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CYPOST CORP
Form 10QSB
August 17, 2001

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended: June 30, 2001

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____

Commission file number 000-26751

CyPost Corporation

(Exact Name of Small Business Issuer as Specified in Its Charter)

Delaware

98-0178674

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification Number)

900-1281 West Georgia St., Vancouver, British Columbia, Canada V6E 3J7

(Address of Principal Executive Offices)

(Zip Code)

(604) 904-4422

(Issuer's Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 No

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 21,559,525 as of July 31, 2001.

Transitional Small Business Disclosure Format (check one): Yes No

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission ("Commission"). While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for fair presentation of the results of the interim period, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the financial statements and footnotes thereto, which are included in the Company's Annual Report on Form 10-KSB, as amended, for the fiscal year ended December 31, 2000, previously filed with the Commission.

The accompanying notes are an integral part of these consolidated financial statements.

CYPOST CORPORATION AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEETS
 JUNE 30, 2001 AND DECEMBER 31, 2000
 (U.S. DOLLARS)

	6/31/01	12/31/00
	-----	-----
	(Unaudited)	(Audited)
ASSETS		
CURRENT ASSETS		
CASH	\$ 102,161	\$ 250,631
ACCOUNTS RECEIVABLE, NET OF ALLOWANCE	331,787	173,207
INSURANCE PROCEEDS RECEIVABLE	2,716	58,488
PREPAIDS AND DEPOSITS	152,390	250,534
	-----	-----
	589,054	732,860
PROPERTY AND EQUIPMENT, NET OF ACCUMULATED DEPRECIATION	607,054	751,020
GOODWILL AND OTHER INTANGIBLES, NET OF ACCUMULATED AMORTIZATION	2,277,090	3,193,015
OTHER ASSETS	9,323	5,371
	-----	-----
	\$ 3,482,521	\$ 4,682,266
	=====	=====
 LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
ACCOUNTS PAYABLE AND ACCRUED LIABILITIES	\$ 1,111,089	\$ 1,026,666
LOANS	2,344,788	2,110,000
DEFERRED REVENUE	547,315	640,483
	-----	-----
TOTAL CURRENT LIABILITIES	4,003,192	3,777,149
	-----	-----
 COMMITMENTS AND CONTINGENCIES		

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STOCKHOLDERS' EQUITY (DEFICIT)

SHARE CAPITAL

AUTHORIZED

5,000,000 PREFERRED STOCK WITH A PAR VALUE OF \$.001

30,000,000 COMMON STOCK

WITH A PAR VAUE OF \$.001

ISSUED AND OUTSTANDING

PREFERRED STOCK -

NONE

COMMON STOCK 21,559,493 -

2001, 21,556,993 - 2000

PAID-IN CAPITAL

ACCUMULATED DEFICIT

CURRENCY TRANSLATION ADJUSTMENT

TOTAL STOCKHOLDERS' EQUITY (DEFICIT)

	-	-
	21,560	21,557
	14,048,816	14,047,544
	(14,587,243)	(13,197,006)
	(3,804)	33,022
	-----	-----
	(520,671)	905,117
	-----	-----
	\$ 3,482,521	\$ 4,682,266
	=====	=====

The accompanying notes are an integral part of these consolidated statements.

CYPOST CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2001 AND 2000
(UNAUDITED)
(U.S. DOLLARS)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	-----	-----	-----	-----
REVENUE	\$ 955,376	\$ 1,354,745	\$ 2,019,199	2,394,305
DIRECT COSTS	(484,358)	(676,546)	(913,029)	(1,296,927)
	-----	-----	-----	-----
	471,018	678,199	1,106,170	1,097,378
	-----	-----	-----	-----
EXPENSES				
SELLING, GENERAL AND ADMINISTRATIVE AMORTIZATION AND DEPRECIATION	723,047	1,403,834	1,345,999	2,411,617
	548,604	847,556	1,067,461	1,506,648
	-----	-----	-----	-----
	1,271,651	2,251,390	2,413,460	3,918,265
	-----	-----	-----	-----
LOSS BEFORE OTHER INCOME (EXPENSE)	(800,633)	(1,573,191)	(1,307,290)	(2,820,887)
	-----	-----	-----	-----

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NET PROCEEDS FROM FIRE INSURANCE	-	22,274	-	129,545
INTEREST EXPENSE	(41,621)	(1,824,611)	(82,947)	(2,003,895)
MINORITY INTEREST	-	92,700	-	108,656
	-----	-----	-----	-----
NET LOSS	(842,254)	(3,282,828)	(1,390,237)	(4,586,581)
	-----	-----	-----	-----
LOSS PER SHARE BASIC & DILUTED	(0.04)	(0.16)	(0.06)	(0.22)
	=====	=====	=====	=====
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	21,559,493	21,138,993	21,558,243	20,892,842
	=====	=====	=====	=====

The accompanying notes are an integral part of these consolidated statements.

CYPOST CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
(U.S. DOLLARS)

	2001	2000
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
NET LOSS	\$ (1,390,237)	\$ (4,586,581)
Adjustments to reconcile net loss to cash used by operating activities:		
Amortization and depreciation	1,067,461	1,506,648
Interest expense	82,947	2,003,451
Fair value of stock issued for services	1,275	-
Net recovery from fire insurance	-	(129,545)
	-----	-----
	(238,554)	(1,206,027)
Changes in non-cash operating accounts	161,755	348,308
	-----	-----
NET CASH USED BY OPERATING ACTIVITIES	(76,799)	(857,719)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of business	-	(300,000)
Purchase of property and equipment	(71,671)	(266,130)
Investment in software development	-	(74,447)
	-----	-----
NET CASH USED IN INVESTING ACTIVITIES	(71,671)	(640,577)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Loan proceeds	-	1,333,589
	-----	-----
NET CASH PROVIDED BY FINANCING ACTIVITIES	-	1,333,589
	-----	-----

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NET INCREASE IN CASH	(148,470)	(164,707)
CASH, BEGINNING OF PERIOD	250,631	415,779
	-----	-----
CASH, END OF PERIOD	\$ 102,161	\$ 251,072
	=====	=====

The accompanying notes are an integral part of these consolidated statements

CYPOST CORPORATION
 NOTES TO CONDENSED CONSOLIDATED
 FINANCIAL STATEMENTS
 JUNE 30, 2001
 (UNAUDITED)

(U.S. DOLLARS)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

GOING CONCERN

These financial statements have been prepared on the basis of accounting principles applicable to a "going concern" which assume that Cypost Corporation (the "Company") will continue in operation for at least one year and will be able to realize its assets and discharge its liabilities in the normal course of operations.

Several conditions and events cast doubt about the Company's ability to continue as a going concern. The Company has incurred net losses of approximately \$14.6 million for the period from inception September 5, 1997 to June 30, 2001, has a working capital deficit of approximately \$3.4 million at June 30, 2001, and requires additional financing for its business operations.

The Company is streamlining operations and consolidating its ISP's to enhance efficiency and reduce operating expenses. As a result of the foregoing efforts, the operations of Intouch Internet Inc. and NetRover Office Inc. have been fully consolidated into the Company's wholly-owned subsidiary, NetRover Inc.

These consolidated financial statements do not reflect adjustments that would be necessary if the Company were unable to continue as a going concern. While management believes that the actions already taken or planned, as described above, will mitigate the adverse conditions and events which raise doubts about the validity of the "going concern" assumption used in preparing these financial statements, there can be no assurance that these actions will be successful.

If the Company were unable to continue as a going concern, then substantial adjustments would be necessary to the carrying values of assets, the reported amounts of its liabilities, the reported revenues and expenses.

INTERIM FINANCIAL STATEMENTS

The interim condensed consolidated financial statements presented have been prepared by the Company without audit and, in the opinion of the management, reflect all adjustments of a normal recurring nature necessary for a fair statement of (a) the consolidated results of operations for the three and six months ended June 30, 2001 and 2000, (b) the consolidated

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financial position at June 30, 2001 and (c) the consolidated cash flows for the six months ended June 30, 2001 and 2000. Interim results are not necessarily indicative of results for a full year.

The consolidated balance sheet presented as of December 31, 2000 has been derived from the consolidated financial statements that have been audited by the Company's independent auditors. The consolidated financial statements and notes are condensed as permitted by Form 10-QSB and do not contain certain information included in the annual financial statements and notes of the Company. The consolidated financial statements and notes included herein should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-KSB.

CONSOLIDATION

The consolidated financial statements include the accounts of CyPost Corporation and its subsidiaries. In 2000, the subsidiaries include CyPost KK, Playa Corporation, ePost Innovations Inc., NetRover Inc., NetRover Office Inc., Hermes Net Solutions Inc., and Intouch.Internet Inc. All of the subsidiaries, except CyPost KK, are wholly owned. Later in 2000, the Company sold its investment in CyPost KK and abandoned its investment in Playa Corporation. Connect Northwest and Internet Arena are DBA of CyPost Corporation. All significant inter-company transactions and balances have been eliminated in consolidation.

2. LOANS

On June 18, 2001 at the request of Blue Heron Venture Fund, Ltd. (Blue Heron), Blue Heron Notes in the aggregate principal amount of \$2,085,000 were cancelled and on June 19, 2001 new promissory notes (the "Blue Heron Shareholder Notes") in the aggregate principal amount of \$2,319,788.24 were issued to the shareholders of Blue Heron. The principal amount of the Blue Heron Shareholder Notes is comprised of the \$2,085,000 principal amount of the Blue Heron Notes and the \$234,788.24 in interest due on the Blue Heron Notes at the time of cancellation. The Blue Heron Shareholder Notes are unsecured and are payable on demand. \$2,085,000 in principal amount of the Blue Heron Shareholder Notes bear interest at 8% per annum. The balance of the Blue Heron Shareholder Notes do not provide for the payment of interest.

3. COMMITMENTS AND CONTIGENCIES

CANADA POST LITIGATION

On June 20, 2001 ePost Innovations, Canada Post and the Company entered into a Settlement and Release Agreement effective as of May 30, 2001 (the "Settlement Agreement"). Pursuant to the Settlement Agreement, the parties executed mutual releases and discontinued their respective claims. The release by Canada Post to ePost Innovations was made subject to the Company and ePost Innovations ceasing all use of the trade name EPOST within Canada within 90 days of the effective date of the Settlement Agreement and transferring all right, title and interest they had with respect to the trade name and trademark EPOST and any goodwill associated therewith to Canada Post upon execution of the Settlement Agreement. The Company has yet to change the name of its subsidiary but intends to do so within the time frame set forth in the Settlement Agreement. All other terms of the Settlement Agreement have been complied with.

BERRY LITIGATION

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On March 31, 2000, the Company commenced suit in the Supreme Court of British Columbia, Action #S001822, Vancouver Registry against Tia Berry (the "Tia Action"), the wife of Steven Berry ("Berry"), the former President and Chief Executive Officer of the Company. In the Tia Action, the Company claims \$42,516 (CDN) from Tia Berry on account of monies paid to her by the Company which she was not entitled to receive. Tia Berry has filed a Statement of Defense in the Tia Action in which she alleges that the payments which she received from the Company were to reimburse her for business expenses which she had charged to her credit cards on behalf of Berry. The Tia Action has not yet been set for trial.

On April 4, 2000, Berry commenced an action in the Supreme Court of the State of New York, County of New York (Index No. 601448/2000), against

the Company and Continental Stock Transfer & Trust Company ("Continental"), (the "New York Action"). In the New York Action, Berry claimed damages for alleged conversion, fraud, breach of contract and breach of fiduciary duty all arising from the alleged wrongful Stop Transfer Order which the Company placed relating to 75,000 shares of the Company's Common Stock registered in Berry's name and the Company's cancellation of a further 600,000 shares (the "Contingent Shares"). The complaint in the New York Action claims damages in excess of \$3,000,000 with the precise amount to be determined at trial.

Berry received the 600,000 Contingent Shares upon condition that he would remain in the Company's employ as Chief Executive Officer for at least two years. Berry commenced his employment with the Company on January 4, 1999, and resigned his employment with the Company on January 17, 2000. Following Berry's resignation, the Company attempted to have a Stop Transfer Order issued with respect to the 75,000 shares registered in Berry's name and cancel the 600,000 Contingent Shares. The Stop Transfer Order was not effective and Berry subsequently sold the 75,000 shares.

On May 19, 2000 CyPost and ePost Innovations commenced suit in the Supreme Court of British Columbia, Action #S002798, Vancouver Registry, against Berry and his wife, Tia Berry (the "BC Action"). In the BC Action, the Company seeks an order directing Berry to return the 600,000 Contingent Shares to the Company for cancellation or an order entitling the Company to cancel the same on the basis that Berry did not fulfill the employment conditions which were the condition precedent to his becoming the beneficial owner of the Contingent Shares.

In the BC Action, the Company also claims at least Cdn\$800,000 from Berry on account of breach of fiduciary duty, negligence, breach of statutory duties and breach of contract arising from Berry's failure to properly carry out his employment responsibilities. In the BC Action, the Company also claims Cdn\$34,013 from Berry and Tia Berry on account of conspiracy to defraud and injure the Company and ePost Innovations by causing certain personal expenses to be paid by the Company rather than by Berry and Tia Berry personally. The Company also claims punitive and exemplary damages from Berry and Tia Berry in the BC Action.

On May 25, 2000, the Company moved in the New York Action for an order dismissing the action against the Company for lack of jurisdiction or, in the alternative, on the basis of forum non conveniens. On September 5, 2000, the court dismissed the New York Action on forum non conveniens grounds, subject to the Company making certain stipulations in the New York Action. Those stipulations have been made and the appeal period in the New York Action has expired without Berry or any other party appealing the

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September 5, 2000 order.

The issues raised by Berry and the Company in the New York Action will be litigated in the BC Action together with the further issues raised by the Company in the BC Action. The Company feels that Berry's claims in the New York Action were without merit and that the Company will be successful in obtaining an order declaring that Berry's 600,000 Contingent Shares be cancelled and further entitling the Company to substantial damages. The Company will vigorously pursue its position in all respects.

On December 21, 2000, Berry and Tia Berry commenced suit in the Supreme Court of British Columbia, Action #S006790, Vancouver Registry, against CyPost, ePost Innovations, Kelly Shane Montalban, J. Thomas W. Johnston, Carl Whitehead and Robert Sendoh (the "Berry Action"). Statements of Defense have been filed on behalf of the Company and the other defendants.

The Plaintiffs in the Berry Action allege that the Tia Action, the BC Action, and the action by Kelly Shane Montalban (Supreme Court of British Columbia, Action #S002147, Vancouver Registry), against Berry for specific

performance of an option agreement (the "Montalban Action"), collectively, amount to an abuse of process, malicious prosecution, unlawful interference with the Plaintiffs' economic rights, or were commenced pursuant to a civil conspiracy to injure the Plaintiffs.

In the Berry Action, the Plaintiffs seek a declaration that Berry is entitled to the 600,000 Contingent Shares and claim unspecified damages which are estimated at Cdn\$2,000,000 based on the Statement of Claim. They also claim punitive or aggravated damages and costs. The Company believes that the allegations in the Berry Action are without merit and they will be vigorously defended.

It is expected that the Tia Action, the BC Action and the Berry Action will be consolidated for the purposes of trial due to the fact that there are numerous issues of fact and law which are common to all of these actions. The Company believes that trial will likely take place in the fall of 2002.

A loss by the Company of the claim against it for monetary damages would have a material adverse effect on the Company's future results of operations, financial condition and liquidity; however, the Company does not expect to lose this action and believes additionally that it would be able to negotiate reasonable payment terms should it lose this suit.

SHANE MONTALBAN LITIGATION

On June 15, 2001, the Company filed a Summons and Complaint against Kelly Shane Montalban, a principal shareholder of the Company, in the US District Court for the Southern District of New York alleging liability by Mr. Montalban to the Company for violations of Section 16(b) of the Securities Exchange Act of 1934, as amended. The suit seeks recovery of short swing profits realized by Mr. Montalban and affiliated persons during the period September 1999 through June 15, 2001 as the result of certain purchases and sales of the Company's common stock by Mr. Montalban and such affiliated persons.

The Company and Mr. Montalban are presently engaged in settlement discussions to resolve the litigation. No assurance can be given, however, that the parties will reach a settlement.

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

The following discussion and analysis is provided to increase the understanding of, and should be read in conjunction with, the Consolidated Financial Statements of the Company and Notes thereto included elsewhere in this Report. Historical results and percentage relationships among any amounts in these financial statements are not necessarily indicative of trends in operating results for any future period. The statements which are not historical facts contained in this Report, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, and Notes to the Consolidated Financial Statements, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are based on currently available operating, financial and competitive information, and are subject to various risks and uncertainties. Future events and the Company's actual results may differ materially from the results reflected in these forward-looking statements. Factors that might cause such a difference include, but are not limited to, dependence on existing and future key strategic and strategic end-user customers, limited ability to establish new strategic relationships, ability to sustain and manage growth, variability of operating results, the Company's expansion and development of new service lines, marketing and other business development initiatives, the commencement of new engagements, competition in the industry, general economic conditions, dependence on key personnel, the ability to attract, hire and retain personnel who possess the technical skills and experience necessary to meet the service requirements of its clients, the potential liability with respect to actions taken by its existing and past employees, risks associated with international sales, and other risks described herein and in the Company's other SEC filings.

Overview

The Company is engaged in the business of providing Internet service provider ("ISP") services ("ISP Services") for business and personal use. Previously, the Company was also involved in developing certain software products, which activities the Company no longer pursues.

The Company was a development stage company until the first quarter of 1999, when it began to broaden its strategic focus through the acquisition of six ISPs. Currently, providing ISP Services is the focus of the Company's business. The Company's business operations are presently conducted in the United States and Canada.

The Company derives virtually all of its revenues from its ISP Services. At present, most of the revenue from ISP Services can be attributed to connectivity, although the Company's network of ISP Services is moving towards focusing on Web hosting and server co-location, anticipating a strong hold over connectivity by the larger ISPs in a few years' time.

During 2000, the Company began streamlining and consolidating its ISP Services operations to enhance efficiency and reduce operating expenses. The Company has embarked on a program to centralize ISP Services to the greatest extent possible, as follows:

- Customer Support. During the second half of 2000, the Company began

consolidating all aspects of customer support (including end user technical issues) into the Chatham, Ontario facility. In early 2001, customer support for Oregon ISP Services customers were consolidated into

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the Chatham facility and by late-2001 it is expected that customer support for all of the Company's ISP Services customers will be handled by the Chatham facility.

- Billing and Collections. During the second half of 2000, the Chatham -----
facility took over billing and collections for British Columbia customers, in addition to continuing billing and collections for all other Canadian customers. In early 2001 the billing and collections for the Oregon ISP customers were consolidated into the Chatham facility, billing and collections for the Washington ISP Services customers will be consolidated in late-2001.
- Network Operations. During 2000, the Company reduced four maintenance and -----
repair teams to two regionally-based teams. A team based in Toronto provides primary monitoring and repair of all servers and routers covering all Canadian ISP Services customers and provides overflow assistance to

the Pacific Northwest, while a Seattle team provides primary monitoring and repair of all servers and routers covering all of the Pacific Northwest ISP Services customers and provides overflow assistance to Canada.

The Company is also consolidating Web hosting and dedicated services into Toronto, a process which began in late-2000 and is expected to be completed by late-2001. Other ISP Services such as e-mail and user authentication (i.e., customer security) will continue to be handled from regional data centers. Beginning in early 2001, all new Web hosting customers, wherever located, will be hosted from Toronto.

The Company is also considering implementing other consolidated services to achieve greater efficiency and cost savings.

Results of Operations for the Three Months Ended June 30, 2001 Compared to the Three Months Ended June 30, 2000

Substantially all of the Company's revenue was earned from its ISP operations during the three months ended June 30, 2001. These revenues are attributable virtually entirely to the operations of the Company's ISP businesses (Hermes Net Solutions, Inc., Intouch.Internet Inc., NetRover Inc., Connect Northwest Internet Services and Internet Arena) which the Company acquired beginning late in the second quarter of 1999. The Company generated net sales of \$955,376 for the three months ended June 30, 2001 compared to \$1,354,745 for the three months ended June 30, 2000. The decrease in the above noted revenue, for the three months ended June 30, 2001 compared to the three months ended June 30, 2000, are primarily due to the discontinuation of Playa Corporation during the fourth quarter of 2000, a decrease in marketing related activities, and the softening of technology related sector spending.

Direct costs, which consist primarily of telecommunications charges in respect of providing Internet connection services to customers, of \$484,358, were incurred for the three months ended June 30, 2001, compared to \$676,546 for the three months ended June 30, 2000. The decrease in the above noted expenses for the three months ended June 30, 2001 compared to the three months ended June 30, 2000 results primarily from having renegotiated certain key telecommunication agreements and receiving service level agreement credits from certain telecommunication providers.

Selling, general and administrative expenses were \$723,047 for the three

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months ended June 30, 2001 compared to \$1,403,834 for the three months ended June 30, 2000. The decrease in the above noted expenses for the three months ended June 30, 2001 compared to the three months ended June 30, 2000 results primarily from a reduction in salaries and benefits and consolidation of the operation of the Company's ISP businesses.

The Company has accrued interest of \$41,621 for the three months ended June 30, 2001, compared to \$1,824,611 for the three months ended June 30, 2000. The interest expense is in respect of promissory notes (the "Blue Heron Notes") issued by the Company in favor of Blue Heron Venture Fund, Ltd. ("Blue Heron"), the Company's former principal creditor. These notes in the aggregate principal amount as at June 18, 2001 of \$2,085,000 were unsecured, bore interest at 8% per annum and were payable on demand. On June 18, 2001 at the request of Blue Heron, these notes were cancelled and on June 19, 2001 new promissory notes (the "Blue Heron Shareholder Notes") in the aggregate principal amount of \$2,319,788 were issued to the shareholders of Blue Heron. The principal amount of the Blue Heron Shareholder Notes is comprised of the \$2,085,000 principal amount of the Blue Heron Notes and the \$234,788 in interest due on the Blue Heron Notes at the time of cancellation. The Blue Heron Shareholder Notes are unsecured and are payable on demand. \$2,085,000 in principal amount of the Blue Heron Shareholder Notes bear interest at 8% per annum. The balance of the Blue Heron Shareholder Notes do not provide for the payment of interest. See "Liquidity and Capital Resources" below.

The Company had a net loss of \$842,254, or \$.04 per share, for the three months ended June 30, 2001, compared to a net loss of \$3,282,828, or \$.16 per share, for the three months ended June 30, 2000. The decrease in net loss for the three months ended June 30, 2001 was primarily a result of significant decreases in direct costs; selling, general and administrative expenses; amortization and depreciation of the assets acquired in the fiscal year 1999; and interest expense.

Results of Operations for the Six Months Ended June 30, 2001 Compared to the Six Months Ended June 30, 2000

Substantially all of the Company's revenue was earned from its ISP operations during the six months ended June 30, 2001. These revenues are attributable virtually entirely to the operations of the Company's ISP businesses (Hermes Net Solutions, Inc., Intouch.Internet Inc., NetRover Inc., Connect Northwest Internet Services and Internet Arena) which the Company acquired beginning late in the second quarter of 1999. The Company generated net sales of \$2,019,199 for the six months ended June 30, 2001 compared to \$2,394,305 for the six months ended June 30, 2000. The decrease in the above noted revenue, for the three months ended June 30, 2001 compared to the three months ended June 30, 2000, are primarily due to the discontinuation of Playa Corporation during the fourth quarter of 2000, a decrease in marketing related activities, and the softening of technology related sector spending.

Direct costs, which consist primarily of telecommunications charges in respect of providing Internet connection services to customers, of \$913,029, were incurred for the six months ended June 30, 2001, compared to \$1,296,927 for the six months ended June 30, 2000. The decrease in the above noted expenses for the six months ended June 30, 2001 compared to the six months ended June 30, 2000 results primarily from having renegotiated certain key telecommunication agreements and receiving service level agreement credits from certain telecommunication providers.

Selling, general and administrative expenses were \$1,345,999 for the six months ended June 30, 2001 compared to \$2,411,617 for the six months ended June 30, 2000. The decrease in the above noted expenses for the six months ended June

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30, 2001 compared to the six months ended June 30, 2000 results primarily from a reduction in salaries and benefits and consolidation of the operation of the Company's ISP businesses.

The Company has accrued interest of \$82,947 for the six months ended June 30, 2001, compared to \$2,003,895 for the six months ended June 30, 2000. The interest expense is in respect of promissory notes (the "Blue Heron Notes") issued by the Company in favor of Blue Heron Venture Fund, Ltd. ("Blue Heron"), the Company's former principal creditor. These notes in the aggregate principal amount as at June 18, 2001 of \$2,085,000 were unsecured, bore interest at 8% per annum and were payable on demand. On June 18, 2001 at the request of Blue Heron, these notes were cancelled and on June 19, 2001 new promissory notes (the "Blue Heron Shareholder Notes") in the aggregate principal amount of \$2,319,788 were issued to the shareholders of Blue Heron. The principal amount of the Blue Heron Shareholder Notes is comprised of the \$2,085,000 principal amount of the Blue Heron Notes and the \$234,788 in interest due on the Blue Heron Notes at the time of cancellation. The Blue Heron Shareholder Notes are unsecured and are payable on demand. \$2,085,000 in principal amount of the Blue Heron Shareholder Notes bear interest at 8% per annum. The balance of the Blue Heron Shareholder Notes do not provide for the payment of interest. See "Liquidity and Capital Resources" below.

The Company had a net loss of \$1,390,237, or \$.06 per share, for the six months ended June 30, 2001, compared to a net loss of \$4,586,581, or \$.22 per share, for the six months ended June 30, 2000. The decrease in net loss for the six months ended June 30, 2001 was primarily a result of significant decreases in direct costs; selling, general and administrative expenses; amortization and depreciation of the assets acquired in the fiscal year 1999; and interest expense.

Liquidity and Capital Resources

The accompanying financial statements have been prepared on a going concern basis, which assumes that the Company will continue in operation for at least one year and will be able to realize its assets and discharge its liabilities in the normal course of business. The Company incurred a net loss for the six months ended June 30, 2001 of \$1,390,237, compared to a net loss for the six months ended June 30, 2000 of \$4,586,581. For the six months ended June 30, 2001, the Company had a working capital deficit of approximately \$3.4M, which is primarily due to the Company's use of current assets to acquire its ISP and Software Products businesses, and professional fees. These factors indicate that the Company's continuation as a going concern is dependent upon its ability to obtain adequate financing.

The Company has obtained most of its financing through Blue Heron. The loans were made under agreements pursuant to which the Company could borrow up to \$16,000,000 in unsecured loans from Blue Heron. The loans were evidenced by the Company's Convertible Demand Notes (the "Blue Heron Demand Notes"). The Blue Heron Demand Notes bore interest at 8% per annum, were payable on demand and were convertible into shares of the Company's Common Stock at the lender's option, in which case Blue Heron would have waived its right to be paid interest under the Blue Heron Demand Notes. On June 18, 2001 the Blue Heron Demand Notes were cancelled and subsequently replaced by the Blue Heron Shareholder Notes. During 1999, \$4,000,000 of outstanding loans were converted into 4,500,000 shares of the Company's Common Stock. On August 16, 1999, \$1,000,000 aggregate principal amount of Blue Heron Demand Notes were converted into 1,500,000 shares of Common Stock, at a conversion price of \$0.67 per share. On November 24, 1999, an aggregate additional principal amount of \$3,000,000 of Blue Heron Demand Notes were converted into an additional 3,000,000 shares of Common Stock, at a conversion price of \$1.00 per share.

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During the fiscal year ended December 31, 2000, the Company borrowed an additional \$1,210,000 from Blue Heron, resulting in an aggregate outstanding principal amount of the loans of \$2,085,000 as of December 31, 2000. The Company did not borrow any additional funds during the six months ended June 30, 2001.

Effective June 18, 2001 Blue Heron has withdrawn this credit facility, and since the Blue Heron Shareholder Notes are payable on demand, the Company's ability to continue operations is dependent upon the willingness of the Blue Heron shareholders to forbear from demanding payment. The Company believes that the Blue Heron shareholders will continue to forbear payment of the loans for the immediately foreseeable future, but they are under no obligation to do so. Should the Blue Heron shareholders demand payment, the Company would be required to obtain financing from other sources to satisfy its obligations or would be in default under the loans. The Company does not believe that bank borrowings are available under present circumstances, and there can be no assurance that any financing could be obtained from other sources. Even if funding were available, it might be available only on terms which would not be favorable to the Company or which management would not find acceptable.

During the fiscal year ended December 31, 2000, the Company borrowed an aggregate of \$125,000 from Pacific Gate Capital Corporation ("Pacific Gate"), a corporation owned by Kelly Shane Montalban, a principal shareholder of the Company, of which amount \$25,000 was outstanding on June 30, 2001. These loans bear interest at 8% per annum and are payable on demand. Since these loans are payable on demand, the Company's ability to continue operations is dependent upon the willingness of Pacific Gate to forbear from demanding payment. The Company believes that Pacific Gate will continue to forbear payment of the loans for the immediately foreseeable future, but it is under no obligation to do so. Should Pacific Gate demand payment, the Company would be required to obtain financing from other sources to satisfy its obligations or would be in default under the loans. The Company does not believe that bank borrowings are available under present circumstances, and there can be no assurance that any financing could be obtained from other sources. Even if funding were available, it might be available only on terms which would not be favorable to the Company or which management would not find acceptable.

On April 11, 2001, the Company received a letter from Pacific Gate, stating its willingness to renegotiate the terms of the Pacific Gate loans from demand loans to terms loans. The actual terms of any such renegotiation are subject to agreement between the Company and Pacific Gate, and no assurance can be given that the parties will reach agreement on the new terms of the loans. No substantive negotiations have commenced as of the date of filing this Report.

The Company's cash position during the six months ended June 30, 2001 was \$102,161, compared to \$250,631 on December 31, 2000. This decrease is primarily due to the Company not borrowing additional funds during the six months ended June 30, 2001.

The Company's net cash used in operating activities totaled \$76,799 during the six months ended June 30, 2001, compared to \$857,719 during the six months ended June 30, 2000. This decrease is primarily due to the interest expense and amortization and depreciation.

The Company's net cash used in investing activities totaled \$71,161 during the six months ended June 30, 2001, compared to \$640,577 during the six months ended June 30, 2000. This decrease is primarily due to the Company's is not as aggressive as previous years in acquisitions.

The Company did not have any proceeds from financing activities during the

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six months ended June 30, 2001, compared to \$1,333,589 of such proceeds during the six months ended June 30, 2000.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Canada Post Litigation

On June 11, 1999, Canada Post Corporation ("Canada Post") filed a Statement of Claim in the Federal Court of Canada (Court File No. T-1022-99) in which it sought injunctive and unspecified monetary relief for the allegedly "improper" use by the Company's subsidiary, ePost Innovations, Inc., ("ePost Innovations"), of certain marks and names which contain the component "post". On October 18, 1999, ePost Innovations filed its Defense and Counterclaim. In a motion heard November 24, 1999, Canada Post Corporation challenged certain parts of the Counterclaim and the Federal Court reserved judgment.

On May 25, 1999, ePost Innovations filed a statement of Claim in the British Columbia Court (Court File No. C992649) seeking a declaration that the public notice of Canada Post's adoption and use of CYBERPOSTE and CYBERPOST on November 18, 1998 and December 9, 1998 respectively, did not affect the Company's use of CyPost and ePost Innovations as trademarks and trade-names prior to said dates. ePost Innovations sought summary judgment for such a declaration and on September 14, 1999, the BC Court rejected summary judgment on the basis that no right of ePost Innovations was being infringed and that a trial of the issues was more appropriate.

On June 20, 2001 ePost Innovations, Canada Post and the Company entered into a Settlement and Release Agreement effective as of May 30, 2001 (the "Settlement Agreement"). Pursuant to the Settlement Agreement, the parties executed mutual releases and discontinued their respective claims. The release by Canada Post to ePost Innovations was made subject to the Company and ePost Innovations ceasing all use of the trade name EPOST within Canada within 90 days of the effective date of the Settlement Agreement and transferring all right, title and interest they had with respect to the trade name and trademark EPOST and any goodwill associated therewith to Canada Post upon execution of the Settlement Agreement. The Company has yet to change the name of its subsidiary but intends to do so within the time frame set forth in the Settlement Agreement. All other terms of the Settlement Agreement have been complied with.

Berry Litigation

On March 31, 2000, the Company commenced suit in the Supreme Court of British Columbia, Action #S001822, Vancouver Registry against Tia Berry (the "Tia Action"), the wife of Steven Berry ("Berry"), the former President and Chief Executive Officer of the Company. In the Tia Action, the Company claims \$42,516 (CDN) from Tia Berry on account of monies paid to her by the Company which she was not entitled to receive. Tia Berry has filed a Statement of Defense in the Tia Action in which she alleges that the payments which she received from the Company were to reimburse her for business expenses which she had charged to her credit cards on behalf of Berry. The Tia Action has not yet been set for trial.

On April 4, 2000, Berry commenced an action in the Supreme Court of the State of New York, County of New York (Index No. 601448/2000), against the Company and Continental Stock Transfer & Trust Company ("Continental"), (the "New York Action"). In the New York Action, Berry claimed damages for alleged conversion, fraud, breach of contract and breach of fiduciary duty all arising from the alleged wrongful Stop Transfer Order which the Company placed relating to 75,000 shares of the Company's Common Stock registered in Berry's name and the Company's cancellation of a further 600,000 shares (the "Contingent

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Shares"). The complaint in the New York Action claims damages in excess of \$3,000,000 with the precise amount to be determined at trial.

Berry received the 600,000 Contingent Shares upon condition that he would remain in the Company's employ as Chief Executive Officer for at least two years. Berry commenced his employment with the Company on January 4, 1999, and resigned his employment with the Company on January 17, 2000. Following Berry's resignation, the Company attempted to have a Stop Transfer Order issued with respect to the 75,000 shares registered in Berry's name and cancel the 600,000 Contingent Shares. The Stop Transfer Order was not effective and Berry subsequently sold the 75,000 shares.

On May 19, 2000 CyPost and ePost Innovations commenced suit in the Supreme Court of British Columbia, Action #S002798, Vancouver Registry, against Berry and his wife, Tia Berry (the "BC Action"). In the BC Action, the Company seeks an order directing Berry to return the 600,000 Contingent Shares to the Company for cancellation or an order entitling the Company to cancel the same on the basis that Berry did not fulfill the employment conditions which were the condition precedent to his becoming the beneficial owner of the Contingent Shares.

In the BC Action, the Company also claims at least Cdn\$800,000 from Berry on account of breach of fiduciary duty, negligence, breach of statutory duties and breach of contract arising from Berry's failure to properly carry out his employment responsibilities. In the BC Action, the Company also claims Cdn\$34,013 from Berry and Tia Berry on account of conspiracy to defraud and injure the Company and ePost Innovations by causing certain personal expenses to be paid by the Company rather than by Berry and Tia Berry personally. The Company also claims punitive and exemplary damages from Berry and Tia Berry in the BC Action.

On May 25, 2000, the Company moved in the New York Action for an order dismissing the action against the Company for lack of jurisdiction or, in the alternative, on the basis of forum non conveniens. On September 5, 2000, the court dismissed the New York Action on forum non conveniens grounds, subject to the Company making certain stipulations in the New York Action. Those stipulations have been made and the appeal period in the New York Action has expired without Berry or any other party appealing the September 5, 2000 order.

The issues raised by Berry and the Company in the New York Action will be litigated in the BC Action together with the further issues raised by the Company in the BC Action. The Company feels that Berry's claims in the New York Action were without merit and that the Company will be successful in obtaining an order declaring that Berry's 600,000 Contingent Shares be cancelled and further entitling the Company to substantial damages. The Company will vigorously pursue its position in all respects.

On December 21, 2000, Berry and Tia Berry commenced suit in the Supreme Court of British Columbia, Action #S006790, Vancouver Registry, against CyPost, ePost Innovations, Kelly Shane Montalban, J. Thomas W. Johnston, Carl Whitehead and Robert Sendoh (the "Berry Action"). Statements of Defense have been filed on behalf of the Company and the other defendants.

The Plaintiffs in the Berry Action allege that the Tia Action, the BC Action, and the action by Kelly Shane Montalban (Supreme Court of British Columbia, Action #S002147, Vancouver Registry), against Berry for specific performance of an option agreement (the "Montalban Action"), collectively, amount to an abuse of process, malicious prosecution, unlawful interference with the Plaintiffs' economic rights, or were commenced pursuant to a civil conspiracy to injure the Plaintiffs.

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In the Berry Action, the Plaintiffs seek a declaration that Berry is entitled to the 600,000 Contingent Shares and claim unspecified damages which are estimated at Cdn\$2,000,000 based on the Statement of Claim. They also claim punitive or aggravated damages and costs. The Company believes that the allegations in the Berry Action are without merit and they will be vigorously defended.

It is expected that the Tia Action, the BC Action and the Berry Action will be consolidated for the purposes of trial due to the fact that there are numerous issues of fact and law which are common to all of these actions. The Company believes that trial will likely take place in the fall of 2002.

A loss by the Company of the claim against it for monetary damages would have a material adverse effect on the Company's future results of operations, financial condition and liquidity; however, the Company does not expect to lose this action and believes additionally that it would be able to negotiate reasonable payment terms should it lose this suit.

Shane Montalban Litigation

On June 15, 2001, the Company filed a Summons and Complaint against Kelly Shane Montalban, a principal shareholder of the Company, in the US District Court for the Southern District of New York alleging liability by Mr. Montalban to the Company for violations of Section 16(b) of the Securities Exchange Act of 1934, as amended. The suit seeks recovery of short swing profits realized by Mr. Montalban and affiliated persons during the period September 1999 through June 15, 2001 as the result of certain purchases and sales of the Company's common stock by Mr. Montalban and such affiliated persons.

The Company and Mr. Montalban are presently engaged in settlement discussions to resolve the litigation. No assurance can be given, however, that the parties will reach a settlement.

ITEM 2. CHANGES IN SECURITIES

On or about May 15, 2001 the Company issued 7,500 shares of its restricted common stock to Jeff Hoag of Celex Agency for services rendered. These shares were issued pursuant to the exemption from registration provided by Sec. 4(2) of the Securities Act of 1933, as amended, as this was a transaction by an issuer not involving a public offering.

ITEM 5. OTHER INFORMATION

Effective June 8, 2001, Robert Adams resigned as the Company's president and chief operating officer and as a director to focus his full attention to the Company's six ISP's with the goal of building the subscriber base and increasing revenues. Effective June 15, 2001, Angela Belcourt was appointed as a director of the Company to fill the vacancy created by Mr. Adams' resignation. Effective June 22, 2001, Ms. Belcourt was appointed as the Company's president, secretary/treasurer and principal financial officer. Ms. Belcourt joined the Company in 2000 serving as General Manager, Asia Pacific in which position she managed the Company's Japanese subsidiary Playa Corporation. She is an active member of the Canada Japan Society of British Columbia and has extensive associations with the Japanese business community.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

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None

(b) Reports on Form 8-K

None.

SIGNATURE

In accordance with the requirements of the Exchange Act, the registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

CYPOST CORPORATION

DATE: August 14, 2001

By: /s/ Angela Belcourt

Angela Belcourt
President and Treasurer
(Principal Financial Officer)