ELEC COMMUNICATIONS CORP
Form 10QSB
October 15, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended August 31, 2003.

OR

[ ] 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 0-4465

eLEC Communications Corp.
(Name of Small Business Issuer as Specified in Its Charter)

New York	13-2511270
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

75 South Broadway White Plains, NY	10601
(Address of Principal Executive Offices)	(Zip Code)

Issuer's Telephone Number, Including Area Code 914-682-0214

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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. Yes [X] No [ ]

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 16,058,282 shares of Common Stock, par value $.10 per share, as of October 1, 2003.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

eLEC Communications Corp. and Subsidiaries
Condensed Consolidated Balance Sheet

	August 31, 2003 (Unaudited)
Assets	
Current assets:	
Cash and cash equivalents	$404,466
Accounts receivable, net	649,612
Assets held for sale	1,628,344
Other investments	20,795
Due from related party	333
Prepaid expenses and other current assets	177,196
Total current assets	2,880,746
Property, plant and equipment, net	34,805
Other assets	69,170
Total assets	$2,984,721
Liabilities and stockholders' equity deficiency	
Current liabilities:	
Short-term borrowings	$350,000
Current maturities of long-term debt and capital lease obligations	1,125,070
Accounts payable and accrued expenses	4,435,987
Liabilities assumed in sale	5,767,271
Income taxes payable	34,000
Total current liabilities	11,712,328
Long-term debt and capital lease obligations, less current maturities	22,288
Stockholders' equity deficiency:	
Preferred stock, $.10 par value, 1,000,000 shares authorized Series B issued, 16 shares, liquidation preference $1,000 per share	2
Common stock $.10 par value, 50,000,000 shares authorized, 16,069,282 shares issued	1,606,928
Capital in excess of par value	25,658,892
Deficit	(35,988,217)
Treasury stock at cost, 11,000 shares	(27,500)
Total stockholders' equity deficiency	(8,749,895)
Total liabilities and stockholders' equity deficiency	$2,984,721

See notes to the condensed consolidated financial statements

eLEC Communications Corp. and Subsidiaries
Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)
(Unaudited)

	For the Nine Months Ended		For the Three Mo
	Aug. 31, 2003	Aug. 31, 2002	Aug. 31, 2003
Revenues	$3,776,334	$11,805,200	$1,275,889
Costs and expenses:			
Costs of services	1,986,726	7,789,871	649,597
Selling, general and administrative	3,841,201	7,286,855	1,102,647
Depreciation and amortization	80,850	180,546	17,207
Total costs and expenses	5,908,777	15,257,272	1,769,451
Loss from operations	(2,132,443)	(3,452,072)	(493,562)
Other income (expense):			
Interest expense	(105,509)	(386,186)	(36,065)
Interest and other income (loss)	88,063	(22,237)	(34,300)
Gain on sale of assets	3,511,297	--	1,254,442
Gain on sale of investment securities and other investments	121,687	1,380,911	37,926
	3,615,538	972,488	1,222,003
Income (loss) before taxes	1,483,095	(2,479,584)	728,441
Provision for taxes	34,000	--	34,000
Net income (loss)	1,449,095	(2,479,584)	694,441
Other comprehensive income - unrealized income on marketable securities	--	92,258	--
Comprehensive income (loss)	$1,449,095	($2,387,326)	$694,441
Basic and diluted earnings (loss) per share	$0.09	($0.16)	$0.04

Weighted average number of common shares

outstanding			
Basic	15,633,829	15,606,818	15,684,369
Diluted	15,664,231	15,606,818	15,733,552

See notes to the condensed consolidated financial statements.

eLEC Communications Corp. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	For the Nine Months Ended	
	Aug. 31, 2003	Aug. 31, 2002
Net cash (used in) provided by operating activities:	($1,099,236)	$ 2,942,305
Cash flows from investing activities:		
Proceeds from sale of investment securities and other investments	198,273	1,380,911
Purchase of property and equipment	(3,200)	--
Proceeds from the sale of property and equipment	16,025	4,000
Proceeds from note	209,102	43,662
Net cash provided by investing activities	420,200	1,428,573
Cash flows from financing activities:		
Proceeds from short-term note	200,000	--
Repayment of long-term debt	(55,026)	(4,202,199)
Proceeds from exercise of stock options	--	45,000
Net cash provided by (used in) financing activities	144,974	(4,157,119)
(Decrease) increase in cash and cash equivalents	(534,062)	213,759
Cash and cash equivalents at beginning of period	938,528	797,616
Cash and cash equivalents at the end of period	$ 404,466	$ 1,011,375
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$ 105,509	$ 386,186

See notes to the condensed consolidated financial statements.

eLEC COMMUNICATIONS CORP.

Notes To Condensed Consolidated Financial Statements (Unaudited)

Note 1-Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine-month period ended August 31, 2003 are not necessarily indicative of the results that may be expected for the year ended November 30, 2003. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-KSB for the year ended November 30, 2002.

Note 2-Principal Financing Arrangements

On August 31, 2003, our financing arrangements consisted of a mortgage loan of $1.1 million due in December 2005, with monthly payments of interest only at the rate of 11% per annum, and no prepayment penalty, $200,000 in bridge financing, including $100,000 to a related party, and a $150,000 working capital loan to our wholly-owned subsidiary, Telecarrier Services, Inc. ("Telecarrier"), which filed for relief under Chapter 11 of the United States Bankruptcy Code. See Note 6. In conjunction with the sale of our New Rochelle headquarters building on October 8, 2003, the above referenced mortgage loan and bridge financing was paid in full. See Note 11.

Note 3-Major Customer

During the three and nine months ended August 31, 2003 and 2002, no one customer accounted for more than 10% of revenue.

Note 4-Income Taxes

At November 30, 2002, we had net operating loss carryforwards for Federal income tax purposes of approximately $24,000,000 expiring in the years 2003 through 2022. There is an annual limitation of approximately $187,000 on the utilization of approximately $1,500,000 of such net operating loss carryforwards under the provisions of Internal Revenue Code Section 382. We expect that we will be subject to certain alternative minimum taxes for the year ended November 30, 2003, and have recorded a provision of $34,000 based on the expected tax rate for the year.

Note 5- Earnings (Loss) Per Common Share

Basic earnings (loss) per common share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is calculated by dividing net income

(loss) by the sum of the weighted average number of common shares outstanding plus all additional common shares that would have been outstanding if potentially dilutive securities had been issued unless such inclusion reduced the loss per share. A reconciliation of the shares used in the computation of our basic and diluted earnings (loss) per common share for the nine and three months ended August 31, 2003 and 2002 is as follows:

	Nine Months Ended August 31,	
	2003	2002
Weighted average common shares outstanding	15,633,829	15,606,818
Dilutive effect of securities	30,402	--
	15,664,231	15,606,818

	Three Months Ended August 31,	
	2003	2002
Weighted average common shares outstanding	15,684,369	15,608,282
Dilutive effect of securities	49,183	--
	15,733,552	15,608,282

For the nine and three months ended August 31, 2003 and 2002, the computation of diluted earnings (loss) per share excludes the effect of the assumed exercise of approximately 1,750,000 and 3,000,000 stock options, warrants and convertible preferred stock that were outstanding because the effect would be anti-dilutive.

Note 6-Petition for Relief Under Chapter 11

On July 29, 2002 (the "Petition Date"), our wholly-owned subsidiary, Telecarrier, which has licenses to resell local and long distance service in four states, filed a voluntary petition for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Southern District of New York and was assigned Case No. 02-20379 (ASH). Under Chapter 11, certain claims (liabilities subject to compromise) against Telecarrier in existence prior to the Petition Date are stayed while Telecarrier continues business operations as a debtor-in-possession. Additional claims (liabilities subject to compromise) may arise subsequent to the filing date resulting from rejection of executory contracts, including equipment leases, and from the determination by the court (or agreed to by parties in interest) of allowed claims for contingencies and other disputed amounts.

As of August 31, 2003, Telecarrier had total assets of approximately $591,000 and total liabilities of approximately $1,333,000, of which approximately $871,000 represented pre-petition liabilities and approximately $462,000 represented post-petition liabilities. Pre-petition liabilities subject to compromise are reflected below:

Line of credit	$150,000
Trade payables	618,000

Other accrued expenses	103,000

Note 7-Legal Proceedings

On August 31, 2003, our former wholly-owned subsidiary, Essex Communications Inc. ("Essex") (See Note 11 regarding the sale of Essex on September 11, 2003), was a party to several legal actions over amounts owed to creditors. While legal counsel was unable to predict the outcome of these actions, we believed such actions would not result in a liability that would have a material adverse effect on our consolidated financial condition. These legal actions were seeking aggregate damages of approximately $1,600,000 from Essex. Essex had counterclaims for the actions and it had accrued payables of approximately $250,000, which the management of Essex believed was an amount sufficient to settle such claims. See Note 9 below regarding the sale of assets by Essex on December 31, 2002 and see Note 11 regarding the sale of all of the common shares of our Essex subsidiary on September 11, 2003.

Note 8-Risks and Uncertainties

We buy substantially all of our telecommunication services from Regional Bell Operating Companies ("RBOCs"), and are, therefore, highly dependent upon them. We believe our relationship with the RBOCs from which we purchase services is satisfactory. We also believe there are less desirable suppliers of telecommunication services in the geographical locations in which we conduct business. In addition, we are at risk to price increases in the rates RBOCs charge us, which are determined by individual state public service commissions. In light of the foregoing, it is possible that the loss of one or more of our relationships with the RBOCs or a significant unfavorable change in the state pricing regulations would have a severe near-term impact on our ability to conduct our telecommunications business.

Future results of operations involve a number of risks and uncertainties. Factors that could affect future operating results and cash flows and cause actual results to vary materially from historical results, include, but are not limited to:

- Our business strategy with respect to bundled local and long distance services may not succeed.

- Failure to manage, or difficulties in managing, our growth, operations or restructurings, including attracting and retaining qualified personnel and opening up new territories for its service with favorable gross margins.

- Dependence on the availability or functionality of incumbent local telephone companies' networks, as they relate to the unbundled network element platform or the resale of such services.

- Increased price competition in local or long distance service.

- Failure or interruption in our network or information systems.

- Changes in government policy, regulation or enforcement.

- Failure of our collection management system and credit controls efforts for customers.

- Inability to adapt to technological change.

- Competition in the telecommunications industry.

- Inability to manage customer attrition or bad debt expense.

- Adverse change in our relationship with third party carriers.

- Failure or bankruptcy of other telecommunications companies upon which we rely for services and revenues.

- Our operations are currently using cash, and our cash position is deteriorating. We may run out of cash and be unable to conduct business.

Note 9-Asset Sale

On September 3, 2002, we entered into an agreement with Essex Acquisition Corp. ("EAC"), a wholly-owned subsidiary of BiznessOnline.com, Inc. ("Biz"), to sell substantially all the assets of Essex (amounting to $1,273,945 at December 31, 2002), for five dollars plus the assumption of certain liabilities of Essex amounting to $10,552,512 at December 31, 2002, including all obligations due and payable to Essex's largest vendor, Verizon Services Corp. ("Verizon"). EAC also paid us $270,000 to reimburse us for amounts paid by us to Essex's former lender, Textron Financial Corporation.

The agreement with Verizon provides that Essex will remain liable for substantially all the obligations assumed in the sale until such time as they are paid by EAC. The last publicly available unaudited financial statements of Biz as of June 30, 2002 indicate that Biz had a stockholders' equity deficiency of approximately $20,500,000 and had negative working capital of approximately $3,500,000. The most recent independent auditor's report of Biz for the calendar year 2001 expressed significant doubt about Biz's ability to continue as a going concern. These factors indicate there is significant uncertainty as to the ability of Biz and its subsidiaries to repay the obligations described above. Accordingly, we only recorded gains on the sale to EAC when Verizon reported to us that EAC made payments to them to reduce the Essex obligations that were assumed by EAC. In the nine months ended August 31, 2003, EAC made payments to Verizon and other of Essex's creditors of $4,785,000, which reduced the liabilities of Essex and resulted in gains to us of approximately $3,511,000.

Assets and liabilities transferred to EAC, as adjusted, consisted of the following at December 31, 2002:

Assets:	
Cash	$44,024
Accounts receivable, net	1,070,013
Property and equipment, net	35,851
Security deposits	124,057
	$1,273,945
Liabilities:	
Accounts payable and accrued expenses	$9,671,563
Taxes payable	782,572
Capital lease obligations	98,377
	$10,552,512

For the nine months ended August 31, 2003, we recorded a gain on the transaction of approximately $3,511,000. This gain was calculated by taking all liabilities assumed by EAC that were paid by EAC during the nine months ended August 31, 2003, and subtracting the book value of the assets transferred.

Assumed liabilities paid by EAC	$4,785,242
Assets transferred to EAC	1,273,945
Gain	$3,511,297

For the three months ended August 31, 2003, we recorded a gain on the transaction of approximately $1,254,000. This gain was calculated by taking all liabilities assumed by EAC that were paid by EAC during the three months ended August 31, 2003. We sold all of the capital stock of Essex on September 11, 2003. As a result, during the fourth quarter, we expect to record the remaining balance of the gain on this transaction, amounting to approximately $5,800,000, as the liabilities of our former Essex subsidiary are no longer includable in our consolidated financial statements. See Note 11.

The following unaudited pro forma summary presents consolidated financial information of our operations for the nine and three-month periods ended August 31, 2003 and 2002, as if the sale of Essex's assets and stock (Note 11) had occurred at the beginning of each period presented. The pro forma amounts include certain adjustments that eliminate all the operations of Essex for the periods presented. The pro forma information does not necessarily reflect the actual results that would have occurred had the sale taken place at the beginning of the periods presented, nor is it necessarily indicative of the future results at the beginning of of operations of the remaining company:

	Unaudited Nine months ended Aug. 31,	
	2003	2002
Revenues	$ 2,883,138	$ 204,031
Net loss	($1,757,858)	($2,598,656)
Basic and diluted loss per share	($ 0.11)	($ 0.17)

	Unaudited Three months ended Aug. 31,	
	2003	2002
Revenues	$ 1,275,889	$ 62,621
Net loss	($ 535,638)	($ 302,258)
Basic and diluted loss per share	($ 0.03)	($ 0.02)

Note 10-Reclassifications

Certain amounts in the August 31, 2002 Condensed Consolidated Statements of Operations and Comprehensive Income (Loss), have been reclassified to conform to the August 31, 2003 presentation.

Note 11- Subsequent Events

On September 11, 2003, we sold all the outstanding capital stock of Essex to Glad Holdings LLC, a New Jersey limited liability company, for an aggregate purchase price of $100. As a result of the sale during the fourth quarter, approximately $7,000,000 of net liabilities of our former Essex subsidiary are no longer included in our consolidated financial statements, and accordingly, we expect to record such amount as gain in the fourth quarter of the current fiscal year.

On October 8, 2003, we closed on the sale of our corporate headquarters at 543 Main Street, New Rochelle, New York to Bluegill Realty, LLC. In conjunction with the sale of the building, we received proceeds of $2.2 million and used $1.1 million of such proceeds to retire in full the mortgage note on this property. We expect to record a gain on the sale of approximately $500,000 in the fourth quarter of the current fiscal year.

Note 12- Stock-Based Compensation Plans

We issue stock options to our employees and outside directors pursuant to stockholder-approved stock option programs. We account for our stock-based compensation plans under the intrinsic value method of accounting as defined by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost is reflected in net income (loss) for the three months and nine months ended August 31, 2003 and 2002, as all options granted under these plans had an exercise price equal to the fair market value of the underlying common stock on the date of the grant. For pro forma disclosures, the estimated fair value of the options are amortized over the vesting period, which range from immediate vesting to three years. The following table illustrates the effect on net income (loss) per share if we had accounted for our stock option and stock purchase plans under the fair value method of accounting under Statement 123, as amended by Statement 148:

	For the Three Months Ended		For the Nine Months Ended	
	Aug. 31, 2003	Aug. 31, 2002	Aug. 31, 2003	Aug. 31, 2002
Net income (loss), as reported	$ 694,441	($ 391,095)	$ 1,449,095	($ 2,479,584)
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects	(79,929)	(90,978)	(235,153)	(272,935)
Pro forma net income (loss)	$ 614,512	($ 482,073)	$ 1,213,942	($ 2,752,519)
Earnings (loss) per share				

Basic, as reported	$ .04	($ .03)	$ .09	($ .16)
Basic, pro forma	$ .04	($ .03)	$ .08	($ .18)
Diluted, as reported	$ .04	($ .03)	$ .09	($ .16)
Diluted, pro forma	$ .04	($ .03)	$ .08	($ .18)

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Item 2. Management's Analysis and Discussion of Financial Condition and Results of Operations

The statements contained in this Report that are not historical facts are "forward-looking statements" which can be identified by the use of forward-looking terminology, such as "estimates," "projects," "plans," "believes," "expects," "anticipates," "intends," or the negative thereof or other variations thereon, or by discussions of strategy that involve risks and uncertainties. Management wishes to caution the reader of the forward-looking statements, that such statements, which are contained in this Report, reflect our current beliefs with respect to future events and involve known and unknown risks, uncertainties and other factors, including, but not limited to, economic, competitive, regulatory, technological, key employee, and general business factors affecting our operations, markets, growth, services, products, licenses and other factors discussed in our other filings with the Securities and Exchange Commission, and that these statements are only estimates or predictions. No assurances can be given regarding the achievement of future results, as actual results may differ materially as a result of risks facing us, and actual events may differ from the assumptions underlying the statements that have been made regarding anticipated events. Factors that may cause our actual results, performance or achievements, or industry results, to differ materially from those contemplated by such forward-looking statements include, without limitation: (1) the availability of additional funds to successfully pursue our business plan; (2) the impact of changes the Federal Communications Commission or State Public Service Commissions may make to existing telecommunication laws and regulations; (3) the cooperation of incumbent carriers in implementing the unbundled network elements platform required by the Federal Communications Commission; (4) our ability to maintain, attract and integrate internal management, technical information and management information systems; (5) our ability to market our services to current and new customers and generate customer demand for our product and services in the geographical areas in which we operate; (6) our success in gaining regulatory approval to access new markets; (7) our ability to negotiate and maintain suitable interconnection agreements with the incumbent carriers; (8) the availability and maintenance of suitable vendor relationships, in a timely manner, at reasonable cost; (9) the intensity of competition; and (10) general economic conditions. All written and oral forward looking statements made in connection with this Report that are attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Given the uncertainties that surround such statements, prospective investors are cautioned not to place undue reliance on such forward-looking statements.

Overview

eLEC Communications Corp. is a full-service telecommunications company that focuses on developing integrated telephone service in the emerging competitive

local exchange carrier ("CLEC") industry. We offer small businesses and residential consumers an integrated set of telecommunications products and services, including local exchange, local access, domestic and international long distance telephone, data and a full suite of local features and calling plans. We utilize a scalable operating platform that can provision a local telephone line, provide dial-tone to our customers, read usage records, rate telephone calls for billing purposes, prepare monthly invoices to customers, provide real-time on-line customer support services at our inbound call centers, capture credit and collection data, calculate gross margins for each line and perform any moves, adds, changes and repairs that a customer requests. We use universal client technology that enables our employees and agents to access our system from any PC using any Internet browser.

We believe that the Telecommunications Act of 1996 (the "Telecommunications Act"), which opened the local exchange market to competition, has created an attractive opportunity for CLECs. Like most CLECs, our entry in this industry was dependent upon the provisions of the Telecommunications Act that allow CLECs to lease various elements of the networks of the incumbent local exchange carriers ("ILECs") that are necessary to provide local telephone service in a cost-effective manner. This aspect of the Telecommunications Act is referred to as "unbundling" the ILEC networks, and allows us to lease unbundled network elements on an as-needed basis and provide such elements to our customers at a lower cost than that which the ILEC is charging.

Although we believe the opportunity for CLECs is attractive, it is also challenging. We must contend with federal and state government regulators, rapidly changing technologies, incumbent carriers that are better staffed and capitalized than us and real-time business partners that also carry our customer's telephone call, whether it is local, long distance or international. At the same time that we are managing these challenges, we also must provide connectivity, superior customer service and a culture of continuous improvement. Because of the complexity of the business, we have focused our energies on simplifying our working environment and improving performance through automation.

Other CLECs have invested a substantial amount of capital to buy circuit-switched equipment and rollout fiber, only to find that their equipment is severely underutilized and that there is a significant shortfall in their revenue stream when compared to their capital investment. We refer to this strategy as a "facilities-first" strategy, because the CLEC has invested in its equipment and placed the equipment in service before the CLEC has developed a customer base. Our strategy is a "customer-first," or a "deferred-build" strategy. We invested our capital in our back office systems to support our customers, and we lease network facilities on an as-needed basis from ILECs while we build our customer base. After we have obtained a substantial geographical concentration of customers, we will make decisions regarding the purchase and installation of our own network equipment. This strategy allows us to be more flexible with our customer base as we grow our business. We can move our customer base to alternative access, if appropriate, and we do not become a captive of our own underutilized equipment, as can happen with a "facilities-first" CLEC. The technological advances in equipment and the lowering of equipment prices have substantiated our deferred-build strategy and have enabled us to better utilize our limited capital.

When we lease lines from an ILEC, we use the unbundled network elements platform ("UNE-P") service offering. UNE-P allows us to lease the network elements we need, such as the local line and the port on a local switch, so that we can provide local dial tone service to our customers. We are capable of providing

virtually all of the same additional voice services provided by any ILEC, such as three-way calling, call waiting, call forwarding and caller ID. We sell our services at a fee that is at least 10% and as much as 25% less than the rate charged by the ILEC. We also offer a bundled package of local and regional calling minutes with popular voice service features.

We believe UNE-P is the preferable platform for any CLEC to operate under while it is growing and building a customer base. UNE-P has substantial value because it allows a CLEC to provide service with significantly lower capital requirements than either fiber-based or wireless systems, and to offer services to a broader customer base more quickly and at a lower price. The ability to

rapidly provision accounts and to deliver reliable service at a lower price than offered by the ILECs should provide us with certain competitive advantages as we market our services to small business and residential customers. Recently, several ILECs have petitioned the Federal Communications Commission ("FCC") to make changes to regulatory requirements for the UNE-P service offering. These ILECs have attempted to lobby the FCC and state public utility commissions to impose restrictions on certain individual network elements that would destroy the competitive value of the UNE-P structure. If the ILECs succeed in their lobbying efforts, it is likely the resulting amendments to the existing UNE-P structure will significantly harm our operations and gross margins.

In March 2002, UNE-P became more valuable to us when the costs charged to us for providing local voice services on the UNE-P service offering in New York State were lowered. We believe current rates are also very attractive in New Jersey and Pennsylvania. Our original CLEC business, built in our former subsidiary, Essex, began as a reseller with approximately 10% gross margins. This former subsidiary was unable to operate profitably and we sold the Essex customer base and related assets on December 31, 2002 and subsequently all of the Common Stock of Essex on September 11, 2003. Another CLEC subsidiary that we own, Telecarrier, is operating under the protection of Chapter 11 of the Federal Bankruptcy Code. As with Essex, Telecarrier began as a reseller and was unable to operate profitably. Our primary operating CLEC, New Rochelle Telephone Corp. ("NRTC"), is selling services in New York State and Pennsylvania, and is currently achieving gross margins over 45%. As a start-up CLEC, NRTC is not yet profitable.

We project that with continued selling of approximately 500 lines a month, we can reach a breakeven level at 12,000 lines. As of August 31, 2003, NRTC and Telecarrier had a combined total of 10,790 lines. However we intend to accelerate our rate of line growth in the short-term so that we can benefit from increased revenue before the end of the year. The increased selling expenses that we intend to incur to achieve this accelerated growth will exceed the associated revenue generated in the fourth quarter. As a result, we anticipate we will incur an operating loss in the fourth quarter, even though we plan to end the fourth quarter with more than 12,000 lines. We believe an accelerated level of growth in the fourth quarter will improve our operating results in future quarters.

Nine Months Ended August 31, 2003 vs. Nine Months Ended August 31, 2002

Our net revenues for the nine months ended August 31, 2003 decreased by approximately $8,029,000, or approximately 68%, to approximately $3,776,000 as compared to approximately $11,805,000 reported for the nine months ended August 31, 2002. The decrease in sales was directly attributable to the sale of Essex's customer base on December 31, 2002, as discussed above. For the nine months

ended August 31, 2003, Essex's sales were approximately $893,000, which represented the sales of this former subsidiary for the period December 1, 2002 to December 31, 2002, the date on which certain of its assets were sold to EAC (See Note 9). After the sale of the customer base on December 31, 2002, Essex did not have any additional sales. Sales of $893,000 represent a decrease in Essex's sales for the nine months ended August 31, 2003 of approximately $10,708,000, or 92%, as compared to approximately $11,601,000 reported for the nine months ended August 31, 2002. The decrease in Essex's sales was offset, in part, by aggregate sales of approximately $2,752,000 reported by NRTC and Telecarrier, each of which had no comparable sales for the nine months ended

August 31, 2002. We anticipate sales for NRTC and Telecarrier to continue to increase in the fourth quarter of fiscal 2003, as noted above.

Our gross profit for the nine months ended August 31, 2003 decreased by approximately $2,225,000 to approximately $1,790,000 from approximately $4,015,000 reported for the nine months ended August 31, 2002, and the gross profit percentage increased to 47.4% from 34.0% reported in the prior fiscal period. The decrease in gross profit is directly related to the sale of the Essex customer base as discussed above. The increase in gross profit percentage reflects our sales strategy to sell in only those states in which we believe we will be able to achieve a margin of at least 40%. In the first nine months of fiscal 2003, NRTC and Telecarrier sold telephone service in New York, New Jersey and Pennsylvania. We are currently negotiating for an interconnection agreement to provide NRTC's service offerings to business and residential consumers in Michigan.

Selling, general and administrative expenses ("SG&A") decreased by approximately $3,446,000, or approximately 47%, to approximately $3,841,000 for the nine months ended August 31, 2003 from approximately $7,287,000 reported in the prior fiscal period. This decrease in expense was directly related to the curtailment of our Essex operations and our on going efforts to implement various cost-cutting measures, which included, among other things, a reduction in staffing. SG&A expenses incurred by Essex represented approximately $650,000 of the $3,841,000 in SG&A costs for the period ended August 31, 2003. Currently, our SG&A costs, exclusive of Essex, have averaged approximately $350,000 per month for the first nine months of fiscal 2003, approximately $80,000 of which represented new line acquisition expenses. In the third quarter of fiscal 2003, we curtailed our in-house billing and telemarketing efforts, and reduced staff and associated overhead costs, such as rent, salaries and telephone expense. We have outsourced our billing operation and believe this is a more effective way to limit our costs as we only pay a fee based on the number of our customers that are billed. We will focus on third-party telemarketing firms to generate new sales, as we believe this is a more efficient means of generating new sales as we only pay for lines that we accept. We continue to evaluate our operations for efficiencies, and we are looking for ways to implement further SG&A reductions in the remainder of fiscal 2003.

Depreciation and amortization expense decreased by approximately $100,000, to approximately $81,000 for the nine months ended August 31, 2003 as compared to approximately $181,000 for the nine months ended August 31, 2002. The decline in depreciation expense was partially attributable to the sale of certain assets to EAC on December 31, 2002.

Interest expense decreased by approximately $280,000, to approximately $106,000 for the nine months ended August 31, 2003 as compared to approximately $386,000 for the nine months ended August 31, 2002. The decrease in interest expense resulted from the termination of our credit facility that was in place in the prior period.

Interest and other income (loss) for the nine months ended August 31, 2003 increased by approximately $110,000 from amounts reported in the prior fiscal period resulting primarily from commission and rental income.

Gain on the sale of assets for the nine months ended August 31, 2003 was approximately $3,511,000 (See Note 9).

Gain on the sale of investment securities and other investments for the nine months ended August 31, 2003 was approximately $122,000, which resulted from the sale of Cordia Corporation ("Cordia") and Talk America Holdings Inc. ("Talk") shares, as compared to $1,381,000 for the nine months ended August 31, 2002, which resulted from the sale of Talk shares.

Three Months Ended August 31, 2003 vs. Three Months Ended August 31, 2002

Our net revenues for the three months ended August 31, 2003 decreased by approximately $2,354,000, or approximately 65%, to approximately $1,276,000 as compared to approximately $3,630,000 reported for the three months ended August 31, 2002. The decrease in sales was directly attributable to the sale of Essex's customer base on December 31, 2002, as discussed above. For the three months ended August 31, 2003, Essex had no sales as compared to approximately $3,567,000 reported for the three months ended August 31, 2002. The decrease in Essex's sales was offset, in part, by aggregate sales of approximately $1,255,000 reported by NRTC and Telecarrier, each of which had no comparable sales for the three months ended August 31, 2002. We anticipate sales for NRTC and Telecarrier to continue to increase in the fourth quarter of fiscal 2003, as we work to add new customers. See the discussion on liquidity below.

Our gross profit for the three months ended August 31, 2003 decreased by approximately $698,000 to approximately $626,000 from approximately $1,324,000 reported in the three months ended August 31, 2002, and the gross profit percentage increased to 49.1% from 36.5% reported in the prior fiscal period. The decrease in gross profit is directly related to the sale of Essex's customer base as discussed above. The increase in gross profit percentage reflects our sales strategy to sell in only those states in which we believe we will be able to achieve a margin of at least 40%, as discussed above.

Selling, general and administrative expenses ("SG&A") decreased by approximately $1,188,000, or approximately 52%, to approximately $1,103,000 for the three months ended August 31, 2003 from approximately $2,291,000 reported in prior fiscal period. As discussed above, this decrease in expense was directly related to the curtailment of our Essex operations and our on-going efforts to implement various cost-cutting measures, which included, among other things, a reduction in staffing.

Depreciation and amortization expense decreased by approximately $27,000, to approximately $17,000 for the three months ended August 31, 2003 as compared to approximately $44,000 for the three months ended August 31, 2002. The decline in depreciation expense was partially attributable to the sale of certain assets to EAC on December 31, 2002.

Interest expense decreased by approximately $51,000 to approximately $36,000 for the three months ended August 31, 2003 as compared to approximately $87,000 for the three months ended August 31, 2002. The decrease in interest expense

resulted from the termination of our credit facility that was in place in the prior period.

Interest and other income (loss) for the three months ended August 31, 2003 decreased by approximately $44,000 from amounts reported in the prior fiscal period, primarily due to the write down of certain fixed assets associated with the curtailment of our telemarketing and billing efforts, as discussed above.

Gain on the sale of assets for the three months ended August 31, 2003 was approximately $1,254,000 (See Note 9).

Gain on the sale of investment securities and other investments for the three-month periods ended August 31, 2003 and 2002 of approximately $38,000 and $697,000, respectively, resulted from the sale of Talk shares.

Liquidity and Capital Resources

At August 31, 2003, we had cash and cash equivalents of approximately $404,000, including approximately $226,000 in Telecarrier, and negative working capital of approximately $8,831,000. Approximately $7,000,000 of the working capital deficit represents liabilities relating to our former Essex subsidary. With the sale of this subsidiary on September 11, 2003, these liabilities are no longer recorded on our books in the fourth quarter.

Net cash (used in) provided by operating activities aggregated approximately ($1,099,000) and $2,942,000 in the nine-month periods ended August 31, 2003 and 2002, respectively. The principal source of cash in fiscal 2003 was the net profit for the period of approximately $1,483,000, which was offset by a non-cash item, the net effect of the gain on the transfer of assets to EAC of approximately $3,511,000 and an increase in accounts payable of approximately $680,000. The principal use of cash in fiscal 2002 was the loss for the period of approximately $2,480,000, which was offset by the increase in accounts payable, principally through the delaying of payments to vendors, and the reduction in accounts receivable of approximately $4,978,000 and $482,000, respectively.

Net cash provided by investing activities aggregated approximately $420,000 and $1,429,000 in the nine-month periods ended August 31, 2003 and 2002, respectively. The principal sources of cash in fiscal 2003 were the proceeds from the sale of investment securities and other investments of approximately $198,000 and the proceeds from a note of approximately $209,000. In fiscal 2002, the principal source of cash was the proceeds from the sale of investment securities and other investments of approximately $1,381,000.

Net cash provided by (used in) financing activities aggregated approximately $145,000 and ($4,157,000) in the nine-month periods ended August 31, 2003 and 2002, respectively. In fiscal 2003, net cash provided by financing activities resulted from proceeds from short-term notes of $200,000 offset by the repayment of long-term debt of approximately $55,000. In fiscal 2002, net cash used in financing activities resulted from the repayment of short and long-term debt of approximately $4,202,000, which was partially offset by the proceeds from the exercise of stock options of approximately $45,000.

For the nine-month period ended August 31, 2003, we had no significant capital expenditures. We do not expect to make any significant capital expenditures over the next twelve months.

At August 31, 2003, we owned 83,180 shares of Cordia (OTCBB:CORG). We have the right to purchase approximately 95,000 shares of Talk if we exercise a warrant. The warrant exercise price is $6.30 per share and, at August 31, 2003, was in-the-money, as Talk common stock was trading at approximately $12.86 per share at such date.

The report of the independent auditors on our 2002 financial statements indicates there is substantial doubt about our ability to continue as a going concern. We have worked during the course of the year to improve our financial condition and, as discussed previously, the sale of most of the assets and liabilities of our former wholly-owned subsidiary, Essex, in December 2002 and the subsequent sale of all the Common Stock of Essex on September 11, 2003, has helped strengthen our financial condition. The sale of our corporate headquarters building has further improved our financial position and has left us with approximately $1,000,000 in cash to pay past due payables and to spend on marketing efforts to obtain new customers. We believe the use of the remaining cash from the sale of our building for marketing expenses and the payment of certain past due payables will leave us with sufficient financial resources to reach profitability and continue our business operations. The inability to carry out this plan may result in the continuance of unprofitable operations, and the eventual inability to pay our operating expenses, which would adversely affect our ability to continue operating as a going concern.

Item 3. Controls and Procedures

(a) Within the 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and principal accounting officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, our Chief Executive Officer and principal accounting officer concluded that our disclosure controls and procedures are effective in timely alerting him to material information relating to our company (including its consolidated subsidiaries) required to be included in our periodic SEC filings.

(b) There have been no significant changes in our internal controls or in other factors that could significantly affect our internal controls subsequent to the date we carried out this evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II-OTHER INFORMATION

Item 1. Legal Proceedings

See Note 7-Legal Proceedings

Item 2. Changes in Securities

In August 2003, we issued an aggregate of 450,000 shares of our common stock in conjunction with certain financing agreements as a fee to consultants and as interest expense. Such shares were issued in reliance upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended, on the basis that such issuances did not involve a public offering, no underwriter fees or commissions were paid in connection with such issuances and the recipiants were `accredited investors' as defined in Regulation D under the Securities Act of 1933, as amended.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

31.1 Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. 1350 (Section 302 of the Sarbanes-Oxley Act of 2002)

32.1 Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. 1350 (Section 906 of the Sarbanes-Oxley Act of 2002)

(b) Reports on Form 8-K

None

Signatures

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

eLEC Communications Corp.

October 14, 2003 — Date

By: /s/ Paul H. Riss

Paul H. Riss
Chief Executive Officer
(Principal Financial and Accounting Officer)

CERTIFICATION

Pursuant to 18 U.S.C. 1350
(Section 302 of the Sarbanes-Oxley Act of 2002)

I, Paul H. Riss, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of eLEC Communications Corp.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and I have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 14, 2003

/s/ Paul H. Riss

Paul H. Riss
Chief Executive Officer and
Principal Financial and
Accounting Officer