have denied the allegations and are attempting to resolve this matter through a settlement.

On May 24, 2002, after being confronted about certain irregularities Pamela Thompson, CPA, resigned as our Chief Financial Officer, Secretary and Treasurer. The Company has initiated a search for a new Chief Financial Officer.

On May 29, 2002, we filed suit against Ms. Thompson and related parties in the Superior Court of Arizona alleging, among other things, that Ms. Thompson and certain other parties removed Company property without authorization and misappropriated Company funds. In this complaint, we also requested a temporary restraining order be issued against Ms. Thompson and others enjoining them from using certain of the Company's property, including trade secrets and proprietary information. Ms. Thompson responded to the Company's request for a temporary restraining order alleging the Company's allegations are unsubstantiated On July 10, 2002, the Superior Court of Arizona for Maricopa County issued a Temporary Restraining Order against Ms. Thompson and certain related parties enjoining them from disclosing or disseminating the Company's trade secrets, financial information or other confidential information, using the Company's computer equipment and disclosing any Company proprietary information for any purpose, or interfering with any of the contractual obligations or contracts of the Company. The Company is also seeking punitive and compensatory damages as well as Attorney's fees.

The Company's Chairman and Chief Executive Officer, Mr. Tullo, is a party defendant in an adversary proceeding ancillary to the Bankruptcy proceedings under Chapter 11 of American Business Funding, Inc. ("ABF"). See United States Bankruptcy Court for the District of Arizona, Case #00-01782-ECF-RJH, and Case #00-00151-RJH American Business Funding Corporation (ABF) v. Tullo, et. al. The suit alleges that all of the former officers of ABF, including Mr. Tullo, and others and entities that may have been controlled by them, made fraudulent conveyances and breached their fiduciary duty to certain shareholders of ABF.

Mr. Tullo has answered the complaints against him and has denied all the allegations and has been vigorously contesting the plaintiffs' claims. Mr. Tullo and his legal counsel have provided the following information:

Mr. Tullo alleges that he discovered a scheme of financial improprieties by his partners and some employees, including misappropriation of funds from ABF. Further that after Mr. Tullo left his former partners and those appointed by them continued to raise funds without disclosure and to pay old obligations with this new money. Mr. Tullo states that it was through his intervention, by contacting many of the creditors, meeting with the Arizona Attorney General's Office, and moving for and obtaining the appointment of a Receiver, and later a court appointed examiner, that the activities stopped. Upon the appointment of the receiver, the directors appointed by Tullo's former partners authorized ABF to file for protection under the United States Bankruptcy Code and initiated the suit referenced above.

There are several other suits related to ABF and its bankruptcy proceedings. In all of the cases not filed by the control persons of ABF, Mr. Tullo is not named as a defendant. The only findings of fact and conclusions of law that have been rendered in this series of cases is against one of the directors installed by Tullo's former partners, and that was by the Arizona

Corporation Commission, docket number S-03443A-01-0000 Decision number 64079.

The Company has conducted a limited investigation of these matters, but is not in a position to confirm or deny the truth of the various and conflicting allegations. The litigation does not presently name the Company as a defendant. The litigation could adversely affect the Company if the litigation diverts Mr. Tullo's attention from his duties as an officer and director of the Company. There can be no assurance that the Company may not be named a defendant in this action in the future.

ITEM 5. OTHER INFORMATION

The Company's Chairman, President and Chief Executive Officer, Mr. Angelo Tullo, is involved in certain legal proceedings that are not adverse to the Company. In February 2000, American Business Funding Corp. ("ABF") filed for protection under Chapter 11 of the Bankruptcy Code in the Federal District Court of Arizona. Mr. Tullo had previously been a director, officer and shareholder of American Business Funding prior to the time of its bankruptcy filing. Mr. Tullo discovered a scheme of improprieties relating to the falsification of ABF's books and records designed to obfuscate that improper payments were being made to Mr. Tullo's partners in ABF, rather than to the vendors listed in the Company's book and records..

See the Company's Form 10-QSB filed with the Securities and Exchange Commission for the three-month period ended March 31, 2002, whereby this reference is incorporated herein.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

EXHIBITS

REPORTS ON FORM 8-K

May 17, 2002, Peter Bergmann appointed to the Board of Directors and Harold Roberts resigned.

SIGNATURES

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

YP.NET, INC.

Dated: August 14th, 2002

/s/ Angelo Tullo

Chairman, President, Chief Executive Officer

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CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906

OF THE SARBANES-OXLEY ACT OF 2002

In connection with the YP.Net, Inc., a Nevada corporation (the "Company"), Quarterly Report on Form 10-Q for the three month period ended June 30, 2002, as filed with the Securities and Exchange Commission on the date hereof, I, Angelo Tullo, Chief Executive Officer and Acting Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

To the best of the undersigned's knowledge, based upon a review of the Company's Form 10-Q for the three month period ended June 30, 2002:

1. The Company's Quarterly Report on Form 10-Q for the three month period ended June 30, 2002, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934;

2. The information contained in the Company's Form 10-Q for the three month period ended June 30, 2002, fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Angelo Tullo, CEO

Angelo Tullo, Chief Executive Officer
Acting Chief Financial Officer

STATE OF ARIZONA)
)
County of Maricopa)

The foregoing was acknowledged before me this 13th day of August, 2002, by Angelo Tullo, Chief Executive Officer and Acting Chief Financial Officer of YP.Net, Inc., a Nevada corporation, on behalf of such corporation.

/s/ Margaret Molter

Notary Public
My Commission Expires: 09/22/2003