9278 COMMUNICATIONS INC
Form 10-K/A
May 30, 2002

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

FORM 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2001

[ ] TRANSITION REPORT PURSUANT TO 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.

(Name of small business registrant in its charter)

DELAWARE	13-4165136
(State or jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1942 WILLIAMSBRIDGE ROAD, BRONX, NEW YORK 10461

(Address of principal executive offices)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each	Name of each exchange on which registered
None	Not applicable

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. [X] Yes [ ] No

Indicate by checkmark if disclosure of delinquent filers pursuant to Item

405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the common stock held by non-affiliated stockholders of the registrant, as of March 28, 2002, was $3,954,163.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

The number of shares outstanding of the registrant's common stock, as of March 28, 2002, was 23,932,912.

DOCUMENTS INCORPORATED BY REFERENCE

None

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PART I

ITEM 1. BUSINESS.

General

We are a value-added integrator of telecommunications services and technologies, specializing in the distribution of prepaid phone cards. We offer over 200 different prepaid card products, including over 120 private label cards, through a network of over 1,000 private distributors. Our headquarters is in New York City and historically a majority of our sales were generated in the New York metropolitan area. In recent years, we have established distribution centers in California, Maryland, Connecticut and Illinois, as well as additional distribution centers in Upstate New York and the New York metropolitan area, and we have established strategic relationships with distributors in Canada and United Kingdom during 2002. Through this network we estimate that our products are sold through over 50,000 retail outlets. Several of our private label products are marketed under national or international brand names, such as Absolute(TM) or Extra(TM), and in some cases also under localized product variations and names tailored to meet the needs or preferences of localized markets. We are continuously seeking to introduce new proprietary or third-party telecommunications related products into our growing distribution channels, including prepaid wireless products and prepaid direct dial long distance services, and to expand upon our existing business relationships with the United States telecommunications companies and large national prepaid card providers we work with. In 2001, we commenced pre-paid phone card sales through our Internet Website 9278.comTM. Though our website, consumers can purchase 9278 phone cards over the Internet from a selection of over 40 cards, searchable by various criteria, e.g., rates, brand name, country, etc., and receive immediate delivery of the card's access number and PIN codes via e-mail.

Industry Overview

Prepaid phone cards have been widely used throughout Europe and Asia for more than fifteen years. Currently being issued in over 140 countries, the prepaid phone card market has grown to an estimated $20 billion dollar worldwide industry.

Prepaid phone cards were introduced into the North American marketplace by small long distance consolidators and resellers, which purchase a high volume of long distance minutes from major carriers at rates significantly lower than those that could be obtained by individuals and small businesses and which then resell those minutes to their established customer base. Originally introduced to meet very specific telephony applications, prepaid telecommunications services have evolved into a widely accepted solution by both businesses and consumers. More recently, major long distance carriers such as AT&T, WorldCom and Sprint have committed considerable resources to the prepaid phone card market.

Prepaid phone cards are a reliable, convenient and cost-effective alternative to coin-operated calling, collect calling, operator assisted calls and standard credit calling cards. Unlike credit calling cards, which provide virtually unlimited credit and impose surcharges on long distance services, prepaid phone cards are paid for in advance and provide finite amounts of

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calling time. Shaped like a credit card, the prepaid phone card easily fits into a standard wallet. Generally, the front face denotes the denomination of the card, and the back of the cards contains a scratch-off surface covering the card number and personal identification number (a "PIN").

Most domestic prepaid cards utilize remote memory technology, which permits users to place local, long distance and international calls from any touch-tone phone by dialing a toll-free or local access number to connect to a prepaid phone card switching platform. After being prompted to enter a PIN, the caller is advised of the value remaining on the card and is prompted to enter the telephone number to be called. The call is then routed to its destination. The per-minute charges for the call are automatically deducted from the prepaid account corresponding to the PIN as the call progresses.

Prepaid phone cards are distributed through a vast network of retail outlets, including convenience stores, newsstands, grocery stores and discount stores. While prepaid phone card products are also sold through vending machines and, more recently, over Internet websites, the vast majority of phone card sales are still made through retail outlets. In the New York metropolitan area, where the majority of the Company's distribution occurs, we estimate that prepaid phone cards are sold at tens of thousands of retail outlets.

The retail outlets are serviced by independent distributors, which often distribute newspapers or other items to the retail outlets. Typically, a wholesale distributor, like us, purchases large quantities of prepaid phone cards from a long distance carrier or reseller, and sells the cards in smaller quantities, together with cards from other carriers, to the independent distributor for ultimate distribution to the retail outlet. The discount from face value at which cards are bought and sold by the participants in the distribution chain varies depending upon the carrier and the features of the card, such as local versus toll free dial-up access, or the rates and geographic regions for which the card can be used.

Products and Services

We are primarily a wholesale distributor of prepaid phone cards, distributing over 200 different types of prepaid phone cards issued from a variety of telecommunications carriers, including over 120 private label cards. The long distance rates available to users of these cards are between 10% and 50% less than the rates for international calls placed by traditional methods. Generally, each type of prepaid phone card is available in $5, $10 and $20 denominations. With the exception of the private label phone cards, which we print and activate ourselves, we purchase pre-printed, pre-activated phone cards from each of the applicable telecommunications carriers and distribute the cards through our network of over 1,000 independent distributors, predominantly in the New York, New Jersey, Connecticut and Washington, D.C. markets, although we have recently expanded into the mid-west, west-coast and international markets.

Historically, we predominantly distributed prepaid phone cards for most of the major telecommunications carriers, including PT-1 Communications, WorldCom, Qwest Communications and AT&T. During 2000, we shifted our focus to developing private label cards in conjunction with top tier carriers and marketing these cards under brand names owned by us.

We currently offer over 120 private label cards, serviced by several long distance carriers, predominantly Worldcom, including, and "Absolute(TM)," "Traveling," "Nickel USA(TM)," and "Extra(TM)," which are serviced by WorldCom and

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"Bollywood Cities(TM)," and 9278 Africa(TM), which are serviced by Qwest. Generally, we determine the design, rates and target market of the cards based upon our perception of market demand. The "Absolute" and "Extra" brand names are marketed in numerous varieties (e.g., "Absolute Europe(TM)," "Absolute New York(TM)," and "Absolute Chicago(TM),") designed to target the needs of certain markets or provide localized features. Private label cards serve as lucrative promotional items and can also be used to help generate brand name awareness. These private label cards are exclusive to us and, unlike the other types of prepaid phone cards which we distribute, we control the discounts for these products, leading to higher margins. Private label cards constituted over 60% of our sales in 2000 and over 70% of our sales in 2001.

Our retail customers can use the prepaid phone cards we distribute at any touch tone telephone by dialing an access number, followed by a PIN assigned to each card and the telephone number the customer seeks to reach. The carrier's switch completes the call, and its debit card platform reduces the outstanding balance of the card during the call. We believe that many of our customers use prepaid cards as their primary means of making long distance calls due to:

- Attractive rates;
- Reliable service;
- Ease of monitoring and budgeting long distance spending; and
- The appealing variety of calling cards offered to different market segments.

One of our focuses has been on distribution in certain ethnic markets in the U.S. that generate high levels of international traffic to specific countries. As a result, we have become one of the premiere phone card distribution channels in the New York City area, which has many such ethnic markets. Recent immigrants and members of ethnic communities are heavy users of international long distance, given their desire to keep in touch with family members and friends back home. In addition, recent immigrants often do not have established credit histories necessary to establish accounts with traditional long distance carriers. An example of one of our products marketed to a specific ethnic group is the Bollywood Phone Card, from which we generated over $15,000,000 in revenues in 2001. There are approximately 465,000 Indians, Pakistanis, and Bengalis residing in the vicinity of New York City. The Bollywood Phone Card is designed for and has become a household name for peoples from the sub-continent of India, who, by using the card to place long distance calls to that region, receive deep discounts on rates. Other examples are 9278 Vietnam, with attractive rates to Vietnam.

We have over 1,000 independent wholesalers and retailers throughout the New York, New Jersey and Connecticut areas and in other areas. These customers serve as a network, purchasing cards from us and further distributing them to an estimated 50,000 retail outlets. Generally, each customer operates on a net 21 payment cycle. In 2001, one of our customers, Sohel Distributor, Inc., accounted for over 11% of our revenues. Sohel Distributor Inc., is owned by the brother of our Chief Executive Officer and controlling stockholder.

Strategy

Our goal is to solidify our position as a dominant player in the pre-paid distribution industry by continuously expanding the breadth of our

distribution network and by offering the most sought after pre-paid products to the marketplace. Our focus also continues to be on building brand name awareness for "9278" with the consumer base, the distribution networks, and with telecommunications carriers. By shifting our product offerings to include a greater percentage and variety of 9278 private label cards, we have strengthened our position as a broad-based, value added telecommunications services corporation.

We anticipate continued growth in our client base and market share of the prepaid card industry through internal expansion and by strategic acquisition of other distributors. We believe that this presents the opportunity for us to secure a significant share of the North American market and to expand into international markets such as Europe, Asia and the Pacific Rim.

In 2001 we implemented a retail e-commerce strategy that has expanded the geographic reach of our distribution. We expect that this distribution channel will also create operational efficiencies and ultimately increase margins.

To date, the ultimate consumer of mass market prepaid phone cards have been travelers, niche market card collectors and new immigrants needing access to the North American and/or international telecommunications systems servicing these customers. To remain competitive, we will be conducting a targeted marketing program to distributors, retailers and corporations. In addition, we will seek out strategic partners who currently provide distribution and marketing of prepaid cards to different customers or regions as a means of increasing overall market share.

Competition

The telecommunications services industry generally, and the prepaid phone card industry specifically, is intensely competitive, rapidly evolving and subject to constant technological change. There are several large and numerous small competitors in the industry, and we expect to face continuing competition based on price and service offerings from existing competitors and new market entrants. In addition, the increasing prevalence of the Internet and emerging technologies seeking to establish Internet telephony pose potential competitive threats to the market for long distance telephone services. The principal competitive factors in the market include:

- Price;
- Quality of service;
- Breadth of geographic presence;
- Customer service;
- Reliability;
- Network capacity; and
- Availability of enhanced communications services.

Our competitors include:

- Other distributors of prepaid products, such as Union Telecard Alliance and Blackstone Calling Card;
- Telecommunications companies that produce their own prepaid products, such as IDT and Qwest; and
- Other telecommunications companies, such as AT&T, Worldcom and Total-Tel USA.

Some of our competitors have substantially greater financial, technical and marketing resources, larger customer bases, longer operating histories, greater name recognition and more established relationships in the industry than we have. As a result, certain of these competitors may be able to adopt more aggressive pricing policies, which could hinder our growth.

Government Regulation

The provision of telecommunications services is regulated by the federal and state governments of the United States. Federal laws and regulations promulgated by the Federal Communications Commission apply to interstate and international telecommunications, while state regulatory authorities have jurisdiction over telecommunications services that originate and terminate within the same state. Various other international authorities also may seek to regulate telecommunications services originating in their respective countries. However, as of the date of this report, we are not aware of any requirement for government approval to manufacture, distribute and/or market prepaid phone cards.

Employees

As of February 28, 2002, we had 102 full-time employees. Of these, 44 were sales and marketing personnel, 12 were management and finance personnel, 6 were information technology personnel and 40 were general and administrative personnel. None of our personnel are covered by a collective bargaining agreement. We have never experienced an employment-related work stoppage and consider our employee relations to be satisfactory.

ITEM 2. PROPERTIES

Our executive offices are located at 1942 Williamsbridge Road, Bronx, New York, where we lease approximately 3,500 square feet, pursuant to a sublease agreement that expires on November 30, 2008. The aggregate annual base rental for this space is $66,000. We sublet these premises from an officer and director of ours, on terms substantially the same as those under which the officer leases the space.

We also lease approximately 2,600 square feet, located at 1938 Williamsbridge Road, Bronx, New York, pursuant to a lease that expires in March 2008. This space is used as additional office space and as a warehouse location for the off-site storage of our products. The annual rent for such space is $102,000.

In addition, we lease approximately 2,700 square feet, located at 1965 Williamsbridge Road, Bronx, New York to house our ecommerce, telemarketing and

customer service operations. We lease this space pursuant to a lease agreement that expires on November 30, 2003. The aggregate annual base rental for this space is $60,000.

We also maintain sales and distribution offices in eight additional sites, servicing principally their respective local markets. These branch offices combine office and warehouse facilities. The following table sets forth certain information with respect to such branch offices.

Location	Square feet	Lease Expiration date	Annua
1601 South Vermont, Suite 103 Los Angeles, CA	1,870	August 9, 2006	$30,2
1099 North Avenue Bridgeport, CT	900	December 31, 2004	$18,0
6635 West Ceramack Road Berwyn, IL	2,340	December 31, 2006	$22,8
13824 Old Columbia Pike	1,160	October 14, 2003	$17,4

Silver Springs, MD			
416 4th Avenue Brooklyn, NY	3,200	June 30, 2004	$36,0
483 Freedom Plains Road Poughkeepsie, NY	900	November 30, 2002	$11,4
9929 Queens Blvd Rego Park, NY	900	January 31, 2004	$16,1
1569 Central Park Ave Yonkers, NY	3,500	June 30, 2005	$33,6

ITEM 3. 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.

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

None

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Market Information

Our common stock is quoted on the over-the-counter bulletin board ("OTCBB") of the Nasdaq Stock Market under the symbol "NTSE". The following table sets forth the range of the high and low bid quotations for our common stock for the periods indicated. Such market quotations reflect inter-dealer prices, without mark-up, mark-down or commission and may not necessarily represent actual transactions.

	High	Low
2001		
First quarter	$1.59	$0.61
Second quarter	0.74	0.40
Third quarter	0.51	0.36
Fourth quarter	0.37	0.20
2000		
First quarter	$4.81	$2.63

Second quarter	3.25	1.28
Third quarter	1.80	0.91
Fourth quarter	1.94	0.78

As of April 1, 2002, there were approximately 360 holders of record of our common stock and the closing bid quotation of our common stock on the OTCBB was $0.36 per share.

Dividend Policy

We do not intend to pay future dividends and intend to reinvest any earnings into our business to finance future growth. Accordingly, our Board of Directors does not anticipate declaring any cash dividends in the foreseeable future.

Recent Sales of Unregistered Securities

On March 22, 2001, Sajid Kapadia, an officer and director of ours, agreed to amend the repayment terms of a $2.0 million promissory note made to him by us in December 1999. As amended, the terms provide for principal repayments by us of (i) $1.0 million on March 31, 2002, and (ii) $1.0 million on December 31, 2002. Mr. Kapadia had previously extended the payment terms of this promissory note, in June 2000. At that time, in consideration for his agreement to extend the repayment terms of the note, we issued him a warrant to purchase 200,000 shares of our common stock at an exercise price of $1.625 per share. The warrant vested immediately as to 100% of the shares of common stock underlying the warrant and is exercisable for ten years from the date of the grant. These transactions were exempt from registration pursuant to Section 4(2) of the

Securities Act of 1933 (the "Act").

ITEM 6. SELECTED FINANCIAL DATA

	For the Year Ended December 31, (in thousands, except share data)		
	2001	2000	1999
Net Sales	$200,177	$80,763	$78,090
Cost of Sales	189,212	77,793	75,473
Operating Expenses	9,924	5,599	2,028

Earnings (loss) before income taxes	$721	$(3,419)	$12	
Earnings (loss) per common share	$.03	$(0.16)	$(0.02)	
Weighted-average shares	24,500,881	20,902,060	19,659,629	14

As at December 31,
(in thousands)

	2001	2000	1999	
Current Assets	$32,879	$14,562	$6,827	
Total Assets	37,968	19,141	7,144	
Convertible Notes Payable	176	--		

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ITEM 7. 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 Annual 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 branded prepaid phone cards, which are produced by a variety of telecommunications long distance carriers and resellers, as well as private label proprietary prepaid phone cards produced exclusively for us by various long distance carriers and/or resellers.

Prepaid phone cards are distributed through a vast network of retail outlets, including convenience stores, newsstands, grocery stores and discount stores. The retail outlets are serviced by independent distributors, which often distribute newspapers or other items to the retail outlets. We purchase large volumes of branded prepaid phone cards from the long distance carrier or reseller and sell the cards in smaller quantities, together with cards from other carriers and/or private label cards we distribute, to the independent distributor, for ultimate distribution to retailer outlet.

We purchase branded cards at a discount from the face value of the card, and resell them to the distributor at a slightly lower discount. The difference between the two discount rates, typically from 1% to 8%, represents the gross margin we retain. We purchase branded cards on varying terms, from C.O.D. to an as used basis. Sales of our products are generally made on a net 21 basis.

Private label cards are generally designed and produced by us, utilizing card numbers and PINs 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. 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 us with the ability to achieve a greater gross margin percentage, typically ranging from 5% to 8%. During the past two years, we have continued to increase our sales of private label cards, both on an absolute dollar volume and as a percentage of our sales. During the year ended December 31, 2001, we sold over 120 varieties of private label cards which accounted for in excess of 70% of our total revenues.

We continue to seek to expand our geographic reach and to increase our sales. In recent years, we have established distribution centers in California, Maryland, Connecticut,Illinois, Upstate New York, as well as additional

distribution centers in the New York metropolitan area, and we have established strategic relationships with distributors in Canada and United Kingdom. In addition, in 2001, we commenced pre-paid phone card sales through our Internet Website 9278.com(TM). Through our website, consumers worldwide can purchase 9278 phone cards over the Internet from a selection of over 40 cards, searchable by various criteria, e.g., rates, brand name, country, etc., and receive immediate delivery of the card's access number and PIN codes via e-mail.

We are 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. In the short-term, additional costs related to the development or acquisition of such products may have an impact on our net profits.

Results of Operations

YEAR ENDED DECEMBER 31, 2001 COMPARED TO YEAR ENDED DECEMBER 31, 2000

Net sales increased by approximately $120 million to $200.2 million for the year ended December 31, 2001, up over 148% from net sales of $80.7 million for the year ended December 31, 2000. The increase in net sales was primarily due to our geographic expansion since the third quarter of calendar year 2000 and continuing in the first three quarters of 2001. In the third quarter of 2000 we acquired two businesses (in Yonkers, New York and Silver Springs, Maryland) that accounted for $27,437,000 of sales for the year ended December 31, 2001. In December 2000, we acquired Reliable Networks, Inc., a competitor of ours located in Queens, New York, which accounted for $36,342,000 of sales for the year ended December 31, 2001. In January 2001, we opened an office in Connecticut, which accounted for an aggregate of $8,469,000 in sales for the year ended December 31, 2001. In May 2001, we opened a new office in Los Angeles, California, which accounted for $14,991,000 in sales for the year ended December 31, 2001. In August 2001, we opened a new location in Brooklyn, New York, which accounted for $3,655,000 in sales since its inception and in September 2001 we opened a new location in Chicago, Illinois, which accounted for $5,079,000 in sales since its inception. Starting July 2001, we began actively selling phone cards over the Internet. Internet sales accounted for $6,649,000 for the year ended December 31, 2001. For the year ended December 31, 2001, same location sales for our Bronx office increased by approximately $21,939,000 or 29% to $98,667,000 in 2001 from $76,728,000 in the prior year.

Gross profit increased to approximately $11 million in 2001, as compared to approximately $3 million in 2000, principally as a result of increased volume and as a result of higher gross margins. As a percentage of sales, gross profit for 2001 increased to 5.48%, as compared to 3.68% for the year ended December 31, 2000. This increase in gross profit was attributable to the 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 year ended December 31, 2001 increased by $4,325,000 to $9,924,000, an increase of 77% over operating expenses of $5,599,000 for the year ended December 31, 2000. Of this, general and administrative expenses increased by $2,358,000 or 53% to $6,810,000 for 2001 as compared to $4,452,000 for 2000. This increase was primarily due to the increase in salaries by $969,000 to $1,998,000 in 2001 as compared to $1,029,000 in 2000 resulting from

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additional personnel required for new offices, direct sales efforts and Internet customer service. Included in the general and administrative expenses is the cost of processing credit card sales over the Internet in the amount of $225,000 for the year 2001. Rent expenses increased by $180,000 to $308,000 in 2001 as compared to $128,000 in 2000 as the company continued to add new locations and expand its existing facilities. Professional fees increased by $393,000 to $1,172,000 in 2001 as compared to $779,000 in 2000. The increase in professional fees was due to legal and accounting fees incurred primarily in connection with lawsuits settled in 2001 and legal and accounting costs incurred in connection with opening new locations during the year. Travel and related expenses increased by $197,000 whereas telephone and utilities increased by $189,000. Other general and administrative expenses increased due to the company opening additional locations and expenses related to increase in sales volume.

Selling expenses increased by $1,680,000 or 306% to $2,229,000 in 2001 as compared to $549,000 during the year 2000. Of this, $330,000 was increases in promotional expenses incurred in connection with the Company promoting its private label cards during the year 2001. The commission expense increased by $892,000 as the Company hired commissioned salespersons in 2001 to promote its sales. Advertising costs increased by $658,000 to $817,000 in 2001 from $159,000 in 2000 as the company increased the sales of its private label cards and sales over the Internet. Trade shows expense was reduced by $138,000 as a result of negotiated packages, and cost of printing of trade publications were reduced by $63,000 as the company utilized its in-house facilities in designing these publications.

Provision for bad and doubtful debts increased by $287,000 to $885,000 in 2001 as compared to $598,000 in 2000 an increase of 48% over prior year. This increase is nominal compared to the 148% increase in sales.

Other Expenses decreased by $470,000 to $320,000 in 2001, as compared to $790,000 during the year 2000. Included in other expenses is a one-time charge for amount payable to an ex-vendor in connection with a litigation settlement in the amount of $203,000.

We had net earnings of $656,000 for 2001 as compared to net loss of $3,444,000 for the year ended December 31, 2000.

YEAR ENDED DECEMBER 31, 2000 COMPARED TO YEAR ENDED DECEMBER 31, 1999

Net sales increased $2.6 million to $80.7 million for the year ended December 31, 2000, up 3.3% from net sales of $78.1 million for the year-ended December 31, 1999. The increase in net sales was due to the addition of new distributors during calendar year 2000.

Gross profit increased to $2,970,000 in 2000, as compared to $2,617,000 in 1999, principally as a result of increased volume. As a percentage of sales, gross profit for 2000 increased to 3.68%, as compared to 3.35% for the year ended December 31, 1999. This increase in gross profit was attributable to the 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 year ended December 31, 2000 increased by $3,571,000 to $5,599,000, an increase of 176% over operating expenses of $2,028,000 for the year ended December 31, 1999. Included in the operating expenses was a one time write off of bad debts of $594,000 from a customer. In addition, general and administrative expenses increased to $4,452,000 for 2000, as compared to

$1,143,000 for 1999. This increase was primarily due to the increase in salaries, constituting $1,029,000 in 2000, as compared to $184,000 in 1999, the one time recognition of public relations costs of $875,000, that resulted from our issuing 800,000 shares of common stock under a four year consulting agreement, and an increase in professional fees to $769,000 in 2000 as compared to $442,000 in 1999. The increase in professional fees was due to legal, accounting and consulting fees incurred primarily in connection with the acquisitions of iLink Telecom and Reliable Networks and certain litigation instituted by former vendors and customers.

Other expenses increased by $213,000 to $790,000 in 2000 as compared to $577,000 during the year 1999. Included in other expenses for 2000 was a charge to operations of $555,000, primarily resulting from and a one-time write off for goodwill that resulted from the 1999 acquisition of iLink Telecom, Inc. and we recorded a $58,000 unrealized loss on investment in marketable securities.

We incurred a net loss of $3,444,000 for 2000 as compared to net income of $7,000 for the year ended December 31, 1999. The decrease in net income was primarily due to the one-time charges described above that total $2,145,000 and the significant professional fees we incurred in connection with the acquisitions. For purposes of earnings per share, net income (loss) attributable to common stock for 1999 reflects a net loss of $368,000. This gives effect to recognition of a beneficial conversion feature of $375,000 attributable to the outstanding series B convertible preferred stock we issued in December 1999.

CAPITAL RESOURCES

At December 31, 2001, we had total current assets of approximately $32,879,000. This included $4,336,000 in cash, $1,051,000 in restricted cash, $12,969,000 of inventory and $14,374,000 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 card companies and the numerous distributors to whom we sell cards. Although we had current liabilities of $35,620,000 at December 31, 2001, we believe that the nature of such liabilities and the cash flow we are generating from operations enable us to have adequate liquidity to fund our operations. We believe that cash flow from operations in fiscal 2002 should permit our current assets to exceed our current liabilities at the end of such year.

We are continuously renegotiating credit terms with their telephone card suppliers. The favorable changes in terms from our vendors has eliminated the temporary cash crunches that have occurred in the past due to the restrictive credit terms previously made available to us from the telecommunications companies we buy branded cards from, as compared to the credit terms we make available to our customers.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

9278 Communications, Inc. and Subsidiaries

INDEX TO FINANCIAL STATEMENTS

Report of Independent Certified Public Accountants

Consolidated Balance Sheets as of December 31, 2001 and 2000

Consolidated Statements of Operations for the years ended
December 31, 2001, 2000 and 1999

Consolidated Statement of Shareholders' Equity for the years ended December 31, 2001, 2000 and 1999

Consolidated Statements of Cash Flows for the years ended December 31, 2001, 2000 and 1999

Notes to Consolidated Financial Statements

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Shareholders of
9278 COMMUNICATIONS, INC.

We have audited the accompanying consolidated balance sheet of 9278 Communications, Inc. and Subsidiaries as of December 31, 2001, and the related consolidated statements of operations, shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of 9278 Communications, Inc. and Subsidiaries as of December 31, 2001, and the consolidated results of their operations and their consolidated cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II - Valuation and Qualifying Accounts for the year ended December 31, 2001. In our opinion, this schedule presents fairly, in all material respects, the information required to be set forth therein.

/s/ GRANT THORNTON LLP

Melville, New York
April 5, 2002

(LETTERHEAD OF FRIEDMAN ALPREN & GREEN LLP)

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
9278 Communications Inc.

We have audited the accompanying consolidated balance sheet of 9278 Communications, Inc. and Subsidiaries as of December 31, 2000, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the years ended December 31, 2000 and 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of 9278 Communications, Inc. and Subsidiaries as of December 31, 2000, and the results of their operations and their cash flows for the years ended December 31, 2000 and 1999, in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II--Valuation and Qualifying Accounts for each of two years in the period ended December 31, 2000. In our opinion, this schedule presents fairly, in all material respects, the information required to be set forth therein.

/S/ FRIEDMAN ALPREN & GREEN LLP

New York, New York
March 23, 2001

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

December 31,

ASSETS	2001
CURRENT ASSETS	
Cash and cash equivalents	$ 4,335,9
Restricted cash	1,051,2
Marketable securities	
Accounts receivable, net of allowance of $760,000 in 2001 and $675,000 in 2000	13,058,7
Accounts receivable - related party	1,315,0
Inventories	12,969,3
Prepaid expenses and other current assets	149,0
Total current assets	32,879,3
PROPERTY AND EQUIPMENT, NET	1,306,8
GOODWILL, NET	3,624,0
OTHER ASSETS	158,1
	$37,968,4

The accompanying notes are an integral part of these statements.

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9278 Communications, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

December 31,

LIABILITIES AND SHAREHOLDERS' EQUITY	2001
CURRENT LIABILITIES	
Accounts payable and accrued expenses	$34,590,3
Accounts payable - related party	318,9
Current maturities of notes and advances payable, Shareholder	570,1
Current maturities of capital lease obligations	45,5

Current maturities of convertible notes payable	35,8
Income taxes payable	59,2

	35,619,9
Total current liabilities	
NOTES AND ADVANCES PAYABLE, SHAREHOLDER, less current maturities	
CAPITAL LEASE OBLIGATIONS, less current maturities	85,9
CONVERTIBLE NOTES PAYABLE, less current maturities	140,1
COMMITMENTS AND CONTINGENCIES	
SHAREHOLDERS' EQUITY	
Convertible preferred stock Class B, $.001 par value; 5,000,000 shares authorized; 505 shares issued and outstanding in 2000	
Common stock - $.001 par value; 40,000,000 shares authorized; 22,932,912 and 23,166,969 shares issued and outstanding in 2001 and 2000, respectively	22,9
Capital in excess of par value	8,248,4
Accumulated deficit	(6,149,0

	2,122,3

	$37,968,4
	========

The accompanying notes are an integral part of these statements.

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS

Year ended December 31,

	2001	2000
Net sales	$200,177,380	$80,763,0
Cost of sales	189,212,225	77,792,8
	-----------	---------
Gross profit	10,965,155	2,970,2

Operating expenses		
Selling	2,228,816	549,3
General and administrative	6,809,862	4,451,5
Provision for bad debts	885,282	598,4
	9,923,960	5,599,3
Operating profit (loss)	1,041,195	(2,629,1
Other expense		
Interest expense	116,821	175,9
Litigation settlement	203,000	
Loss on disposal of assets	-	555,4
Unrealized loss on investment	-	58,4
Loss attributable to major supplier	-	
	319,821	789,9
Earnings (loss) before income taxes	721,374	(3,419,0
Income tax provision	65,400	25,4
NET EARNINGS (LOSS)	655,974	(3,444,4
Preferred stock dividend	-	-
Net earnings (loss) attributable to common stock	$ 655,974	$(3,444,4
Earnings (loss) per common share		
Basic and diluted	$0.03	$(0.1
Weighted-average shares		
Basic and diluted	24,500,881	20,902,0

The accompanying notes are an integral part of these statements.

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9278 Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

Years ended December 31, 2001, 2000 and 1999

	Convertible preferred stock		Common stock	
	Shares	Amount	Shares	Amount
Balance at January 1, 1999			200	$ 1,000

Contribution of common stock by founding shareholders			23	
Reissuance of treasury stock			(23)	
Effective stock split of 74,500 shares at merger			14,899,800	13,900
Effective acquisition of ilink excluding contemporaneous private placement			4,259,629	4,259
Issuance of common stock through private placement			500,000	500
Issuance of preferred stock through private placement	1,500	$1,500,000		
Dividends declared				
Imputed preferred stock dividend attributable to the beneficial conversion feature				
Net income				
Balance at December 31, 1999 (carried forward)	1,500	1,500,000	19,659,629	19,659

	Additional paid-in capital	Accumulated decicit	Total
Balance at January 1, 1999	$ 199,000	$ 72,600	$ 272,600
Contribution of common stock by founding shareholders	350,721		701,442
Reissuance of treasury stock			(350,721)
Effective stock split of 74,500 shares at merger	(13,900)		
Effective acquisition of ilink excluding contemporaneous private placement	451,061		455,320
Issuance of common stock through private placement	999,500		1,000,000
Issuance of preferred stock through private placement			1,500,000
Dividends declared		(3,065,000)	(3,065,000)
Imputed preferred stock dividend attributable to the beneficial conversion feature	375,000	(375,000)	
Net income		6,835	6,835
Balance at December 31, 1999 (carried forward)	2,361,382	(3,360,565)	520,476

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (CONTINUED)

Years ended December 31, 2001, 2000 and 1999

	Convertible preferred stock		Common stock	
	Shares	Amount	Shares	Amount
(brought forward)	1,500	$1,500,000	19,659,629	$19,659
Conversion of preferred stock to common stock	(995)	(995,000)	873,340	873
Issuance of common stock through private placement			529,000	529
Issuance of common stock to officer in exchange for advances payable			250,000	250
Issuance of common stock for services rendered			855,000	855
Issuance of common stock upon acquisition of Reliable Networks, Inc.			1,000,000	1,000
Net loss				
Balance at December 31, 2000	505	505,000	23,166,969	23,166
Conversion of preferred stock to common stock	(505)	(505,000)	776,013	777
Repurchase and retirement of common stock			(1,010,070)	(1,010
Net income				
BALANCE AT DECEMBER 31, 2001	-	$	22,932,912	$22,933

	Additional paid-in capital	Accumulated decicit	Total
(brought forward)	$2,361,382	$(3,360,565)	$ 520,476
Conversion of preferred stock to common stock	994,127		
Issuance of common stock through private placement	997,471		998,000
Issuance of common stock to officer in exchange for advances payable	499,750		500,000
Issuance of common stock for services rendered	929,186		930,041

Issuance of common stock upon acquisition of Reliable Networks, Inc.	1,961,336		1,962,336
Net loss		(3,444,426)	(3,444,426)
Balance at December 31, 2000	7,743,252	(6,804,991)	1,466,427
Conversion of preferred stock to common stock	504,223		
Repurchase and retirement of common stock	983		(27)
Net income		655,974	655,974
BALANCE AT DECEMBER 31, 2001	$8,248,458	$(6,149,017)	$ 2,122,374

The accompanying notes are an integral part of this statement.

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9278 Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended December 31,

	2001	200
Cash flows from operating activities		
Net income (loss)	$ 655,974	$(3,444
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Depreciation and amortization	511,175	186
Provision for doubtful accounts	885,282	598
Loss attributable to major supplier	-	
Issuance of common stock for services rendered	-	930
Unrealized loss on investments	-	58
Loss on sale of equipment	-	555
Changes in assets and liabilities, net of assets acquired and liabilities assumed		
Restricted cash	(1,051,215)	
Accounts receivable	(8,015,461)	(2,773
Accounts receivable - related party	(250,868)	(849
Inventories	(9,319,292)	(2,279
Prepaid expenses and other current assets	(149,044)	30
Other assets	(18,149)	(46
Accounts payable and accrued expenses	20,110,295	11,560
Accounts payable - related party	91,006	227
Income taxes payable	34,995	22

Net cash provided by (used in) operating activities	3,484,698	4,777
Cash flows from investing activities		
Acquisition of property and equipment	(878,969)	(491
Acquisition of businesses	(207,742)	(1,000
Disposition of marketable securities	20,962	
Cash received in merger	-	
Merger transaction costs	-	
Net cash used in investing activities	(1,065,749)	(1,491
Cash flows from financing activities		
Notes and advances payable, shareholder, net	(2,334,836)	(128
Principal payments on capital lease obligations	(38,771)	(66
Proceeds from convertible notes payable	203,000	
Principal payments on convertible notes payable	(27,030)	
Repurchase and retirement of common stock	(27)	
Issuance of common stock	-	998
Issuance of preferred stock	-	
Dividends paid	-	
Net cash provided by (used in) financing activities	(2,197,664)	803
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	221,285	4,088
Cash and cash equivalents, beginning of year	4,114,651	26
Cash and cash equivalents, end of year	$ 4,335,936	$ 4,114

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

Year ended December 31,

	2001	200
Supplemental disclosures of cash flow information:		
Cash paid during the year for		
Interest	$ 122,742	$ 175
Income taxes	30,405	10
Noncash investing and financing activities:		
Equipment acquired under capital leases	$ 19,200	$ 75
Conversion of notes and advances payable, shareholder for common stock		500
Conversion of preferred stock to common stock	505,000	995
Notes issued for accrued dividends		
Issuance of common stock for net noncash assets received in merger		

Additional paid-in capital arising from contribution of treasury shares	
Acquisition of Reliable Networks, Inc.	
Net assets acquired	$ 38
Goodwill	3,901
	3,940
Less	
Common stock issued	970
Contingent consideration - common stock	970
Promissory notes payable	1,000
	2,940
Cash paid	$ 1,000

The accompanying notes are an integral part of these statements.

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2001, 2000 and 1999

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company distributes prepaid telephone calling cards to distributors and retail establishments through its various sales locations throughout the United States.

9278 Communications, Inc. is the successor-consolidated entity formed by the merger, on December 10, 1999, of 9278 Distributor Inc. (the "Company") and iLink Telecom, Inc. ("iLink"). iLink was originally incorporated in Colorado on December 10, 1997 and was reincorporated in Nevada on July 14, 1998. Concurrent with the merger, iLink, a publicly held company and the legally surviving parent company, changed its name to 9278 Communications, Inc. This event has been given retroactive treatment in these financial statements. The Company was incorporated in New York on April 17, 1997 and reincorporated in Delaware on April 3, 2000. This reincorporation had no impact on the Company's authorized stock.

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

1. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of 9278 Communications, Inc. and its wholly-owned subsidiaries, 9278 Distributors, Inc., 9278 DotCom, Inc., E-Store Solution, Inc. and Reliable Acquisition Corp. (hereinafter, the "Company"). All significant intercompany transactions and balances have been eliminated in consolidation.

2. Cash and Cash Equivalents

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

3. Inventories

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

NOTE A (CONTINUED)

4. 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.

5. Goodwill

Goodwill represents the excess purchase price paid by the Company over the estimated fair value of net assets acquired and is being amortized on a straight-line basis over fifteen years. The amortization of such excess was approximately $260,000 and $17,000 for the years ended December 31, 2001 and 2000, respectively. Accumulated amortization totaled approximately $277,000 and $17,000 for the years ended December 31, 2001 and 2000, respectively.

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. 121 ("SFAS No. 121"), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of", as amended. The Company has elected to adopt SFAS No. 142 for the year beginning January 1, 2002. The impact of adopting SFAS No. 142 is not expected to be material to the consolidated financial statements. The Company will continue to amortize goodwill under its current method until January 1, 2002, the first day of the SFAS No. 142 implementation year. Once adopted, annual goodwill amortization of $260,000 will no longer be recorded.

NOTE A (CONTINUED)

In accordance with the new standards, during 2002, the Company will perform a transitional fair value-based impairment test. If the fair value is less than the recorded value at January 1, 2002, the Company will record an impairment loss during 2002 as a cumulative effect of a change in accounting principle.

6. 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, the Company evaluates recoverability by a comparison of the carrying amount of the assets to future undiscounted net cash flows that the Company expects to generate from these assets. If the assets are impaired, the Company recognizes 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.

On February 28, 2000, and again on October 8, 2000, the Company sold all of the assets acquired in the acquisition of iLink and recognized a loss on sale of $555,447, primarily attributable to the write-off of the related goodwill.

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 143 ("SFAS No. 143"), "Accounting for Asset Retirement Obligations," which is effective for years beginning after June 15, 2002. SFAS No. 143 addresses legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development or normal operation of a long-lived asset. The standard requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. Any associated asset retirement costs are to be capitalized as part of the carrying amount of the long-lived asset and expensed over the life of the asset. The Company has elected to adopt SFAS No. 143 for the year beginning January 1, 2002. The impact of adopting SFAS No. 143 is not expected to be material to the consolidated financial statements.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets," which is effective for fiscal years beginning after December 15, 2001. SFAS No. 144 clarifies accounting and reporting for assets held for sale, scheduled for abandonment or

NOTE A (CONTINUED)

other disposal, and recognition of impairment loss related to the carrying value of long-lived assets. The Company has elected to adopt SFAS No. 144 for the year beginning January 1, 2002. The impact of adopting SFAS No. 144 is not expected to be material to the consolidated financial statements.

7. Income Taxes

Income taxes are accounted for in accordance with 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 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.

8. Earnings Per Share

Basic earnings (loss) per share is 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, 235,000 and 23,000 options and warrants to purchase the Company's common stock in 2001, 2000 and 1999, respectively, as their inclusion would have been antidilutive.

9. Stock-Based Compensation Plans

The Company maintains two stock option plans, as more fully described in Note J to the consolidated financial statements, which are accounted for using the "intrinsic value" method pursuant to the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, and, accordingly, recognizes no compensation expense. Therefore, the Company has elected the disclosure provisions only of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation."

NOTE A (CONTINUED)

10. Revenue Recognition

Revenue is recognized from sales when products are shipped and title passes to the customer. Sales incentives in the form of free products given to the Company's distributors are classified as a reduction of revenues.

11. Advertising

Advertising costs are expensed as incurred and totaled $817,000, $159,000 and $125,000 in 2001, 2000 and 1999, respectively.

12. Shipping and Handling Fees and Costs

The Company includes fees billed to a customer relating to shipping and handling costs in net sales. All shipping and handling expenses incurred by the Company are included in cost of sales.

13. Uses of Estimates and Fair Value of Financial Instruments

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

Management of the Company believes that the fair value of financial instruments, consisting of cash, accounts receivable and debt, approximates carrying value due to the immediate or short-term maturity associated with its cash and accounts receivable and the interest rates associated with its debt.

14. Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

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9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2001, 2000 and 1999

NOTE B - SUMMARY OF QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the Company's unaudited quarterly operating results for the years ended December 31, 2001 and 2000.

	Three months ended					
	December 31, 2001	September 30, 2001	June 30, 2001	March 31, 2001	December 31, 2000	September 2000
Sales	$57,423,182	$55,736,568	$49,578,900	$37,438,730	$26,990,325	$20,032,20
Gross profit	1,959,143	3,091,352	3,191,235	2,723,425	91,019	1,141,10
Net earnings (loss)*	(1,630,486)	219,996	1,082,827	983,637	(3,160,719)	102,22
Earnings (loss) per share*						
Basic	$(0.07)	$0.01	$0.05	$0.04	$(0.14)	$0.0
Diluted	(0.07)	0.01	0.05	0.04	(0.14)	0.0
Weighted-average common outstanding						
Basic	24,942,982	23,942,982	23,643,089	23,593,153	22,284,038	20,561,84
Diluted	24,942,982	23,942,982	23,643,089	23,593,153	22,284,038	20,561,84

* As adjusted to reflect the provision for officer's compensation

During the fourth quarter of 2001, the Company recognized approximately $1,945,000 of losses, which include the following significant items: bad debt expense of $812,000, a provision for officers compensation of $450,000, a decline in the gross profit due to lower selling prices and additional selling expenses associated with the Company's geographic expansion.

During the fourth quarter of 2000, the Company recognized approximately $3,161,000 of losses, which include the following significant items: $875,000 for management consulting and public relations services; a 1.7% gross profit erosion of approximately $1,400,000 due to unfavorable product cost variances from estimated costs; $294,000 of additional accounts receivable reserves; $58,000 of unrealized losses on investments and a $192,000 loss on the sale of the balance of the iLink assets acquired, primarily consisting of the write-off of the related goodwill.

NOTE C - ACQUISITIONS

On January 23, 2001, the Company acquired certain assets of two of its distributors in an asset purchase transaction, wherein it acquired accounts receivable, inventories, fixed assets and customer lists of the distributors, net of accounts payable. The Company paid $100,000 in excess of its net assets for the

NOTE C (CONTINUED)

customer lists. The assets acquired and liabilities assumed were recorded at estimated fair values. The consolidated statements of operations include the results of this acquisition beginning January 23, 2001. 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.

Acquisition of Reliable Networks, Inc.

On December 8, 2000, the Company acquired, through its wholly-owned subsidiary, Reliable Acquisition Corp., all of the outstanding common stock of Reliable Networks, Inc. ("Reliable") in a business combination accounted for by the purchase method of accounting. Reliable had total sales of approximately $35 million in 1999. The assets acquired and liabilities assumed were recorded at estimated fair values based on information currently available and on current assumptions as to future operations. The consolidated statements of operations include the results of Reliable beginning December 8, 2000.

The Company paid a total of $3,940,000 for Reliable, which consisted of $1,000,000 in cash, $1,000,000 in promissory notes, and 1,000,000 shares of common stock valued at $970,000. An additional 1,000,000 shares of common stock, also valued at $970,000, was recorded as contingent consideration because the Company deemed it probable that certain contingency provisions in the merger agreements would be met. Such conditions were met during the year ended December 31, 2001.

NOTE C (CONTINUED)

The following unaudited pro forma information presents the results of operations of the Company as if the acquisition had taken place on January 1, 1999:

	Year ended December 31,	
	2000	1999
Net sales	$125,714,692	$113,246,565
Net loss	(3,472,509)	(293,879)
Loss per share	$(.15)	$(.02)

Acquisition of iLink

The Company consummated the reverse acquisition of iLink on December 10, 1999. The Company's shareholders were issued 14,900,000 iLink shares in exchange for the 200 shares of the Company. For accounting purposes, the shares retained by the original shareholders of iLink, subject to certain adjustments, are treated as being issued by the Company to effect the merger, hence the term "reverse acquisition." These shares were valued at $155,000 based upon an independent valuation of iLink. In addition to the value of these shares, the Company's acquisition cost includes the eight shares (post-split equivalent of 596,000 shares) issued to a creditor of iLink valued at $123,330, legal fees of $42,455, and investment banker fees of $13,226, for total acquisition costs of $334,011.

Concurrent with the closing of the merger, iLink completed two private placements pursuant to which it sold 500,000 new common shares for $1,000,000 and 1,500 convertible preferred shares for $1,500,000.

Immediately prior to the closing of the merger, the Company declared a $3,000,000 dividend ($15,000 per share), of which $1,000,000 was paid in cash and the balance of $2,000,000 in the form of a two-year promissory note (Note H). The payment of $1,000,000 was funded by the private placements consummated as of that date.

Also prior to the merger, iLink issued 300,000 shares in satisfaction of $300,000 in debt, issued 190,000 shares for services upon the achievement of certain vesting provisions and also issued 200,000 common shares for advisory and related services in connection with the private placement and merger.

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2001, 2000 and 1999

NOTE C (CONTINUED)

The following unaudited pro forma information presents the results of operations of the Company as if the acquisition had taken place on January 1, 1999:

	Year ended December 31, 1999
Net sales	$78,121,200
Net loss	(1,497,438)
Loss per share	$(.08)

NOTE D - INVESTMENTS AND OTHER TRANSACTIONS

On September 1, 2000, the Company entered into an agreement with Rapid Release Research, LLC ("Rapid Release"), a company that is in the business of providing services for management consulting, business advisory, shareholder information and public relations (the "Consulting Agreement"). Rapid Release will be used to inform the public of the potential investment merit of the Company and its securities, thereby increasing investor recognition and market liquidity and improving shareholder value, and to assist the Company in acquisitions, mergers and other financial transactions. This agreement was for a period of four years. The Company issued Rapid Release 800,000 shares of its common stock and has recognized the expense from this agreement based on the market value of the stock of the Company at the date of issue, which was $875,040

On January 29, 2001, the Company acquired, for a nominal amount, 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 10,800,000 shares of Cirus was diluted to 18%. The Company's investment in Cirus was restricted and subject to other conditions pursuant to the distribution agreement. The investment in Cirus is accounted for at cost and is not material to the Company's financial position.

NOTE D (CONTINUED)

On September 26, 2001, under the terms of the Consulting Agreement between Rapid Release and the Company, Rapid Release returned to the Company 800,000 shares of the Company's common stock in exchange for 600,000 shares of Cirus stock held by the Company. As additional consideration, the two parties mutually agreed to declare the Consulting Agreement as null and void. The Company also delivered 60,000 shares of Cirus stock to a consulting firm, for its services in negotiating this settlement agreement. The Company has recorded no gain or loss from this transaction.

On September 26, 2001, the Company transferred the balance of 10,140,000 shares of Cirus stock back to Cirus in exchange for (i) Cirus' consent to the September 26, 2001 transaction between the Company and Rapid Release; (ii) 210,070 shares of the Company's common stock held by certain shareholders of Cirus; and (iii) an unconditional release from the Distribution Agreement dated February 6, 2001, signed between Cirus and the Company, from the day of its inception.

On September 30, 2001, the Company retired 1,010,070 shares of its common stock it received from the above settlements.

NOTE E - PREFERRED STOCK

During the year ended December 31, 2001, the Company converted 505 shares of Class B, $.001 par value convertible preferred stock into 776,013 shares of common stock.

NOTE F - RESTRICTED CASH

Restricted cash consists of the following at December 31, 2001:

Amounts invested in certificate of deposit, which is pledged as collateral for a letter of credit issued by the bank	$1,000,000
Amounts invested in certificate of deposit, held by bank as collateral for deposited funds returned for insufficient funds by customers' bank	51,215

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9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2001, 2000 and 1999

NOTE G - PROPERTY AND EQUIPMENT

Property and equipment consist of the following at December 31:

	Estimated useful life (years)	2001
Furniture and equipment	5 - 7	$ 483,
Automobiles	5 - 7	224,
Computer equipment	5	731,
Leasehold improvements	3 - 8	245,
		1,685,
Less accumulated depreciation and amortization		378,
		$1,306,

Depreciation and amortization expense for property and equipment for the years ended December 31, 2001, 2000 and 1999 was approximately $242,000, $115,000 and $66,000, respectively.

Property and equipment under capital leases totaled approximately $215,440 and $196,240 and accumulated amortization on such property and equipment aggregated approximately $61,185 and $30,063 at December 31, 2001 and 2000, respectively.

NOTE H - NOTES PAYABLE - SHAREHOLDER

On December 10, 1999, the Company declared $3,000,000 in dividends, of which $1,000,000 was paid. On December 13, 1999, the Company executed a promissory note for $2,000,000 for the declared but unpaid dividends, 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 originally payable on December 13, 2001. On March 22, 2001, the Company amended the terms of these promissory notes to defer both payments to March 31, 2002 and December 31, 2002, respectively. The final payment is accelerated if the Company's gross revenue exceeds $10 million in each of any six consecutive calendar months or exceeds $60 million in any six-month period. During the year-ended December 31, 2001, the Company made principal payments aggregating

$1,430,000. Interest is payable at a rate of 8%. Interest expense on this note was $90,100 and $160,000 for the years ended December 31, 2001 and 2000, respectively.

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2001, 2000 and 1999

NOTE I - INCOME TAXES

The provision (benefit) for income taxes is summarized as follows:

	2001	2000
Current		
Federal	$31,400	$ -
State	34,000	25,404
	65,400	
Deferred	-	-
	$65,400	$25,404

The actual income tax expense (benefit) differs from the Federal statutory rate as follows:

	2001		2000		
	AMOUNT	%	Amount	%	Amoun
Federal statutory rate	$ 245,000	34.0 %	$(1,171,000)	(34.0)%	$ 2,00
State income taxes, net of Federal income tax benefit	22,044	2.0	25,404	0.1	5,00
Utilization of net operating loss carryforwards	(201,644)	(31.0)			
Valuation allowance			1,171,000	34.0	(2,00
	$ 65,400	5.0 %	$ 25,404	0.1%	$ 5,00

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2001, 2000 and 1999

NOTE I (CONTINUED)

The tax effects of temporary differences which give rise to deferred tax assets at December 31, 2001 and 2000 are summarized as follows:

	2001
Deferred tax assets	
Allowance for doubtful accounts	$ 342,
Accrued compensation	213,
Net operating loss carryforwards	576,
Federal AMT credit	14,
Gross deferred tax assets	1,146,
Valuation allowance	(1,146,
Net deferred tax asset	$

At December 31, 2001, the Company has net operating loss carryforwards for Federal income tax purposes aggregating approximately $1,280,000 expiring in 2020.

NOTE J - STOCK OPTION PLANS AND WARRANTS

The Company established a nonqualified stock option plan pursuant to which options to acquire a maximum of 500,000 shares of the Company's common stock were exercisable (the "1993 Plan"). Under the terms of the Plan, the options, which expire ten years after grant, are exercisable at prices equal to the fair market value of the common stock at the date of the grant and become exercisable in accordance with terms established at the time of the grant. At December 31, 2001, there were 477,000 shares available for grant under the 1993 Plan.

In March 2001, the Company adopted, subject to shareholder approval, its 2001 Stock Option Plan (the "2001 Plan") and reserved 5,000,000 shares of common stock thereunder. Options are nonqualified and are granted at a price equal to the fair market value of the Company's common stock at the date of grant. At December 31, 2001, all 5,000,000 shares were available for grant under the 2001 Plan.

On June 13, 2000, in consideration for an officer's agreement to amend the repayment terms of a $2,000,000 promissory note, the Company issued a ten-year nonqualified warrant to purchase 200,000

NOTE J (CONTINUED)

shares of the Company's common stock at an exercise price of $1.625 per share (which represented the fair market value of the underlying common stock at the time of grant). The warrant, which vested immediately, is exercisable through June 2010 (Note H).

On June 1, 2000, pursuant to an employment agreement between the Company and an officer, the Company issued nonqualified options to purchase 10,000 shares of common stock, at an exercise price of $4.00 per share. The options vested 100% upon grant and are exercisable for three years from the date of grant.

On March 15, 2000, the Company issued ten-year nonqualified options to purchase 25,000 shares of common stock, at an exercise price of $4.00 per share to a director of the Company. The options vested as to 50% of the underlying shares on September 15, 2000 and the balance vested on March 15, 2001.

On June 9, 1999, the Company issued to employees qualified options to purchase 23,000 shares of common stock at an exercise price of $5.25. These options were exercisable by June 9, 2000 and expired unexercised.

The following is a summary of activity with respect to stock options and warrants:

	Shares	Price per shar
Outstanding at January 1, 1999	-	
Granted	23,000	$5.25
Outstanding at December 31, 1999	23,000	$5.25
Granted	235,000	1.63 to 4.00
Expired	(23,000)	5.25
Outstanding at December 31, 2000	235,000	1.63 to 4.00
Forfeited	(25,000)	4.00

Outstanding at December 31, 2001	210,000	1.63 to 4.00
	=======	
Balance exercisable at December 31, 2001	210,000	
	=======	

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2001, 2000 and 1999

NOTE J (CONTINUED)

The following table summarizes significant ranges of outstanding and exercisable options and warrants at December 31, 2001:

	Options and warrants outstanding			Options
Ranges of exercise prices	Shares	Weighted-average remaining life in years	Weighted-average exercise price	Sha
$1.63	200,000	8.45	$1.63	200,
$4.00	10,000	1.42	4.00	10,

The weighted-average fair value on the grant date was $1.96 for options and warrants issued during the year ended December 31, 2000. No options or warrants were granted during the year ended December 31, 2001.

Pro forma earnings and earnings per share are not presented as the pro forma information is not materially different from the Company's reported results.

NOTE K - RELATED PARTY TRANSACTIONS

Pursuant to an acquisition, the Company issued three promissory notes with a 5% interest rate aggregating $1,000,000 due in various times through June 2001. At December 31, 2001, the promissory notes have been paid in full.

Sales of inventory to a customer who is related to an officer of the Company were approximately $21,125,000, $4,390,000 and $9,500,000 for the years ended December 31, 2001, 2000 and 1999, respectively. The Company also purchased inventory from this customer in the amount of $11,151,000 and $6,323,000 during the years ended December 31, 2001 and 2000, respectively. The Company did not purchase inventory from this customer during the year ended December 31, 1999. Sales to this related party represented 11% and 12% of total sales during the years ended December 31, 2001 and 1999, respectively. No other single customer represented greater than 10% of total sales during the three years in the period ended December 31, 2001.

The Company leases certain office space pursuant to a sublease agreement with the Company's Chairman at an annual rental of $63,000 during the years ended December 31, 2001 and 2000.

NOTE L - CONCENTRATIONS

The Company made purchases from one prepaid telephone calling card supplier which aggregated approximately 43% and 16% of total purchases during the years ended December 31, 2001 and 2000, respectively. Additionally, liabilities to this supplier aggregated approximately 59% and 31% of total accounts payable and accrued expenses at December 31, 2001 and 2000.

The Company made purchases from two separate prepaid telephone card suppliers which aggregated approximately 13% and 15% of total purchases during the years ended December 31, 2001 and 2000, respectively.

NOTE M - COMMITMENTS AND CONTINGENCIES

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 countersued. In the Company's opinion, with which its legal counsel concurs, no material liability will result from the countersuit. The Company incurred a loss of $553,547, which was reflected in the fourth quarter of 1999. The Company subsequently mitigated, in substantial part, its reliance on this supplier by increasing its purchases from other vendors. On September 30, 2001, in order to avoid protracted litigation and mounting legal fees, the Company decided to settle the case, wherein it agreed to pay $250,000 to the supplier over a period of four years beginning in August 2001, pursuant to a nonnegotiable, convertible promissory note (the "Convertible Note"). This amount is payable in four monthly installments of $7,500 and 44 subsequent monthly installments of $5,000, each exclusive of interest. The Company has recorded a $203,000 charge representing the net present value of the settlement amount. The Convertible Note contains conditions, whereby, upon occurrence of an event of default, as defined, the supplier shall have the right to convert 100% of the unpaid principal balance, plus an additional $200,000 (the "Default

Amount") into fully paid nonassessable shares of the Company's common stock at a conversion price equal to the greater of the fair market value of the common stock on the date of default ($0.20 at December 31, 2001) or $1.00 per share.

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2001, 2000 and 1999

NOTE M (CONTINUED)

Aggregate annual maturities of the Convertible Note are summarized as follows:

Year ending December 31,	
2002	$ 35,824
2003	50,020
2004	55,258
2005	34,868
	$175,970

In November 1999, a distributor of the Company's prepaid telephone cards instituted an action for approximately $575,000, based on a purported breach of oral contract by the Company. The Company filed an answer and counterclaim against the distributor for approximately $575,000 of unpaid invoices.

On September 30, 2001, the Company settled its case against this distributor and received $50,000, writing off approximately $525,000 of uncollectible receivables. In previous years, the Company had provided an allowance for this doubtful account equal to the total of the unpaid invoices.

The Company from time to time is subject to other certain legal proceedings and claims which have arisen in the ordinary course of its business. These actions when ultimately concluded will not, in the opinion of management, have a material adverse effect upon the financial position, results of operations or liquidity of the Company.

Employment Agreements

On December 10, 1999, the Company entered into a three-year employment agreement with its chief executive officer. Base salary for each of the three years will be $200,000, $225,000 and $250,000, respectively. At the end of the three-year period, the employment agreement will automatically be extended for an additional year without any action by the Company or the chief executive officer, unless there is a submitted written notice four months prior to expiration of the agreement by either party. In addition to the base salary, the Company will compensate the chief executive officer with cash bonuses and stock option grants based on the Company's economic performance.

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2001, 2000 and 1999

NOTE M (CONTINUED)

On March 22, 2001, in consideration for this officer's agreement to further amend the repayment terms of a $2,000,000 promissory note (Note H), the Company amended the officer's employment agreement whereby the officer shall receive an additional bonus equal to 5% of the gross profit of the Company, as defined. Such bonus shall be paid in cash, or, at the discretion of the officer, in shares of the Company's common stock, based upon a per share price equal to 75% of fair market value of the common stock. Approximately $450,000 is payable to the officer and is included in accounts payable and accrued expenses on the consolidated balance sheet at December 31, 2001.

On December 8, 2000, the Company entered into a two-year employment contract with an option to renew for an additional year, with a shareholder who is the President of Reliable Acquisition Corp. The base salary for the first year was $150,000, plus a cash bonus equal to 15 percent of the pretax income of the subsidiary as long as the contract is in effect. The compensation for the second year will be $150,000 as determined by the Board of Directors.

Lease Commitments

The Company leases its main office and sales office facilities and certain equipment pursuant to noncancellable operating and capital leases expiring through November 2008. The minimum rental commitments under these noncancellable leases, at December 31, 2001, are summarized as follows:

	Operating leases
Year ending December 31,	
2002	$ 450,116
2003	466,047
2004	317,141
2005	293,865
2006	292,872
Thereafter	470,244
	2,290,285
Less amount representing interest	-
Total minimum lease payments	$2,290,285
Less current maturities	

Long-term capitalized lease obligations

Rent expense for all operating leases was $234,080, $128,067 and $68,910 in 2001, 2000 and 1999, respectively.

9278 Communications, Inc. and Subsidiaries

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

Years Ended December 31, 2001, 2000 and 1999

Column A	Column B	Column C		C
		Additions		
		(1)	(2)	
Description	Balance at beginning of period	Charged to costs and expenses	Charged to other accounts - describe	Ded d
Allowance for doubtful accounts				
YEAR ENDED DECEMBER 31, 2001	$ 675,000	$ 885,282	$	$8
Year ended December 31, 2000	$ 125,000	$ 598,474	$ -	$
Year ended December 31, 1999	$ -	$ 519,962	$ -	$3
Valuation allowance-Deferred tax				
YEAR ENDED DECEMBER 31, 2001	$1,512,180	$ -	$ -	$3
Year ended December 31, 2000	$ -	$1,512,180	$ -	$

(a) Accounts receivable written off

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

On April 24, 2001, Friedman Alpren & Green ("Friedman") resigned as our independent certified public accountant. The reports of Friedman on our financial statements for the fiscal years ended December 31, 1999 and 2000 did not contain an adverse opinion, or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principle. Our Board of Directors approved the decision to change accountants. During our two most recent fiscal years and subsequent interim periods, there were no disagreements with Friedman on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedures, which disagreements, if not resolved to the satisfaction of Friedman would have caused it to make reference to such disagreement in its reports.

We engaged Grant Thornton LLP ("GT") to act as our independent certified public accountant, effective May 14, 2001. During the two most recent fiscal years and subsequent interim periods, we had not consulted GT regarding the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on our financial statements, or any matter that was the subject of a disagreement or a reportable event.

On December 28, 1999, we dismissed Ernst & Young LLP ("E&Y") as our independent certified public accountant. The reports of E&Y on our financial statements for the fiscal years ended December 31, 1998 and 1997 did not contain an adverse opinion, or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principle. Our Board of Directors approved the decision to change accountants. During our two most

recent fiscal years and subsequent interim periods, there were no disagreements with E&Y on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedures, which disagreements, if not resolved to the satisfaction of E&Y would have caused it to make reference to such disagreement in its reports.

We engaged Friedman Alpren & Green LLP ("Friedman") to act as Our independent certified public accountant, effective December 28, 1999. During the two most recent prior fiscal years and subsequent interim periods, the we have not consulted Friedman regarding the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on our financial statements, or any matter that was the subject of a disagreement or a reportable event.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The following persons are our executive officers and directors as of the date hereof:

NAME	AGE	OFFICES HELD
Sajid Kapadia	28	Chairman, Chief Executive Officer and Director
Haris Syed	27	President, Secretary and Director
James Scigliano	58	Chief Financial Officer and Treasurer
Hanif Bhagat	28	Director

SAJID KAPADIA. Mr. Kapadia has been our Chairman, Chief Executive Officer and a director of ours since December 1999. In April 1997, Mr. Kapadia founded 9278 Distributor Inc. and served as its President from inception through its merger with iLink Telecom, Inc., our predecessor. Prior to this, Mr. Kapadia was involved in several short-term telemarketing positions. Mr. Kapadia has a degree in mechanical engineering from Gandhi Engineering College in Gujarat, India.

HARIS SYED. Mr. Syed has been our President since March 2001 and has been our Secretary and a director of ours since December 1999. Prior to being named President, he served as our Chief Operating Officer beginning June 2000. Before being appointed as our Chief Operating Officer, he was a Vice President of ours, beginning December 1999. Prior to this, from November 1996 through December 1999, he was the Vice President of TCI Telecom of NY, a telecom switching and voice over Internet protocol integrator.

JIM SCIGLIANO. Mr. Scigliano has been our Chief Financial Officer since February 2001. Prior to this he served as our Office Manager and Sales Development Manager, beginning in June 1999. Before joining us, he was the Office Manager for World Telecommunications Corp., beginning in October 1998, and a Branch Manager and Assistant Vice President for North Fork Bank, beginning in January 1997. Before that, he was a Branch Manager and Assistant Vice President for Citibank.

HANIF BHAGAT. Mr. Bhagat has been a director of ours since March 2001. He has provided consulting services to us since January 2001. Prior to this he was a student at Dawson College in Montreal, Quebec, where he received a Bachelor of Arts degree in communications.

Board of Directors

All of our directors hold office until the next annual meeting of stockholders and the election and qualification of their successors. Our executive officers are elected annually by the Board of Directors to hold office until the first meeting of the Board following the next annual meeting of stockholders and until their successors are chosen and qualified.

Directors' Compensation

We reimburse our directors for expenses incurred in connection with attending Board meetings but we do not pay director's fees or other cash compensation for services rendered as a director.

ITEM 11. EXECUTIVE COMPENSATION.

Summary Compensation

Set forth below is the aggregate compensation for services rendered in all capacities to us during our fiscal years ended December 31, 2000, 1999 and 1998 by our Chief Executive Officer. No other executive officer of ours had compensation in excess of $100,000 during the fiscal years ended December 31, 2000 or 1999.

SUMMARY COMPENSATION TABLE

ANNUAL COMPENSATION				LONG-TERM COMPENSATION
NAME AND PRINCIPAL POSITION	YEAR	SALARY ($)	($)	ANNUAL
Sajid Kapadia,	2001	$200,000		$475,000
	2000	$200,000		
Chairman and Chief Executive Officer	1999	$80,815		
Haris Syed, President	2001	$150,000		
	2000	$ 99,231		

We did not grant any options to the named executive officers.

EMPLOYMENT AGREEMENTS

Contract with Sajid Kapadia

On December 10, 1999, we entered into an Employment Agreement with Sajid Kapadia. Under the terms of this agreement, Mr. Kapadia will serve as our Chairman of the Board and Chief Executive Officer for an initial term of three years, which term will be automatically extended for additional one year periods unless either party submits a notice of non-extension to the other not less than four months prior to the end of the existing term.

Pursuant to the agreement, Mr. Kapadia receives a base salary of

$200,000, $225,000 and $250,000 during his first, second and third years of

employment, respectively. In addition, during each year of employment Mr. Kapadia shall receive cash bonuses and stock option grants in amounts to be determined by our Board of Directors. We also lease an automobile for Mr. Kapadia's exclusive use. Mr. Kapadia is also entitled to participate in all plans adopted for the general benefit of our employees and executive employees. In March 2001, in consideration for his agreement to extend the payment terms of a promissory note which we made to him and other consideration, we amended Mr. Kapadia's employment agreement to provide that he will receive additional bonus compensation equal to five (5%) percent of our gross profit. This bonus compensation may be paid in cash, or with restricted shares of our common stock based upon a price per share 75% of the fair market value of the shares, at Mr. Kapadia's sole discretion.

The agreement with Mr. Kapadia automatically terminates upon his death. In addition, we can terminate the agreement based on Mr. Kapadia's continued disability, for due cause or without due cause. Mr. Kapadia can terminate his employment for good reason. If the agreement is terminated for death, disability, or due cause, we will pay Mr. Kapadia any unpaid base salary and bonus through the date of termination. If we terminate Mr. Kapadia's employment for any other reason, or if he terminates it for good reason, we will pay him his base salary for the remaining term of the agreement, but in no event less than 24, nor more than 35 months.

Mr. Kapadia's agreement contains standard provisions regarding confidentiality and non-competition during the term of his employment.

Compensation Plans

iLink Telecom, Inc. Non-Qualified Stock Option Plan

Effective June 1, 1999, iLink Telecom, Inc., our predecessor, adopted the iLink Telecom, Inc. Non-Qualified Stock Option Plan (the "iLink Plan"). Options granted under the iLink Plan are not intended to be incentive stock options as defined in Section 422 of the Internal Revenue Code of 1954, as amended. Our employees, directors, officers, consultants and advisors are eligible to be granted options pursuant to the iLink Plan. The exercise price of the options is determined by our Board of Directors.

Options granted pursuant to the iLink Plan terminate on the date established by the Board of Directors when the options are granted.

The iLink Plan is administered by our Board of Directors. The Board of Directors has the authority to interpret the provisions of the iLink Plan and supervise the administration of the iLink Plan. In addition, our Board of Directors is empowered to select those persons to whom options are to be granted, to determine the number of shares subject to each grant of an option and to determine when, and upon what conditions or options granted under the iLink Plan will vest or otherwise be subject to forfeiture and cancellation.

In the discretion of our Board of Directors, any option granted pursuant to the iLink Plan may include installment exercise terms so that the option becomes fully exercisable in a series of cumulating portions. The Board of Directors may also accelerate the date upon which any options, or any part of any options, are first exercisable. In the discretion of the Board of Directors payment for shares of common stock underlying options may be paid through the delivery of shares of our common stock having an aggregate fair market value

equal to the option price, provided that such shares have been owned by the option holder for at least one year prior to the exercise. A combination of cash and shares of common stock may also be permitted at the discretion of the Board of Directors. Options are generally non-transferable except upon death of the option holder.

Our Board of Directors may at any time, and from time to time, amend, terminate, or suspend the iLink Plan in any manner it deems appropriate, provided that the amendment, termination or suspension cannot adversely affect rights or obligations with respect to shares or options previously granted.

The iLink Plan is not qualified under Section 401(a) of the Internal Revenue Code, and is not subject to any provisions of the Employee Retirement Income Security Act of 1974.

The maximum number of shares of our common stock for which options may be granted under the iLink Plan is 500,000. If any option expires or is canceled without having been fully exercised we may regrant that option. Options are not exercisable after ten years after the date we grant them. Options we grant under the iLink Plan generally are not transferable and terminate upon severance of employment.

As of the date hereof, no options are outstanding under the iLink Plan.

2001 Stock Option Plan

In March 2001, we adopted our 2001 Stock Option Plan (the "2001 Plan"). The purpose of the 2001 Plan is to further our growth, development and financial success by providing additional incentives and personal interest in our company by those responsible for securing our continued growth and success.

The 2001 Plan is administered by our Board of Directors, and provides for the grant to our employees of both incentive options, intended to qualify under Section 422 of the Internal Revenue Code, and non-qualified options to purchase our common stock. The compensation committee, or Board of Directors if there is no compensation committee, will grant options subject to a vesting schedule, conditions, restrictions and other provisions.

The price of the shares subject to each option will be equal to the fair market value of the shares on the date we grant them. However, if we grant incentive stock options to an individual owning more than 10% of the total combined voting power of all classes of our stock, the exercise price of the options will not be less than 110% of the fair market value of the underlying shares on the date of grant, as required by Section 162(m) of the Internal Revenue Code. If the aggregate fair market value of our shares with respect to which incentive stock options are exercisable by any person for the first time during any calendar year exceeds $100,000, the options will be treated as non-qualified options.

A holder of options to purchase our common stock under the 2001 Plan may exercise the options by delivery to us of cash equal to the exercise price, or with approval of the board of directors, shares of our common stock equal to the exercise price, a promissory note equal to the exercise price, or a combination of these forms of payment.

If the outstanding shares of our common stock are changed into or

exchanged for a different number or kind of shares or other securities by reason of reorganization, merger, consolidation, reclassification or combination of shares, we will make adjustments in the number and kind of shares for the purchase of which options may be granted.

The holders of options under our 2001 Plan will not be considered shareholders of ours unless and until certificates representing shares of our common stock have been issued by us to such holders.

The maximum number of shares of our common stock for which options may be granted under the 2001 Plan is 5,000,000. If any option expires or is canceled without having been fully exercised we may regrant that option. Options are not exercisable after ten years after the date we grant them. Options we grant under the 2001 Plan generally are not transferable and terminate upon severance of employment.

As of the date hereof, no options are outstanding under the 2001 Plan.

Compensation Committee Interlocks and Insider Participation

Each member of our Board of Directors participates in the determination of the level of compensation of our executive officers. Two of such directors, Sajid Kapadia and Haris Syed, are officers of ours.

Limitation of Liability and Indemnification Matters

Article nine of our certificate of incorporation provides that the personal liability of our directors will be eliminated to the fullest extent permitted by the provisions of paragraph (7) of subsection (b) of ss.102 of the General Corporation Law of the State of Delaware, as the same may be amended and supplemented.

Article ten of our certificate of incorporation provides that we will, to the fullest extent permitted by the provisions of the General Corporation Law of the State of Delaware, as now or hereafter in effect, indemnify all persons whom we may indemnify under such provisions. The indemnification provided by this section shall not limit or exclude any rights, indemnities or limitations of liability to which any person may be entitled, whether as a matter of law, under our bylaws, by agreement, vote of our stockholders or disinterested directors, or otherwise. Except as specifically required by the General Corporation Law of the State of Delaware, as the same exists or may be amended, none of our directors of will be liable to us or our stockholders for monetary damages for breach of his or her fiduciary duty as a director. No amendment to or repeal of this provision of our certificate of incorporation will apply to or have any effect on the liability or alleged liability of any director for or with respect to any acts or omissions of that director occurring prior to the amendment or repeal.

Under Section 145 of the Delaware General Corporation Law, we have the power, under certain circumstances, to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or contemplated action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he is or was a director, officer, employee or agent of ours, or is or was serving at our request as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses, including attorneys' fees, and judgments against, fines and amounts paid in settlement actually and reasonably

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incurred by him in connection with the action, suit or proceeding.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers, or persons controlling us pursuant to the foregoing provisions, we have been informed that, in the opinion of the SEC, that type of indemnification is against public policy as expressed in the Act and is therefore unenforceable.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table sets forth information as of the date hereof, based on information obtained from the persons named below, with respect to the beneficial ownership of shares of our common stock by (i) each of our directors, (ii) our named executive officer, (iii) each person known by us to be the owner of more than 5% of our outstanding shares of common stock and (iv) all executive officers and directors as a group.

Unless otherwise indicated, we believe that all persons named in the table have sole voting and investment power with respect to all shares of common stock beneficially owned by them. A person is deemed to be the beneficial owner or securities that can be acquired by such person within 60 days from the date of this prospectus upon exercise of options, warrants or convertible securities. Each beneficial owner's percentage ownership is determined by assuming that all options, warrants or convertible securities that are held by that person, but not those held by any other person, and which are exercisable within 60 days of the date of this prospectus have been exercised and converted. This table assumes a base of 23,593,173 shares of common stock outstanding as of the date hereof, before any consideration is given to outstanding options, warrants or convertible securities.

Unless otherwise noted, the address for each of the persons listed below is: c/o 9278 Communications, Inc., 1942 Williamsbridge Road, Bronx, New York 10461.

NAME AND ADDRESS OF BENEFICIAL HOLDER	NUMBER OF SHARES	APPROXIMATE PERCENTAGE OF CLASS
Sajid Kapadia..............	13,355,125(1)	56.13%
Haris Syed.........	194,000(2)	*
Hanif Bhagat................	0	*
All executive officers and directors as a group (4 persons).....	13,549,125	59.1%

* Less than 1%

(1) Does not includes warrants to purchase 200,000 shares of our common stock currently held by Mr. Kapadia, which expire on June 13, 2010.

(2) Represents shares of common stock held by KAPH Groups, Inc., a company 100% owned by Mr. Syed.

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ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

In March 2001, Sajid Kapadia, an officer and director of ours, agreed to amend the repayment terms of a $2.0 million promissory note made to him by us at the time of the merger between iLink Telecom, Inc., our predecessor, and 9278 Distributor Inc., in December 1999. As amended, the terms provide for principal repayments by us of (i) $1.0 million on March 31, 2002, and (ii) $1.0 million on December 31, 2002. In consideration for his agreement to extend the payment terms of the note and other consideration, we amended Mr. Kapadia's employment agreement to provide that he will receive an annual bonus equal to five (5%) percent of our gross profit. This bonus compensation may be paid in cash, or with restricted shares of our common stock based upon a price per share 75% of the fair market value of the shares, at Mr. Kapadia's sole discretion. Mr. Kapadia had previously extended the payment terms of this promissory note, in June 2000. At that time, in consideration for his agreement to extend the repayment terms of the note, we issued him a warrant to purchase 200,000 shares of our common stock at an exercise price of $1.625 per share. The warrant vested immediately as to 100% of the shares of common stock underlying the warrant and is exercisable for ten years from the date of the grant.

In December 2000, we acquired Reliable Networks, Inc., a company controlled by Nasir Ghesani, an officer of ours. Mr. Ghesani was not an officer of ours at the time of the acquisition. In connection with the acquisition, Mr. Ghesani was issued: (i) a cash payment in the amount of $1.0 million, (ii) 1,000,000 shares of our common stock, and (iii) three promissory notes, in the aggregate amount of $1.0 million. Pursuant to the terms of our agreement with Mr. Ghesani, we issued an additional 1,000,000 shares of our common stock to Mr. Ghesani which was due to him in December 2001.

In March 2000, we sold an aggregate of 154,000 shares of our common stock to six different investors at a price of $2.00 per share and exchanged 250,000 shares of our common stock for $500,000 of advances from Sajid Kapadia, an officer and director of ours. Haris Syed, an officer and director of ours, purchased 37,500 shares in this offering. Sohel Kapadia, the brother of an officer of ours, purchased 32,500 shares in this offering.

In December 1999, iLink Telecom, Inc., our predecessor, agreed to purchase 9278 Distributor Inc., a company controlled by Sajid Kapadia, an officer and director of ours. Mr. Kapadia was not an officer or director of iLink. In connection with that merger, the shareholders of 9278 Distributor were issued an aggregate of 14,900,000 shares of our common stock, as well as a dividend of $3.0 million, of which $1.0 million was paid in December 1999 and the balance of $2.0 million was in the form of a two-year promissory note. Of these shares, 13,205,125 were issued to Mr. Kapadia. In addition to such shares, Mr. Kapadia was granted proxies to vote an aggregate of 2,150,000 additional shares of our common stock.

In December 1999, we entered into a sublease agreement with Sajid Kapadia, an officer and director of ours, pursuant to which we sublease the entire premises at 1942 Williamsbridge Road, Bronx, New York as our corporate offices, at an annual rent of $63,000. The rental terms of the sublease agreement are substantially the same as the terms under which Mr. Kapadia leases the space.

We sell phone cards to Sohel Distributors Inc. ("SDI"), a company owned by a brother of our Chief Executive Officer. Sales to SDI were approximately $21,125,000, $4,390,000 and $9,500,000 for the years ended

December 31, 2001, 2000 and 1999, respectively. We also purchased inventory from SDI in the amount of $11,151,000 and $6,323,000 during the years ended December 31, 2001 and 2000, respectively. We did not purchase inventory from SDI during the year ended December 31, 1999.

PART IV

ITEM 13. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) The following documents are filed as part of this report:

(1) Financial Statements. See Index to Consolidated Financial Statements in Item 8 hereof.

(2) Financial Statement Schedules.

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

(3) Exhibits.

Exhibit Number	Description of Exhibit
2.1	Agreement and Plan of Merger, dated December 17, 1999, among iLink Telecom, Inc., 9278 Distributors Acquisition Corp. and 9278 Distributor Inc. (3)
2.2	Agreement and Plan of Merger, dated April 24, 2000, between the Company and 9278 Communications, Inc., a Nevada corporation (5)
2.3	Agreement and Plan of Merger, dated December 8, 2000, among Reliable Networks, Inc., Nasir Ghesani, Reliable Acquisition Corp. and the Company (6)
3.1	Certificate of Incorporation of the Company (5)
3.2	Bylaws of the Company (5)

4.1	Specimen Common Stock Certificate of the Company (2)
4.2	Non-Qualified Stock Option Plan of the Company (4)
4.3	2001 Stock Option Plan of the Company (7)
4.4	Amended and Restated Promissory Note, in the Amount of $2.0 million, made by the Company to Sajid Kapadia, dated December 10, 1999 (7)
4.5	Promissory Note, in the amount of $400,000, made by the Company to Nasir Ghesani, dated December 8, 2000 (6)
4.6	Promissory Note, in the amount of $100,000, made by the Company to Nasir Ghesani, dated December 8, 2000 (6)
4.7	Promissory Note, in the amount of $500,000, made by the Company to Nasir Ghesani, dated December 8, 2000 (6)

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10.1	Employment Agreement, dated December 10, 1999, between the Company and Sajid Kapadia (4)
10.2	Employment Agreement, dated December 8, 2000, between the Company, Reliable Acquisition Corp. and Nasir Ghesani (6)
10.3	Amendment, dated March 22, 2000, to Employment Agreement between the Company and Sajid Kapadia (7)
21.1	Subsidiaries of the Company (1)

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(1)	Filed herewith
(2)	Incorporated by reference from the Company's registration statement on Form SB-2 (Registration No. 333-84845)
(3)	Incorporated by reference from the Company's report on Form 8-K, dated December 10, 1999
(4)	Incorporated by reference from the Company's report on Form 10-KSB for the year ended December 31, 1999
(5)	Incorporated by reference from the Company's report on Form 10-QSB for the three-month period ended March 31, 2000
(6)	Incorporated by reference from the Company's report on Form 8-K, dated December 8, 2000
(7)	Incorporated by reference from the Company's report on Form 10KSB for the year ended December 31, 2000

(b) Reports on Form 8-K.

We filed the following Current Reports on Form 8-K during the fiscal year ended

December 31, 2001:

On May 1, 2001, we filed a current report on Form 8-K to announce the resignation of our independent accountants.

On February 9, 2001 and on April 13, 2001, we amended a previously filed current report on Form 8-K to disclose financial and other information concerning an acquisition of a business effected in 2000.

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SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

9278 COMMUNICATIONS, INC.

Date: May 13, 2002

By: /s/ Sajid Kapadia

Sajid Kapadia, Chairman,
Chief Operating Officer
and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report on Form 10-K has been signed below by the following persons in the capacities and on the dates indicated:

/s/ Sajid Kapadia — May 13, 2002

Sajid Kapadia
Chairman, Chief Executive Officer, Director
(Principal Executive and Accounting Officer)

/s/ Haris Syed — May 13, 2002

Haris Syed
President and Director

/s/ Hanif Bhagat — May 13, 2002

Hanif Bhagat
Director

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