9278 COMMUNICATIONS INC
Form 10-Q
June 27, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2003

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to ________

Commission file number: 333-37654

9278 COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Delaware	13-4165136
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1942 Williamsbridge Road, Bronx, New York 10461
(Address of principal executive offices)

(718) 887-9278
(Registrant's telephone number, including area code)

Not applicable

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

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 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 [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 after the distribution of securities under a plan confirmed by a court.

Yes [ ] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date:

Common Stock, $.001 par value - 100 shares issued and outstanding as of June 20, 2003

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

9278 Communications, Inc. and Subsidiaries

INDEX TO FINANCIAL STATEMENTS

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED CONDENSED BALANCE SHEETS

	March 31, 2003 (UNAUDITED)	December 31, 2002
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 6,974,587	$ 7,527,098
Restricted cash	-	1,020,809
Accounts receivable, net of allowance of $678,000 at March 31, 2003 and $760,000 at December 31, 2002	15,092,164	14,711,918
Accounts receivable-related party	4,964,653	4,963,508
Inventories	19,932,413	18,041,063
Prepaid expenses and other current assets	141,315	32,622
Total current assets	47,105,132	46,297,018
PROPERTY AND EQUIPMENT, NET	1,720,405	1,801,798
NOTE RECEIVABLE - STRATEGIC PARTNER	3,982,823	1,530,975
GOODWILL, NET	3,624,071	3,624,071
OTHER ASSETS	730,830	690,831
	$57,163,261	$53,944,693

The accompanying notes are an integral part of these statements.

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9278 Communications, Inc. and Subsidiaries

CONSOLIDATED CONDENSED BALANCE SHEETS

	March 31, 2003 (UNAUDITED)	De
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 61,984,754	$ 57
Accounts payable - related party	2,700	
Current maturities of capital lease obligations	31,779	
Current maturities of convertible notes payable	52,520	
Income taxes payable	-	
Total current liabilities	62,071,753	57
CAPITAL LEASE OBLIGATIONS, less current maturities	23,460	
CONVERTIBLE NOTES PAYABLE, less current maturities	75,126	
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY (DEFICIT)		
Common stock - $.001 par value; 40,000,000 shares authorized; 23,932,912 shares issued and outstanding at March 31,2003 and December 31,2002	23,933	
Additional paid-in capital	8,247,458	8
Accumulated deficit	(13,278,469)	(12
Total Shareholders' Equity (deficit)	(5,007,078)	(3
	$ 57,163,261	$ 53

The accompanying notes are an integral part of these statements.

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Net sales	$ 72,949,014	$ 57,365,454
Cost of sales	67,986,011	53,069,185
Gross profit	4,963,003	4,296,269
Operating expenses		
Selling	3,151,419	1,466,587
General and administrative	2,859,017	2,418,929
Depreciation and amortization	111,732	72,606
Provision for bad debts	-	51,792
	6,122,168	4,009,914
Operating profit/(loss)	(1,159,165)	286,355
Other expenses		
Interest expense, net	482	10,778
	482	10,778
Earnings/(loss) before income taxes	(1,159,647)	275,577
Income tax provision	-	15,000
Net income/(loss)	$ (1,159,647)	$ 260,577
Earnings/(loss) per common share		
Basic and diluted	$(0.05)	$0.01

Weighted-average shares		
Basic and diluted	23,932,912	23,932,912

The accompanying notes are an integral part of these statements.

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENT OF SHAREHOLDERS' EQUITY

Three months ended March 31, 2003

	Common stock		Additional paid-in capital	A
	Shares	Amount		
Balance at January 1,2002	22,932,912	$ 22,933	$ 8,248,458	
Issuance of common stock in connection with acquisition of Reliable Networks, Inc.	1,000,000	1,000	(1,000)	
Net loss for the year ended December 31, 2002				
Balance at December 31, 2002	23,932,912	23,933	8,247,458	
Net loss for the three months ended March 31, 2003				
Balance at March 31, 2003	23,932,912	$ 23,933	$ 8,247,458	

The accompanying notes are an integral part of this statement.

9278 Communications, Inc. and Subsidiaries
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	March 31, 2003	March 31, 2002
Cash flows from operating activities		
Net income (loss)	$(1,159,647)	$ 260,577
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	111,732	72,606
Provision for doubtful accounts	-	51,792
Changes in assets and liabilities		
Restricted cash	1,020,809	(4,629)
Accounts receivable	(381,391)	339,235
Inventories	(1,891,350)	(6,239,028)
Prepaid expenses and other current assets	(108,693)	(218,610)
Other assets	(40,000)	(11,569)
Accounts payable and accrued expenses	4,435,606	4,572,826
Income taxes payable	(14,145)	(44,250)
Net cash provided by (used in) operating activities	1,972,921	(1,221,050)
Cash flows from investing activities		
Acquisition of property and equipment	(30,340)	(195,312)
Notes Receivable, Strategic Partner	(2,451,848)	-
Net cash used in investing activities	(2,482,188)	(195,312)
Cash flows from financing activities		
Notes and advances payable, shareholder, net	-	(292,825)
Principal payments on capital lease obligations	(30,744)	(9,412)

Principal payments on convertible notes payable, net	(12,500)	(10,689)
Net cash used in financing activities	(43,244)	(312,926)
Net decrease in cash and cash equivalents	(552,511)	(1,729,288)
Cash and cash equivalents, beginning of period	7,527,098	4,335,936
Cash and cash equivalents, end of period	$ 6,974,587	$ 2,606,648

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (continued)
(UNAUDITED)

	March 31, 2003	March 31, 2002
Supplemental disclosures of cash flow information:		
Cash paid during the period for		
Interest	$ 482	$ 17,130
Income taxes	$ 14,145	$ 67,381

The accompanying notes are an integral part of these statements.

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTION

The accompanying consolidated unaudited financial statements of 9278 Communication Inc. and subsidiaries (collectively, the "Company") have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for quarterly reports on Form 10-Q and do not include all of the information and footnote disclosures generally required by accounting principles generally accepted in the United States and should be read in conjunction with our consolidated financial statements and notes thereto for the fiscal year ended December 31, 2002, included in the Company's Form 10-K as filed with the SEC. The accompanying condensed consolidated unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States and reflect all adjustments (consisting of normal recurring accruals) which are, in the opinion of the management, considered necessary for a fair presentation of results for these interim periods. Operating results for the three month periods ended March 31, 2003 and 2002 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2003.

The accompanying condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The Company sustained substantial losses from operations and its current liabilities exceeded its current assets by approximately $14,967,000 as of March 31, 2003. The company is largely dependent upon the extension of credit from its vendors, in particular on credit granted by a significant supplier. These factors raise substantial doubt about the Company's ability to continue as a going concern.

In the event sufficient vendor credit is no longer available, the Company would be required to seek other financing, however there can be no assurance that the Company will be able to obtain such financing on commercially reasonable terms, or otherwise or that the Company would be able to satisfy short-term cash flow needs. The Company is continuously renegotiating credit terms with its suppliers and, to date, has received favorable terms. The Company believes its relationships with its vendors are satisfactory; however, the Company's creditors currently have the right to modify credit terms.

NOTE 2 - NATURE OF BUSINESS

The Company distributes prepaid telephone calling cards to distributors and retail establishments through its various sales locations throughout the United States. In addition, the Company markets certain prepaid calling cards directly to consumers via its internet websites.

On January 31, 2003, the Company announced the execution of a Merger Agreement with NTSE Holding Corp., a corporation wholly owned by the Chairman, Chief Executive Officer and the principal stockholder, which will result in the Company becoming a privately held corporation, owned by the Company's Chairman. Pursuant to this agreement, all of the existing stockholders will receive a cash payment of $0.10 per share. The transaction was approved by its public stockholders on June 3, 2003 and the merger was consummated on June 4, 2003. Total payment in terms of the merger agreement amounted to approximately $1,092,000.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows:

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of 9278 Communications, Inc. and its wholly owned subsidiaries, 9278 Distributors, Inc., 9278 Dot Com Inc., E-Store Solutions Inc., Inc., 9278 Mobile, Inc., 9278 Technologies, Inc., NTSE Communications, Inc., 9278 Distributors Illinois, Inc., 9278 California, Inc., 9278 Distributors Maryland Inc., 9278 Distributors New Jersey Inc., Reliable Acquisition Corp., 9278 Distributors Ohio Inc., 9278 Distributors Florida Inc., and 9278 Distributors North Carolina Inc. (hereinafter, the "Company"). All significant inter-company transactions and balances have been eliminated in consolidation.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include all cash and highly liquid investments with an original maturity of three months or less.

INVENTORIES

Inventories, which consist of prepaid telephone cards, are stated at the lower of cost (first-in, first-out) or market.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation and amortization are provided for, using straight-line and accelerated methods, in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives. Leased property under capital leases is amortized over the shorter of the service lives of the assets or the term of the lease. Repairs and maintenance are charged to operations as incurred.

INCOME TAXES

Income taxes are accounted for under the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 109 ("SFAS No. 109"), "Accounting of Income Taxes." Under SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The company has made provision for various minimum state and local taxes. The provision, in 2002, for federal taxes has been offset against the company's net operating losses carried forward from prior years. A valuation allowance has been established as the likelihood of realizing net deferred tax benefits is presently doubtful.

EARNINGS/LOSS PER SHARE

Basic earnings per share are determined by dividing the Company's net earnings/loss by the weighted-average shares outstanding. Diluted earnings per share include the dilutive effects of outstanding stock option and warrants. Excluded from the calculation of diluted earnings per share are 210,000 options and warrants to purchase the Company's common stock as their inclusion would have been antidilutive.

GOODWILL

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141 ("SFAS No. 141"), "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). For all business combinations initiated after June 30, 2001, SFAS No. 141 eliminates the pooling-of-interests method of accounting and requires the purchase method of accounting, including revised recognition criteria for intangible assets other than goodwill. Under SFAS No. 142, which is effective for years beginning after December 15, 2001, goodwill and indefinite-lived intangible assets are no longer amortized but are reviewed annually, or more frequently if impairment indicators arise, for impairment. Intangible assets that have finite lives will continue to be amortized over their useful lives and reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." The Company has adopted SFAS No. 142 for the year beginning January 1, 2002.

LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or group of assets may not be fully recoverable. If an impairment indicator is present, we evaluate recoverability by a comparison of the carrying amount of the assets to future undiscounted net cash flows that we expect to generate from these assets. If the assets are impaired, we recognize an impairment charge equal to the amount by which the carrying amount exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying values or fair values, less estimated costs of disposal.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2002, the FASB issued SFAS No.148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No.123." SFAS No.148 amends SFAS No.123,"Accounting for Stock-Based Compensation," to provide alternative methods of transition for an entity that voluntarily changes to the fair value-based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No.25 and related interpretations as provided for under SFAS No.148. Accordingly, compensation expense is only recognized when the market value of the Company's stock at the date of the grant exceeds the amount an employee must pay to acquire the stock.

Proforma earnings (loss) and earnings (loss) per share are not presented as the proforma information is equal to the Company's reported results.

In January 2003, the FASB issued FASB Interpretation No.46 "Consolidation of Variable Interest Entities." In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. A variable interest entity often holds financial assets, including loans or receivables real estate or other property. A variable interest entity may be essentially passive or it may engage in activities on behalf of another company. Until now, a company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN No.46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN No. 46's consolidation requirements apply immediately to variable interest entities created or acquired after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year on interim period beginning after June 15, 2003. Certain of the disclosure requirements apply to all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Company has not adopted FIN No.46 for the three months ended March 31, 2003, however the Company has provided for the required disclosures required by FIN No. 46 (see Note 5). The Company has not completed its Decembers 31, Estimated useful life March 31, of the effects of adopting FIN No. 46.

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - SUMMARY OF SIGNIF