

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

ELEC COMMUNICATIONS CORP
Form 10QSB
April 08, 2004

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended February 29, 2004.

OR

TRANSITION REPORT UNDER 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.

(Exact 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, Suite 302, White Plains, New York

10601

(Address of Principal Executive Offices)

(Zip Code)

Issuer's Telephone Number, Including Area Code

914-682-0214

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 16,259,782 shares of Common

Stock, par value \$.10 per share, as of April 1 2004.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

eLEC Communications Corp. and Subsidiaries
Condensed Consolidated Balance Sheet

Feb. 29, 2004

(Unaudited)

| | |
|---|-----------------------|
| Assets | |
| Current assets: | |
| Cash and cash equivalents | \$ 608,710 |
| Accounts receivable, net | 779,663 |
| Tax refund receivable | 141,617 |
| Prepaid expenses and other current assets | 162,140 |
| Due from related party | 84,223 |
| | ----- |
| Total current assets | 1,776,353 |
| Property, plant and equipment, net | 21,533 |
| Other assets | 48,000 |
| | ----- |
| Total assets | \$ 1,845,886 ===== |
| Liabilities and stockholders' equity deficiency | |
| Current liabilities: | |
| Short-term borrowings | \$ 150,000 |
| Current maturities of long-term debt and capital lease obligations | 37,629 |
| Accounts payable and accrued expenses | 3,062,834 |
| Due to related parties | 259,317 |
| Deferred revenue | 144,407 |
| | ----- |
| Total current liabilities | 3,654,187 ----- |
| Stockholders' equity deficiency: | |
| Common stock \$.10 par value, 50,000,000 shares authorized, 16,265,282 shares issued | 1,626,528 |
| Capital in excess of par value | 25,636,884 |
| Deficit | (29,057,963) |
| Treasury stock at cost, 5,500 shares | (13,750) |
| | ----- |
| Total stockholders' equity deficiency | (1,808,301) ----- |
| Total liabilities and stockholders' equity deficiency | \$ 1,845,886 ===== |

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

See notes to the condensed consolidated financial statements.

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

| | For the Three Months Ended Feb. 29, 2004 | Months Ended Feb. 28, 2003 |
|--|---|-------------------------------|
| | ----- | ----- |
| Revenues | \$ 1,873,992 | \$ 1,347,029 |
| | ----- | ----- |
| Costs and expenses: | | |
| Costs of services | 880,075 | 757,695 |
| Selling, general and administrative | 1,056,712 | 1,533,415 |
| Depreciation and amortization | 3,858 | 30,816 |
| | ----- | ----- |
| Total costs and expenses | 1,940,645 | 2,321,926 |
| | ----- | ----- |
| Loss from operations | (66,653) | (974,897) |
| | ----- | ----- |
| Other income (expense): | | |
| Interest expense | (2,762) | (35,087) |
| Interest and other income | 29,081 | 85,058 |
| Gain on debt modification | 51,474 | -- |
| Gain on sale of assets | -- | 1,596,889 |
| Gain on sale of investment securities and other investments | -- | 33,836 |
| | ----- | ----- |
| | 77,793 | 1,680,696 |
| | ----- | ----- |
| Net income before income tax benefit | 11,140 | 705,799 |
| Income tax benefit | 45,000 | -- |
| | ----- | ----- |
| Net income | 56,140 | 705,799 |
| Other comprehensive loss - unrealized loss on marketable securities | -- | (23,430) |
| | ----- | ----- |
| Comprehensive income | \$ 56,140 | \$ 682,369 |
| | ===== | ===== |
| Basic and diluted earnings per share | \$ 0.00 | \$ 0.05 |

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

| | ===== | ===== |
|--|------------|------------|
| Weighted average number of common shares outstanding | | |
| Basic | 16,257,667 | 15,608,282 |
| | ===== | ===== |
| Diluted | 16,568,565 | 15,626,377 |
| | ===== | ===== |

See notes to the condensed consolidated financial statements.

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

| | For the Three Months En | |
|---|-------------------------|---------|
| | Feb. 29, 2004 | Feb. 28 |
| Net cash used in operating activities: | (\$ 58,581) | (\$51 |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Proceeds from sale of investment securities and other investments | - | 10 |
| Proceeds from note | - | |
| | ----- | ----- |
| Net cash provided by investing activities | - | 11 |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Repayment of long-term debt | (1,731) | (2 |
| | ----- | ----- |
| Net cash used in financing activities | (1,731) | (2 |
| | ----- | ----- |
| Decrease in cash and cash equivalents | (60,312) | (428 |
| Cash and cash equivalents at beginning of period | 669,022 | 938 |
| | ----- | ----- |
| Cash and cash equivalents at the end of period | \$608,710 | \$51 |
| | ===== | ===== |

See notes to the condensed consolidated financial statements.

eLEC COMMUNICATIONS CORP.

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

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 three-month period ended February 29, 2004 are not necessarily indicative of the results that may be expected for the year ended November 30, 2004. 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, 2003.

Note 2-Principal Financing Arrangements

Short-term borrowings consist of an unsecured line of credit of \$150,000, owed by our wholly owned subsidiary, Telecarrier Services Inc. ("Telecarrier"), from a finance company, which is due on demand with interest payable monthly at the prime lending rate plus 2% (6.0% at February 29, 2004). Repayment of this line of credit is currently stayed as a result of the bankruptcy proceedings of Telecarrier (See Note 6).

Note 3-Major Customer

During the three months ended February 29, 2004 and February 28, 2003, no one customer accounted for more than 10% of revenue.

Note 4-Income Taxes

At November 30, 2003, we had net operating loss carryforwards for Federal income tax purposes of approximately \$19,000,000 expiring in the years 2004 through 2022. There is an annual limitation of approximately \$187,000 on the utilization of approximately \$1,300,000 of such net operating loss carryforwards under the provisions of Internal Revenue Code Section 382.

Note 5- Earnings (Loss) Per Common Share

Basic earnings per common share are calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income 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 per common share is as follows:

| Three Months Ended | |
|--------------------|---------|
| 2/29/04 | 2/28/03 |
| ----- | ----- |

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

| | | |
|--|------------|------------|
| Weighted average common shares outstanding | 16,257,667 | 15,608,282 |
| Dilutive effect of securities | 310,898 | 18,095 |
| | ----- | ----- |
| | 16,568,565 | 15,626,377 |
| | ===== | ===== |

For the three months ended February 29, 2004 and February 28, 2003, the computation of diluted earnings per share excluded the effect of the assumed exercise of approximately 1,500,000 and 1,770,000 outstanding stock options and warrants that were outstanding because the effect would be anti-dilutive.

Note 6-Subsidiary's Petition for Relief Under Chapter 11

On July 29, 2002 (the "Petition Date"), Telecarrier, which had licenses to resell local and long distance telephone service in four states, filed a voluntary petition for relief under Chapter 11 of the Federal Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. Under Chapter 11, certain claims (liabilities subject to compromise) against Telecarrier in existence prior to the filing of the petition for relief under the Federal Bankruptcy Code, are stayed while Telecarrier continues business operations as a debtor-in-possession. Telecarrier has filed a plan of reorganization pursuant to which the capital stock of a reorganized Telecarrier would be sold either to us or to an unrelated third party, and the proceeds from the sale of the stock of the reorganized entity would be used to make distributions to creditors of Telecarrier. While we are unable to predict whether the plan of reorganization will be consummated, we expect to retain control of Telecarrier following its expected emergence from bankruptcy in fiscal 2004. Additional claims (liabilities subject to compromise) may arise subsequent to the filing date, resulting from rejection of executory contracts, including leases, and from the determination of the Court (or agreement of parties-in-interest) of allowed claims for contingencies and other disputed amounts.

For the three-months ended February 29, 2004, Telecarrier reported a gain of approximately \$51,000 as a result of a court-stipulated reduction in post-petition liabilities.

As of February 29, 2004, Telecarrier had total assets of approximately \$469,000 and total liabilities of approximately \$1,358,000, of which approximately \$872,000 represented pre-petition liabilities and approximately \$486,000 represented post-petition liabilities. Pre-petition liabilities subject to compromise are reflected below:

| | |
|---|-----------|
| Line of credit | \$150,000 |
| Trade payables and due to related parties | 619,000 |
| Other accrued expenses | 103,000 |

Note 7-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 other suppliers of telecommunication services in the geographical locations in which we conduct business. In

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

addition, we are at risk to regulatory agreements that govern the rates we are to be charged. 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 regulatory agreements structure 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 8-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 (amounting to \$1,102,103 at November 30, 2002) of our formerly wholly-owned subsidiary, Essex Communications Inc. ("Essex"), for five dollars plus the assumption of certain liabilities of Essex (amounting to \$10,081,382 at November 30, 2002), including all obligations due and payable to

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

Essex's largest vendor, Verizon Services Corp. ("Verizon"). EAC entered into an agreement with Verizon that provided a payment schedule for the liabilities assumed from Essex and Verizon granted EAC a discount on the assumed liabilities provided EAC adheres to the payout schedule. EAC also paid us \$270,000 to reimburse us for amounts paid by us to Essex's former lender, Textron Financial, formerly known as RFC Capital Corporation. The sale to EAC closed on December 31, 2002. As the creditors of Essex did not consent to the assignment of their claims, Essex had remained liable for substantially all the obligations assumed in the sale until such time as they were paid. The June 30, 2002 unaudited financial statements of Biz indicated 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 (dated 2002) expressed significant doubt about Biz's ability to continue as a going concern. These factors indicated there was significant uncertainty as to the ability of Biz and its subsidiaries' to repay the obligations described above. Accordingly, we did not record any gain until Essex was released from the assumed obligations. During the period December 1, 2002 through February 28, 2003, EAC had settled liabilities of approximately \$1,597,000 and accordingly, gain was recorded during such period for such amount.

On September 11, 2003, we sold all the outstanding capital stock of Essex to Glad Holdings, LLC, a New Jersey limited liability company owned by a former shareholder ("Glad Holdings"), for an aggregate purchase price of \$100 and a general release from Glad Holdings with respect to any and all matters arising prior to September 11, 2003. Based on all available information and consultation with counsel, we concluded that it was unlikely that any creditor of Essex would be able to hold us responsible for any debts or liabilities of Essex. As a result, we believe we have been released of all the liabilities related to Essex, which amounted to approximately \$7,314,000 on such date, and accordingly, recorded such amount as gain in the fourth quarter of fiscal 2003.

The following unaudited pro forma summary presents consolidated financial information of our operations for the three-month periods ended February 29, 2004 and February 28, 2003, as if the sale of Essex's assets 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 for the periods presented, nor is it necessarily indicative of the future results of operations of the remaining company:

| | For the Three Months Ended | |
|---|----------------------------|--------------|
| | 2/29/04 | 2/28/03 |
| Revenues | \$1,873,992 | \$ 453,833 |
| | ----- | ----- |
| Net income (loss) | \$ 56,140 | (\$ 597,292) |
| | ----- | ----- |
| Basic and diluted income (loss) per share | \$ 0.00 | (\$ 0.04) |
| | ----- | ----- |

Note 9- 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

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

Employees, and related interpretations. No stock-based employee compensation cost was reflected in net income for the three months ended February 29, 2004 and February 28, 2003, 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 option was amortized over the vesting periods, which range from immediate vesting to three years. The following table illustrates the affect 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 | |
|---|----------------------------|------------|
| | 2/29/04 | 2/28/03 |
| Net income, as reported | \$ 56,140 | \$ 705,799 |
| Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects | (58,986) | (77,547) |
| Pro forma net income (loss) | (\$ 2,846) | \$ 628,252 |
| Earnings (loss) per share | | |
| Basic, as reported | \$.00 | \$.05 |
| Basic, pro forma | \$.00 | \$.04 |
| Diluted, as reported | \$.00 | \$.05 |
| Diluted, pro forma | \$.00 | \$.04 |

Note 10 Related Party Transactions

Telecarrier had an agreement, effective January 2, 2002, with Telco Services, Inc. ("Telco"), a corporation owned by a former shareholder, under which Telco provided Telecarrier with collection, sales and other services. As a result of a court-stipulated agreement between Telecarrier and Telco, entered into on February 6, 2004, the amount owed Telco for such services was reduced by approximately \$51,000 and such reduction was reported as a gain for the three-month period ended February 29, 2004. As of February 29, 2004, \$259,317 was owed to Telco. The President of Telco is also the President of Glad Holdings (See Note 8).

During the three months ended February 29, 2004 and February 28, 2003, we billed Cordia Corporation ("Cordia"), a related party, \$135,322 and \$144,397, respectively, for rent, telemarketing services, telecommunications services, commissions, and other costs and Cordia billed us \$51,099 and \$109,908, respectively, for telecommunications services and other costs. As of February 29, 2004, Cordia owed us \$84,223.

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" within the meaning of the Private Securities

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

Litigation Reform Act of 1995 with respect to the financial condition, results of operations and business of the Company, 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 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, and a full suite of local features and calling plans. In the states in which we operate, we compete with the incumbent local carrier and a variety of other competitive carriers, including companies that were originally long distance service providers or data service providers. We find that approximately 90% of the local telephone lines in the states in which we are operating are served by Verizon, AT&T Corp. ("AT&T") or WorldCom Inc., which operates under the brand name of MCI ("MCI"). Our strategy is to offer the same telephone products and services offered by Verizon, AT&T and MCI at discounts of 10% to 25%

off their rates. We also strive to provide friendly and helpful customer service that exceeds the service provided by these large competitors.

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

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 carrier ("ILEC") 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 creating web based "back-office" support systems so that we can mine data, easily analyze our customer base, and provide comprehensive customer service to handle repairs, moves, adds and changes to lines. 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 very 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 can provide 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 under which any CLEC should operate while it is growing and building a customer base. 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,

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

Michigan and Pennsylvania. Our primary operating CLEC, New Rochelle Telephone Corp. ("NRTC"), is selling services in New York State and Pennsylvania, and is currently achieving gross margins of approximately 50%.

Regulatory Developments

Our ability to continue achieving our current level of gross margins is dependent upon the pricing structure of the network elements that we obtain from the ILECs. The requirement that the ILECs provide us with unbundled network elements at the current rates is the subject of regulatory and judicial actions that may affect their availability and pricing. Because of a legal challenge from the ILECs, on March 2, 2004 the U.S. Court of Appeals for the District of Columbia released a decision that reversed, vacated and remanded the FCC's Triennial Review Order that is the basis for current pricing and unbundled network elements availability, and is critical to our business. The FCC, state public service commissions, or individual CLECs could appeal this decision and ask the Supreme Court to rule on the case.

On March 31, 2004, the FCC sent a letter to telecom companies urging negotiation rather than litigation of the issues raised by the FCC's Triennial Review Order. The letter states that the FCC is seeking a 45-day extension of the stay that the U.S. Court of Appeals imposed on its decision that overturned parts of the Triennial Review Order. The FCC letter asked telecom companies to indicate by April 6, 2004 whether they will participate in negotiations. We have responded to the FCC in writing by indicating that we will attempt to negotiate commercial agreements with the ILECs. Several of the ILECs have expressed a willingness to negotiate. Although we and other CLECs are willing to negotiate our own agreements, the possibility of appeal to the Supreme Court has been preserved.

Plan of Operation

Our primary methods of obtaining new customer accounts will continue to be through telemarketing and outside sales agents. We believe these are effective low-cost methods of building new accounts, and our past history with these customer acquisition methods is helpful in planning and budgeting our operations on a going forward basis. While we believe our cash balances are adequate for continued limited growth, our cash balances are not sufficient to generate the growth we desire or the growth that our internal operating systems are capable of handling. We are therefore beginning to explore opportunities for raising cash through asset-based borrowings or through a modest equity placement.

We do not expect to purchase any significant assets or make any significant capital expenditures in the next 12 months. We believe our back-office systems are adequately developed and functioning well, and we anticipate only minor expenditures to further automate such systems during the next 12 months. We are continuing to pursue the utilization of a packet-based network, such as Voice over Internet Protocol ("VoIP"), to carry our local voice traffic. This technology is used to transmit voice conversations over a data network using the Internet Protocol. Such data network may be the Internet or may be a managed network.

While many carriers are providing VoIP for international calls and long distance calls, we believe very few carriers have implemented VoIP for local telephone service. We believe the most important trend in the industry will be the replacement of traditional circuit-switched voice technology with packet-based networks. Packet switching has tremendous advantages over circuit switching. Packets can be transmitted over copper wire or over wireless facilities, packet-

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

switched equipment is substantially less expensive than circuit-switched equipment and the price of packet-switched equipment is continually dropping, even as it becomes technologically more sophisticated. We plan to move toward this technology over the next six to 12 months, as this technology also allows us to bypass the ILECs when we provide local telephone service to our customers. Additionally, VoIP allows for added and integrated new service offerings, such as integrated messaging, bandwidth on demand and voice emails. While we will continue to seek and evaluate new technologies, our focus will continue to be on building our customer base, and not in developing new technology. We plan to continue our efforts on improving customer service and in maintaining efficient systems that allow us to sell, provision, bill and collect, as our first priority is to develop and maintain a stable core UNE-P business that generates positive cash flow from operations. As we move towards a VoIP product, we anticipate that we will partner with a carrier's carrier or with another CLEC in order to provide VoIP local service to our customers. We do not plan to have substantial equipment purchases, although we may consider sharing a switch with another service provider.

Three Months Ended February 29, 2004 vs. Three Months Ended February 28, 2003

Our revenue for the three-month period ended February 29, 2004 increased by approximately \$527,000, or approximately 39.1%, to approximately \$1,874,000 as compared to approximately \$1,347,000 reported for the three-month period ended February 28, 2003. Included in our revenue for the three-month period ended February 28, 2003 were approximately \$412,000 in sales reported by NRTC and Telecarrier and approximately \$893,000 in sales reported by our formerly wholly-owned subsidiary, Essex (See Note 8). Revenue reported by NRTC and Telecarrier for the three-month period ended February 29, 2004 increased by approximately \$1,462,000, or approximately 354.9%, over the year-ago period. We anticipate revenues for NRTC and Telecarrier to continue to increase in the second quarter of fiscal 2004, as we work to add new customers. Our line count and customer base has continued to grow in the second quarter of 2004 but additional growth will be directly related to the cash we have available for new line acquisition costs. See the discussion on liquidity below.

Our gross profit for the three-month period ended February 29, 2004 increased by approximately \$405,000 to approximately \$994,000 from approximately \$589,000 reported in the three-month period ended February 28, 2003, and our gross profit percentage increased to 53.0% from 43.8% reported in the prior fiscal period. The increase in our gross profit and 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 over 40%. The increase in gross profit and gross profit percentage was attributable to lower buying prices from ILECs in the states in which we operated during the first fiscal quarter of 2004, compared to the states in which we were operating during the first fiscal quarter of 2003. NRTC and Telecarrier are operating in states in which we can purchase unbundled network elements at prices that are significantly lower than the prices charged in some of the states in which our formerly wholly-owned subsidiary, Essex, was operating. Our selling strategy in fiscal 2004 is to continue to penetrate states that offer the opportunity to achieve higher margins.

Selling, general and administrative expenses ("SG&A") decreased by approximately \$476,000, or approximately 31.1%, to approximately \$1,057,000 for the three-month period ended February 29, 2004 from approximately \$1,533,000 reported in prior year fiscal period. Approximately \$645,000 of this decrease in expense was directly related to the sale of our Essex operations and approximately \$32,000 was related to lower occupancy costs as a result of the sale of our headquarters building in the fourth quarter of fiscal 2003. These expense reductions were

partially offset by an increase of approximately \$31,000 in new line acquisition costs and approximately \$85,000 in legal fees related to bankruptcy proceedings for Telecarrier. Currently, our SG&A costs are approximately \$350,000 per month, approximately \$90,000 of which represents new line acquisition costs.

Depreciation expense decreased by approximately \$27,000, to approximately \$4,000 for the three months ended February 29, 2004 as compared to approximately \$31,000 for the three months ended February 28, 2003. The decline in depreciation is primarily attributable the sale of our headquarters building in the fourth quarter of fiscal 2003 and to the sale of certain assets to EAC on December 31, 2002.

Interest expense decreased by approximately \$32,000, to approximately \$3,000 for the three months ended February 29, 2004 as compared to approximately \$35,000 for the three months ended February 28, 2003. The decrease in interest expense was partially attributable to the repayment of a mortgage note in conjunction with the sale of our headquarters building in the fourth quarter of fiscal 2003.

Interest and other income decreased by approximately \$56,000, to approximately \$29,000 for the three months ended February 29, 2004 as compared to approximately \$85,000 for the three months ended February 28, 2003. The decrease resulted primarily from a reduction in commission and rental income.

For the three-months ended February 29, 2004, Telecarrier reported a gain of approximately \$51,000 as a result of a court-stipulated reduction in post-petition liabilities (See Note 6). No such gain was reported for the three-month period ended February 28, 2003.

Gain on the sale of assets for the three months ended February 28, 2003 was approximately \$1,597,000 (See Note 8). We had no such sale for the three-month period ended February 29, 2004.

Gain on the sale of investment securities and other investments for the three-month period ended February 28, 2003 was approximately \$34,000, which resulted from the sale of Cordia shares. No such shares were sold in the three-month period ended February 29, 2004.

For the three-month period ended February 29, 2004, we recorded a tax benefit of \$45,000, which resulted from the reduction of an estimated accrual of corporate tax expense for fiscal 2003. No such benefit was recorded for the three-month period ended February 28, 2003.

Liquidity and Capital Resources

At February 29, 2004, we had cash and cash equivalents of approximately \$609,000 and negative working capital of approximately \$1,878,000. Our cash balances at February 29, 2004 included approximately \$160,000 that was in the Telecarrier bankruptcy estate. This cash was only available for the operations of Telecarrier.

Net cash used in operating activities aggregated approximately \$59,000 and \$515,000 in the three-month periods ended February 29, 2004 and February 28, 2003, respectively. The principal use of cash

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

in fiscal 2004 was the net change in operating assets and liabilities, which was partially offset by the income for the period of approximately \$56,000. The principal use of cash in fiscal 2003 was the loss for the period of approximately \$1,165,000, 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 \$899,000 and \$264,000, respectively.

There were no investing activities in the three-month period ended February 29, 2004. Net cash provided by investing activities aggregated approximately \$115,000 for the three-month period ended February 28, 2003. The principal source of cash in fiscal 2003 was the proceeds from the sale of investment securities and other investments of approximately \$100,000 and the proceeds of a note of approximately \$15,000.

Net cash used in financing activities aggregated approximately \$2,000 and \$27,000 in the three-month periods ended February 29, 2004 and February 28, 2003, respectively. In fiscal 2004 and 2003, net cash used in financing activities resulted from the repayment of debt.

For the three-month period ended February 29, 2004, there were no capital expenditures. We do not expect to make any significant capital expenditures over the next 12 months.

We have stock purchase warrants that entitle us to purchase approximately 95,000 shares of Talk America Holdings Inc. ("Talk"). The warrant exercise price is \$6.30 per share and, at March 29, 2004, our warrants were in-the-money, as Talk common stock was trading at approximately \$8.56 per share at such date. We have been in discussions with Talk management regarding our intention to exercise the warrants during fiscal 2004, as we plan to use the proceeds of the warrants to generate additional cash for line acquisition costs.

The report of the independent auditors on our 2003 financial statements indicates there is substantial doubt about our ability to continue as a going concern. The auditors noted a deficit in working capital and continuing losses from operations. We are continuously working to improve our financial condition and we are now operating our business with fixed costs that are substantially lower than our fixed overhead during the previous three years. To maintain our revenues at the current level, and to further improve our balance sheet, we anticipate being able to purchase the outstanding capital stock of our wholly owned subsidiary, Telecarrier, in a transaction that will allow Telecarrier to emerge from a Chapter 11 bankruptcy. We were the high bidder for the capital stock of Telecarrier when the bidding period ended on March 29, 2004. We anticipate the bankruptcy court will approve our purchase of the reorganized business for a total amount of \$325,000. This purchase and reorganization is projected to eliminate approximately \$872,000 in pre-petition liabilities that are carried on our consolidated balance sheet. If we are successful in maintaining ownership of a reorganized Telecarrier, we anticipate we will be able to achieve profitable operations and will be able to further pursue implementation of VoIP technology to establish an additional network on which to carry the voice traffic of our customers. The failure to retain our Telecarrier subsidiary and to settle past due amounts within our financial means will have an adverse effect on our ability to carry out our business plan. The inability to carry out this plan may result in unprofitable operations, and the eventual shut down of vendor credit facilities, which would adversely affect our ability to continue operating as a going concern.

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

Item 3. Controls and Procedures

Disclosure Controls and Procedures. Our management, with the participation of our chief executive officer/chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, our chief executive officer/chief financial officer has concluded that, as of the end of such period, our disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

Internal Control Over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the first quarter of 2004 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

eLEC COMMUNICATIONS CORP.

PART II-OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Purchases of Equity Securities

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

Edgar Filing: ELEC COMMUNICATIONS CORP - Form 10QSB

31.1 Certification of our Chief Executive Officer and Chief Financial Officer, Paul H. Riss, Pursuant to 18 U.S.C. 1350 (Section 302 of the Sarbanes-Oxley Act of 2002)

32.1 Certification of our Chief Executive Officer and Chief Financial Officer, Paul H. Riss, 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.

April 7, 2004

Date

By: /s/ Paul H. Riss

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