9278 COMMUNICATIONS INC
Form 10-Q
August 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
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 June 30, 2001

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

For the transition period ____________ to ___________

Commission file number: 333-37654

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

Delaware	98-0207906
(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

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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 - 23,943,002 shares issued and outstanding as of August 14, 2001

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

9278 COMMUNICATIONS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	Jun 2 - (UNA
ASSETS	
Current Assets:	
Cash and cash equivalents	$ 6,
Marketable Securities	
Accounts receivable, less allowance for doubtful accounts of $710,000 and $675,000 at June 30, 2001 and December 31, 2000 respectively	10,
Inventory	6,
Prepaid expenses and all other current assets	
Total Current Assets	24,
Furniture and Equipment - Net of accumulated depreciation of $234,574 and $133,378 at June 30, 2001 and December 31, 2000 respectively	
Goodwill, net of accumulated amortization of $150,070 and $17,154 at June 30, 2001 and December 31, 2000 respectively	3,
Other Assets	
	$ 28,
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current Liabilities	
Accounts payable and accrued expenses	$ 23,
Current maturities of notes payable	
Current maturities of Debt obligations	
Income taxes payable	
Total Current Liabilities	24,
Notes payable, shareholder, less current maturities	1,

Debt obligations, less current maturities	
	25,
Shareholders' equity	
Convertible preferred stock	
Class B, $0.001 par value, 5,000,000 shares authorized 0 and 505 issued and outstanding, respectively	
Common Stock, $0.001 par value; 40,000,000 shares authorized, 23,942,982 and 23,166,969 issued and outstanding, respectively	
Paid in capital	8,
Accumulated Deficit	(4,
Total Shareholders' Equity	3,
	$ 28,

9278 COMMUNICATIONS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,		
	2001	2000	
Sales	$ 49,578,900	$ 16,857,595	$ 8
Cost of Sales	46,387,665	15,820,410	8
Gross Profit	3,191,235	1,037,185	
Operating Expenses			
Selling	177,292	146,546	
General and administrative	1,558,469	646,038	
Depreciation and amortization	119,110	55,740	
Loss on Disposition of Assets	-	-	
Bad and Doubtful Debts	69,347	40,000	
Interest expense	24,881	42,532	
Realized (Gain) on Investment in Securities	(6,428)	-	
	1,942,671	930,856	
Income/(Loss) from Operations Before Income Taxes	1,248,564	106,329	
Provision for Income Taxes	6,175	-	
Net Income / (Loss) attributable to common stock	1,242,389	106,329	$

Basic and diluted earnings (loss) per share	$ 0.05	$ 0.01	$
Shares used in the calculation of earnings per share	23,643,089	20,152,356	2

9278 COMMUNICATIONS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
SIX MONTHS ENDED JUNE 30,
(UNAUDITED)

	2001	20
Cash Flows From Operating Activities		
Net Income / (Loss)	$ 2,226,027	$ (38
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	234,112	8
Provision for Doubtful Accounts	35,000	30
Issuance of stock for services rendered	-	3
Loss attributable to sale of equipment	-	36
Changes in current assets and liabilities:		
Accounts receivable	(3,754,480)	(1,29
Inventory	(3,296,802)	15
Prepaid expenses	(84,534)	(5
Other Assets	(2,628)	(1
Accounts payable	9,250,575	27
Income taxes payable	(21,255)	
Net Cash provided by (used in) Operating Activities	4,586,015	(53
Cash flows From Investing Activities		
Acqusition of property and equipment	(350,292)	(23
Acqusition of businesses in Connecticut	(207,741)	
Disposition of Marketable Securities	20,962	
Net Cash used in Investing Activities	(537,071)	(23
Cash flows From Financing Activities		
Notes and Advances Payable, shareholder	(960,289)	
Notes Payable - Other	(900,000)	
Notes Payable - leases	-	7
Principal payments on debt obligations	(26,547)	(3
Issuance of common stock	-	92

Net cash (used in) provided by Financing Activities	(1,886,836)	96
Net Increase (Decrease) in Cash and Cash Equivilents	$ 2,162,108	$ 18

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9278 COMMUNICATIONS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
SIX MONTHS ENDED JUNE 30,

	2001
Net Increase (Decrease) in Cash and Cash Equivilents	$ 2,162,108
Cash and Cash Equivilents - Beginning of Period	4,114,651
Cash and Cash Equivilents - Ending of Period	$ 6,276,759
Supplemental disclosure of cash flow information:	
Cash paid for interest	$ 70,339
Cash paid for taxes	6,746
Noncash investing and financing activities	
Equipment acquired under capital leases	-
Conversion of notes and advances payable, shareholder for common stock	-
Conversion of preferred stock to common stock	505,000
Common stock issued for services rendered	-

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9278 COMMUNICATIONS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2001
(UNAUDITED)

	Preferred Stock	Number of shares	Amount	Additional Paid-in Capital

Balance at January 1, 2001	$ 505,000	23,166,969	$ 23,166	$ 7,743,252
Conversion of preferred stock to common stock	(505,000)	776,013	777	504,223
Net income for the six months ended June 30, 2001	-	-	-	-
	$ -	23,942,982	$ 23,943	$ 8,247,475

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9278 COMMUNICATIONS INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

1 - BASIS OF PRESENTION

The accompanying condensed consolidated unaudited financial statements of 9278 Communications 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, 2000, included in the Company's Form 10-KSB 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 six month periods ended June 30, 2001 and 2000 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2001.

2 - NATURE OF BUSINESS

The Company markets and distributes prepaid telephone cards to small retail establishments and distributors across the United States.

Inventories

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

Income Taxes

The Company accounts for income taxes under the Financial Accounting Standards Board Statement of Financial Accounting Standards ("SFAS") No. 109 "Accounting of Income Taxes" (SFAS 109). Under SFAS 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 expected to be recovered or settled. Under SFAS109, 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 provision for income taxes for the six months ended June 30, 2001 reflects the utilization of the Company's net operating loss carryforwards in the amount of approximately $3,100,000 from prior years. At June 30, 2001 net operating losses of approximately $875,000 are available to be setoff against possible future taxable income.

(Continued)

9278 COMMUNICATIONS INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

3 - EARNINGS PER SHARE

Basic earning per common share is calculated by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share for the six months ended June 30, 2001 and 2000 excludes all potentially dilutive securities, as the effect of the related incremental shares (210,000 and 235,000 shares in 2001 and 2000, respectively) would be antidilutive.

4 - ACQUISITIONS

On January 23, 2001, the Company purchased certain assets of two of its distributors in an asset purchase transaction, wherein the Company acquired all the accounts receivables, inventories, fixed assets and customer lists of the distributors net of accounts payable. The Company paid $100,000 in excess of their net assets for the customer lists. A summary of the transactions is as follows:

Assets purchased:	
Accounts receivable	$ 147,904
Inventories	68,015
Other assets	5,500
Customer lists	100,000
	321,419
Liabilities assumed:	
Accounts payable	(113,677)
Net assets acquired	$ 207,742
Cash Paid	$ 207,742

Pro-forma results of operations are not presented, as they are not material to the historical results presented herein.

5 - INVESTMENTS

On January 29, 2001 the Company acquired a 27% equity interest in DMS Acquisition Corp., (a Delaware Corporation), as an inducement to enter into a long-term distribution agreement with DMS Acquisition Corp. DMS Acquisition Corp. is a facility-based carrier of long distance telephone service. On

February 8, 2001 DMS Acquisition Corp. was a party to a triangular merger with Capital One Ventures Corp. (an OTC publicly traded company) with Capital One Ventures Corp. as the surviving entity. DMS Acquisition Corp. became a wholly owned subsidiary of Capital One Ventures Corp. Simultaneous with the merger Capital One Ventures Corp. changed the corporate name to Cirus Telecom, Inc. ("Cirus"). As a result of the merger, the Company's equity interest of 8,100,000 shares of Cirus was diluted to 18%. The Company's investment in Cirus is restricted and subject to other conditions pursuant to the service agreement. The investment in Cirus is accounted for at cost and is not material to the Company's financial position. Cirus Telecom Inc. trades under ticker symbol "CTLE".

(Continued)

6 - NOTES AND ADVANCES PAYABLE, SHAREHOLDER

On December 10, 1999 the Company declared $3,000,000 in dividends, of which $1,000,000 was paid at that time. On December 13, 1999, the Company executed a promissory note for the benefit of the shareholders in the amount of $2,000,000, payable to the Company's chief executive officer, who is also a shareholder. A principal payment of $1,000,000 was originally due on June 13, 2000, and the second payment was originally payable on December 13, 2001. In consideration for deferring these payments, on June 13, 2000, the Company issued warrants to purchase 200,000 shares of common stock at an exercise price of $1.625 per share. The warrants vested immediately and are exercisable until 2010.

Further, on March 22, 2001, the Company amended the terms of these promissory notes to defer the payments to March 31, 2002 and December 31, 2002, respectively, reserving the right to prepay on the note prior to the due date. As of June 30, 2001, the Company had repaid $960,000 on this note.

Interest on the note is payable at a rate of 8%. For the six months ended June 30, 2001, interest expense on this note was $60,000 and was paid in full as of that date.

7 - RELATED PARTY TRANSACTIONS

Sales of inventory to a customer who is related to an officer were approximately $11,628,000 and $3,088,000 for the six months ended June 30, 2001 and 2000 respectively. The Company also purchased inventory from this customer during this period in the amount of $5,839,000 in 2001 and $0 in 2000. Included in accounts receivable and accounts payable at June 30, 2001 is $2,659,124 and $183,740 respectively from this customer.

8 - LITIGATION

For the year ended December 31, 1999, purchases from one telephone card supplier were approximately 55% of total purchases. In November 1999, the Company commenced an action against this supplier to recover damages resulting from cancellation of the telephone card purchases by the Company. The supplier subsequently counter sued. In the Company's opinion, with which its legal counsel concurs, no material liability will result from the counter suit. The Company incurred a loss of $553,547, which was reflected in the fourth quarter of 1999. The Company is doubtful as to the prospects for recovery against such loss. The Company subsequently mitigated, in substantial part, its reliance on this supplier by increasing its purchases from other vendors.

In November 1999, a distributor of the Company's prepaid telephone cards instituted an action for approximately $600,000, based on a purported breach of oral contract by the Company. The Company filed an answer and counterclaim against the distributor for approximately $600,000 of unpaid invoices. The Company believes it has meritorious defenses to the claims of the distributor and is pursuing its claim for unpaid invoices. The Company has provided an allowance for doubtful accounts equal to the total unpaid invoices.

(Continued)

9 - PREFERRED STOCK

During the six months ended June 30, 2001, the remaining 505 preferred shares were converted into 776,013 common shares.

10 - EFFECT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board approved the issuance of SFAS No. 141- "Business Combinations" and SFAS 142- "Goodwill and Other Intangible Assets". The new standards require that all business combinations initiated after June 30, 2001 must be accounted for under the Purchase Method. In addition, all intangible assets acquired that are obtained through contractual or legal right, or are capable of being separately sold, transferred, licensed, rented or exchanged shall be recognized as an asset apart from goodwill. Goodwill and intangibles with indefinite lives will no longer be subject to amortization, but will be subject to, at least, an annual assessment for impairment by applying a fair value based test.

The company will continue to amortize goodwill existing at June 30, 2001 under its current method until December 31, 2001. Thereafter, annual and quarterly goodwill amortization of $266,756 and $66,689 respectively will no longer be recognized. The company will perform a transitional fair value based impairment test at March 31, 2002 and if the fair value is less than the recorded value at January 1, 2002 the company will record an impairment loss in the March 31, 2002 quarter as a cumulative effect of a change in accounting principle.

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

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE CONSOLIDATED FINANCIAL STATEMENTS AND NOTES THERETO SET FORTH IN ITEM 7 OF THIS QUARTERLY REPORT. IN ADDITION TO HISTORICAL INFORMATION, THIS DISCUSSION AND ANALYSIS CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS, UNCERTAINTIES AND ASSUMPTIONS, WHICH COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM MANAGEMENT'S EXPECTATIONS. FACTORS THAT COULD CAUSE DIFFERENCES INCLUDE, BUT ARE NOT LIMITED TO, EXPECTED MARKET DEMAND FOR THE COMPANY'S PRODUCTS, FLUCTUATIONS IN PRICING FOR PRODUCTS DISTRIBUTED BY THE COMPANY AND PRODUCTS OFFERED BY COMPETITORS, AS WELL AS GENERAL CONDITIONS OF THE TELECOMMUNICATIONS

MARKETPLACE.

OVERVIEW

To date, our principal source of revenue has been the marketing and distribution of prepaid phone cards. We market and distribute private label proprietary prepaid phone cards produced exclusively for the Company by various long distance carriers and/or resellers, as well as branded prepaid phone cards produced by other telecommunications long distance carriers and resellers.

Prepaid phone cards are distributed through a vast network of retail outlets, including convenience stores, newsstands, grocery stores and discounts stores. The retail outlets are serviced by independent distributors, which often distribute newspapers or other items to them. Beginning May 2001, we have started selling prepaid cards to end users via the Internet.

Private label cards are generally designed and produced by us, utilizing card numbers or Personal Identification Numbers ("PIN") provided by the telecommunications' carrier or reseller providing the long distance service for the card. We incur the upfront expense of printing the phone cards with the PINs already printed on the cards. However, we do not pay the long distance carrier until it activates the cards, which occurs upon our sale to the distributor. Accordingly, through the use of private label cards, our cost of inventory is significantly reduced, as purchases are effectively made on an as-needed basis. In addition, private label cards generally provide the Company with the ability to achieve a greater gross margin percentage, typically ranging from 6% to 10%.

In order to better serve our distributors, we also resell branded prepaid calling cards of other companies and resellers along with our private label cards. We purchase branded cards at a discount from the face value of the card, and resold to the distributor at a slightly lower discount. The difference between the two discount rates, typically from 3% to 8%, represents the gross margin we retain. We purchase branded cards on varying terms, from C.O.D. to as used basis. Sales of our product are generally made on a net 14 days basis.

We are continually seeking to develop and acquire rights to additional prepaid telecommunications services and other prepaid products or services to diversify our product offerings and increase our overall gross margin.

We are actively looking for ways to increase sales and profitability. To achieve that goal, we are looking at various avenues for expansion. The first is geographical expansion, and to that end, we are currently negotiating opening two new locations, one in Brooklyn, New York and the other in the Chicago, Illinois area. These two new offices should be operating by the end of August 2001. The second avenue for additional sales is "Internet E-Commerce" sales to the public. We unveiled our e-commerce website in May 2001. These sales are made utilizing consumer credit card payment and existing inventory. To date we have received a strong response to our web sales and are continuing to grow.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2001 COMPARED TO THREE MONTHS ENDED JUNE 30, 2000

Net sales increased $32,721,000 to $49,579,000 for the three months ended June 30, 2001, up 194.1% from net sales of $16,858,000 for the three months ended June 30, 2000. The increase in net sales was primarily due to our acquisitions and geographic expansion in the third and fourth quarters of calendar year 2000 and the first quarter of 2001 and, to a lesser extent, opening of a branch office in Los Angeles, California in May 2001. In September 2000 we acquired two businesses (in Yonkers, New York and Silver Springs, Maryland) that accounted for $7,145,000 of sales in the three months ended June

30, 2001. In December 2000, we acquired Reliable Networks, Inc., a competitor of ours located in Queens, New York, which accounted for $10,827,000 of sales for the three months ended June 30, 2001. In January 2001, we acquired two separate operations in Connecticut and opened an office in Connecticut, which accounted for an aggregate of $2,552,000 in sales for the three months ended June 30, 2001. The new office in Los Angeles, California accounted for $3,445,000 in sales since its inception in May 2001. For the three months ended June 30, 2001, same location sales increased by approximately $8,752,000 or 51.91% to $25,610,000 in 2001 from $16,858,000 in the prior year.

Gross profit increased to $3,191,235 for the three months ended June 30, 2001, as compared to $1,037,185 in same period in 2000, as a result of increased volume and greater sales margins. As a percentage of sales, gross profit increased to 6.44% for the three months ended June 30, 2001 as compared to 6.15% for the three months ended June 30, 2000. This increase in gross profit was attributable to our addition of higher margin private label cards, slightly offset by the decrease in margins attributable to branded products and increasing competition from additional cards entering the marketplace.

Operating expenses for the three months ended June 30, 2001 increased by $1,012,000 to $1,943,000 an increase of 109% over operating expenses of $931,000 for the three months ended June 30, 2000. Selling expenses increased by $31,000 to $177,000 for the three months ended June 30, 2001 from $146,000 for the same period in 2000, as a result of our utilizing commissioned sales staff to make bulk sales. In addition, general and administrative expenses increased by $912,000 to $1,558,000 for the three months ended June 30, 2001, as compared to $646,000 for the same period in 2000. This increase was primarily due to the increase in salaries of $382,000 that is directly related to our growth and adding new locations, an increase in professional and consulting fees of $215,000 due to legal, accounting and consulting fees incurred primarily in connection with the mergers and certain lawsuits instituted by former vendors and customers and communication with investors, and an increase in trade publication advertising of $58,000. The remainder of the increase in general and administrative expenses of approximately $257,000 reflects the normal escalation of overhead required to support our growth.

Depreciation and amortization for the three months ended June 30, 2001 equaled $119,000, an increase of $63,000 compared to the same period in 2000. The increase is comprised of $16,000 in increased depreciation of fixed assets and $47,000 in increased amortization of goodwill. In the three months ended June 30, 2001 we recorded bad debts of $69,000 as compared to $40,000 for the same period in 2000.

We had a net profit before tax of $1,249,000 for the three months ended June 30, 2001 as compared to $106,000 for the three months ended June 30, 2000. The increase in net income was due to the increase in sales volume and gross profit margins, improved internal controls for overhead, reduced bad debts and lack of any other significant losses. For purposes of earnings per share, net income/loss attributable to common stock reflects net income of $1,249,000 for the three months ended June 30, 2001 as compared to $106,000 for the three months ended June 30, 2000.

SIX MONTHS ENDED JUNE 30, 2001 COMPARED TO SIX MONTHS ENDED JUNE 30, 2000

Net sales increased $53,277,000 to $87,018,000 for the six months ended June 30, 2001, up 157.9% from net sales of $33,741,000 for the six months ended June 30, 2000. The increase in net sales was primarily due to our acquisitions and geographic expansion in the third and fourth quarters of calendar year 2000 and the first quarter of 2001 and, to a lesser extent, opening of a branch office in Los Angeles, California in May 2001. In September 2000 we acquired two businesses (in Yonkers, New York and Silver Springs, Maryland) that accounted for $11,885,000 of sales in the first six months of 2001. In December 2000, we acquired Reliable Networks, Inc., a competitor of ours located in Queens, New York, which accounted for $21,888,000 of sales in the first six months of 2001. In January 2001, we acquired two separate operations in Connecticut and opened an office in Connecticut, which accounted for an aggregate of $4,063,000 in sales since its acquisition. The new office in Los Angeles, California accounted for $3,445,000 in sales since its inception in May 2001. Same location sales increased in first six months of 2001 by approximately $11,996,000 or 35.55% to $45,736,000 in 2001 from $33,740,000 in the prior year.

Gross profit increased to $5,914,660 for the six months of 2001, as compared to $1,738,112 in same period in 2000, as a result of increased volume and greater sales margins. As a percentage of sales, gross profit increased to 6.8% for six months ended June 30, 2001 as compared to 5.15% for the six months ended June 30, 2000. This increase in gross profit was attributable to our addition of higher margin private label cards, slightly offset by the decrease in margins attributable to branded products and increasing competition from additional cards entering the marketplace.

Operating expenses for the six months ended June 30, 2001 increased by $1,555,000 to $3,679,000 an increase of 73% over operating expenses of $2,124,000 for the six months ended June 30, 2000. Selling expenses increased by $410,000 to $564,000 for the first six months of 2001 from $154,000 for the same period in 2000, as a result of our utilizing commissioned sales staff to make bulk sales. In addition, general and administrative expenses increased by $1,570,000 to

$2,698,000 for the six months of 2001, as compared to $1,128,000 for the same period in 2000. This increase was primarily due to the increase in salaries of $592,000 that is directly related to our growth and adding new locations, an increase in professional and consulting fees of $426,000 due to legal, accounting and consulting fees incurred primarily in connection with the mergers and certain litigations, and communication with investors, and an increase in trade publication advertising of $130,000. The remainder of the increase in general and administrative expenses of approximately $379,000 reflects the normal escalation of overhead required to support our growth.

Depreciation and amortization for the six months ended June 30, 2001 equaled $234,000, an increase of $147,000 compared to the same period in 2000. The increase is comprised of $53,000 in increased depreciation of fixed assets and $94,000 in increased amortization of goodwill. In the six months ended June 30, 2000 we recorded a loss on the disposition of assets of $363,000 and a provision for bad debts of $303,000. During the six months ended June 30, 2001, the provision for bad debts was only $122,000.

We had a net profit before taxes of $2,226,000 for the six months ended June 30, 2001 as compared to a loss of $386,000 for the six months ended June 30, 2000. The increase in net income was due to the increase in sales volume and gross profit margins, improved internal controls for overhead, reduced bad debts and lack of any other significant losses. For purposes of earnings per share, net income/loss attributable to common stock reflects net income of $2,226,000 for the six months ended June 30, 2001 as compared to a net loss of $386,000 for the six months ended June 30, 2000.

CAPITAL RESOURCES

At June 30, 2001, we had total current assets of approximately $24,020,000. This included $6,277,000 in cash, $6,947,000 of inventory and $10,712,000 of accounts receivable. Our cash balances vary significantly from day-to-day due the large volume of purchases and sales we make from the various prepaid phone cards companies and the numerous distributors to whom we sells cards.

We generated $4,586,000 in cash from operating activities during the six months ended June 30, 2001 as compared to utilizing $540,000 during the same period in 2000. Increases in cash flows during the six months ended June 30, 2001 are related to the higher net income and increase in accounts payable, offset by increase in accounts receivable and inventory.

Cash utilized by investing activities amounted to $537,000 during the six months ended June 30, 2001, utilized to acquire additional fixed assets and acquire another business operation. Cash utilized by financing activities amounted to $1,887,000 during the six months ended June 30, 2001, of which, $960,000 was utilized to pay down notes payable to shareholder, $900,000 to pay down notes payable to the former owner on acquisition of Reliable Networks, Inc. and $27,000 to pay down principal on debt obligations.

We believe that existing cash and cash equivalents, cash flow from operations and available vendor credit will be sufficient to meet its planned working capital and capital expenditure budget through the remainder of 2001. However, there are no assurances that we will not be required to seek additional financing. If we are required to seek other sources of financing, there can be no assurance that we will be able to obtain such financing on commercially reasonable terms, or otherwise, or that it will be able to otherwise satisfy it short-term cash flow needs from other sources in the future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are subject to certain legal proceedings and claims which have arisen in the ordinary course of our business. These actions when ultimately concluded will not, in the opinion of management, have a material adverse effect on our financial position, results of operations or liquidity. We are also subject to other legal proceedings which we have previously disclosed.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits.

None.

(b) Reports on Form 8-K.

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

9278 COMMUNICATIONS, INC.

Date: August 14, 2001

By /s/ James Scigliano

James Scigliano
Chief Financial Officer
(Principal Financial and
Accounting Officer)