ELEC COMMUNICATIONS CORP
Form 10-K
March 08, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

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

For the fiscal year ended November 30, 2006

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to _____________.

Commission File No. 0-4465

eLEC COMMUNICATIONS CORP.
(Exact Name of Registrant 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)

(914) 682-0214
(Registrant's Telephone Number, Including Area Code)

Securities registered under Section 12(b) of the Exchange Act:

None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value $.10 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes |_| No |X|

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes |_| No |X|

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 by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K |_|

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer |_| Accelerated filer |_| Non-accelerated filer |X|.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes |_| No |X|

On February 15, 2007, 22,434,282 shares of registrant's common stock were outstanding. The aggregate market value of the voting stock held by non-affiliates as of May 31, 2006 was approximately $5,463,000.

Documents Incorporated by Reference: The definitive proxy statement relating to the registrant's 2007 Annual Meeting of Stockholders is incorporated by reference into Part III of this Form 10-K to the extent described therein.

TABLE OF CONTENTS

The statements contained in this Report that are not historical facts are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our financial condition, results of operations and business, 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:

- The availability of additional funds to successfully pursue our business plan;
- The impact of changes the Federal Communications Commission or State Public Service Commissions may make to existing telecommunication laws and regulations, including laws dealing with Internet telephony;
- The ability to comply with provisions of our financing agreements (we are currently in default in certain of the covenants contained therein);
- The highly competitive nature of our industry;
- The acceptance of telephone calls over the Internet by mainstream consumers;
- Our ability to retain key personnel;
- Our ability to maintain adequate customer care and manage our churn rate;
- The cooperation of incumbent carriers and industry service partners that have signed agreements with us;
- Our ability to maintain, attract and integrate internal management, technical information and management information systems;
- Our ability to market our services to current and new customers and generate customer demand for our products and services in the geographical areas in which we operate;
- The availability and maintenance of suitable vendor relationships, in a timely manner, at reasonable cost;
- Our ability to manage rapid growth while maintaining adequate controls and procedures;
- The decrease in telecommunications prices to consumers; and
- General economic conditions.

These forward-looking statements are subject to numerous assumptions, risks and uncertainties that may cause our actual results to be materially different from any future results expressed or implied by us in those statements. Some of these risks are described in "Risk Factors" in Item 1A of this Report.

These risk factors should be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue. 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 these uncertainties, we caution investors not to unduly rely on our forward-looking statements. We do not undertake any obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions

to any forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events. Further, the information about our intentions contained in this document is a statement of our intention as of the date of this document and is based upon, among other things, the existing regulatory environment, industry conditions, market conditions and prices, the economy in general and our assumptions as of such date. We may change our intentions, at any time and without notice, based upon any changes in such factors, in our assumptions or otherwise.

PART I

In this Annual Report on Form 10-K, we will refer to eLEC Communications Corp., a New York corporation, as "our company," "we," "us," and "our."

Item 1. - Business

Overview

We are a provider of local, long distance and international voice telephone services. We provide these services over wirelines, using leased facilities of other carriers, and over broadband services, using our own Internet Protocol ("IP") telephony product. IP telephony is the real time transmission of voice communications in the form of digitized "packets" of information over the Internet or a private network, which is analogous to the way in which e-mail and other data is transmitted. We use proprietary softswitch technology that runs on Cisco and Dell hardware to provide broadband telephone services to other service providers, such as cable operators, Internet service providers, WiFi and fixed wireless broadband providers, data integrators, value-added resellers, and satellite broadband providers. Our technology enables these carriers to quickly and inexpensively offer premiere broadband telephone services, complete with order flow management for efficient provisioning, billing and support services and user interfaces that are easily customized to reflect the carrier's unique brand.

The worldwide rollout of broadband voice services has allowed consumers and businesses to communicate at dramatically reduced costs in comparison to traditional telephony networks. Traditionally, telephone service companies have built networks based on circuit switching technology, which creates and maintains a dedicated path for individual telephone calls until the call is terminated. While circuit-switched networks have provided reliable voice communications services for more than 100 years, transmission capacity is not efficiently utilized in a circuit-switched system. Under circuit-switching technology, when a person makes a telephone call, a circuit is created and remains dedicated for the entire duration of that call, rendering the circuit unavailable for the transmission of any other calls. Because of the high cost and inefficiencies of a circuit-switched network, we have never owned a circuit-switched network. Instead, we have leased circuit-switched network elements from other carriers in order to provide wireline services to customers.

Data networks, such as IP networks, utilize packet switching technology that divides signals into packets and simultaneously routes them over different channels to a final destination where they are reassembled into the original order in which they were transmitted. No dedicated circuits are required and a fixed amount of bandwidth is not needed for the duration of each call. The more efficient use of network capacity results in the ability to transmit significantly higher amounts of traffic over a packet-switched network than a circuit-switched network. Packet-switching technology enables service providers to converge traditional voice and data networks in an efficient manner by carrying voice, fax, video and data traffic over the same network. IP networks are therefore less expensive for carriers to operate, and these cost savings can be passed on to the consumer in the form of lower costs for local, long distance and international long distance telephone services.

We have created our own proprietary IP platform and have transitioned into a facilities-based broadband service provider to take advantage of the network cost savings that are inherent in an IP network. We have signed a contract to sell our leased lines telephone business to another company, so that we can focus our resources and our energies on our broadband voice product. In addition to the cost savings we obtain from the efficient use of network capacity, we believe our network equipment costs are lower than most other carriers as our network and technology require significantly less capital expenditures than a traditional Class 5 telecom switch in a circuit-switched network, and less equipment costs than our broadband voice competitors that utilize a packet-switched network. Our proprietary softswitch provides more than 20 of the Class 5 call features, voice mail and enhanced call handling on our own Session Initiation Protocol ("SIP") server suite. We control all of the features we offer to broadband voice customers, because instead of a relying on a software vendor, we write the code for any new features that we desire to offer our customers. We have no software licensing fees and our other variable network costs are expected to drop as we increase our network traffic and as we attract more pure IP telephony users with traffic that does not incur the cost of originating or terminating on a circuit- switched network.

Our SIP servers are part of a cluster of servers, which we refer to as a server farm, in which each server performs different network tasks, including back-up and redundant services. We believe the server farm structure can be easily and cost-effectively scaled as our broadband voice business grows. In addition, servers within our server farm can be assigned different tasks as demand on the network dictates. If an individual server ceases to function, our server farm is designed in a manner that subscribers should not have a call interrupted. We support origination and termination using both the G.711 and G.729 voice codecs. Codecs are the algorithms that enable us to carry analog voice traffic over digital lines. There are several codecs that vary in complexity, bandwidth required and voice quality. We primarily use G.711 and G.729 codecs. G.711 is a standard to represent 8 bit compressed pulse code modulation samples for signals of voice frequency. It creates a 64 kilobit per second bitstream, and we find that approximately 90% of the current IP telephony traffic in the United States uses G.711. We frequently process G.711 traffic because some of our wholesale customers do not have the ability to handle G.729. We prefer the G.729 codec, which allows us to utilize the Internet in more cost effective ways. It allows for compressing more calls in limited bandwidth, reducing the call to 8 kilobits per second. For all of our retail customers and our more sophisticated wholesale accounts, we use G.729 to save cost and enhance the quality of the call.

Development of Business

We were incorporated in the State of New York in 1964 under the name Sirco Products Co. Inc. and developed a line of high quality handbags, totes, luggage and sport bags. Between 1995 and 1999, we divested our handbag and luggage operations, which had experienced several years of operating losses.

We commenced operations in the telecommunications industry in fiscal 1998 by acquiring Essex Communications, Inc. ("Essex"), a newly-formed Competitive Local Exchange Carrier ("CLEC") formed to attract and retain a geographically concentrated customer base in the metropolitan New York region, primarily through the resale of products and services of incumbent and alternative facilities-based local providers.

In January 2000, we acquired Telecarrier Services, Inc. ("TSI"), a CLEC that operated primarily in the states of New Jersey and New York provided long distance service in 13 states. Most of TSI's operations were acquired by Essex after the acquisition was complete, and TSI maintained its licenses as an inactive subsidiary. On July 29, 2002, TSI commenced a case under chapter 11 of the Bankruptcy Code. In February 2004, TSI filed a plan of reorganization pursuant to which the capital stock of a reorganized TSI would be sold by competitive bid and the proceeds from the sale of such stock would be used to make distributions to creditors of TSI. In April 2004, the court accepted our plan to purchase all the stock of a reorganized TSI for a price of $325,000. The purchase of TSI and its emergence from bankruptcy was completed in October 2004.

On December 31, 2002, we sold certain assets of Essex to Essex Acquisition Corp. ("EAC"), a wholly-owned subsidiary of BiznessOnline.com, Inc. ("Biz"). EAC purchased selected assets and assumed certain liabilities in conjunction with this transaction. The remaining shell of Essex was sold to Glad Holdings, LLC on September 11, 2003.

In November 2002, we began the operations of New Rochelle Telephone Corp. ("NRTC") as a start-up CLEC. We built a customer base in NRTC similar to the one we had sold to EAC. On December 14, 2006, we entered into two separate definitive purchase agreements ("Agreements") to sell TSI and NRTC to two wholly-owned subsidiaries of Cyber Digital, Inc. ("Purchaser"), a publicly traded shell company. The planned sales are subject to the receipt of required regulatory approvals and other closing conditions.

If the sale of our CLECs is consummated, Purchaser will acquire all the outstanding shares of the CLECs and either pay or assume $1.3 million of outstanding debt that we owe to Laurus Master Fund, Ltd. ("Laurus"). In the Agreements, we have guaranteed maximum levels of negative working capital of the CLECs and we indemnified the Purchaser against liabilities that would reduce working capital, as defined in the Agreements, below the agreed upon levels. In accordance with an amendment to the Agreements, if the closing of the transaction has not occurred by April 12, 2007, we or the Purchaser may terminate the Agreements with no penalty to the terminating party, so long as such delay in closing the transaction is not the result of willful and material breach by the terminating party of any of its obligations under the Agreements.

On August 4, 2004, we incorporated VoX Communications Corp. ("VoX") as our wholly-owned IP subsidiary to pursue the deployment of our own IP network for broadband telephony services. In addition to the general cost advantages of broadband telephone service noted above, we believe that IP communication technologies will continue to rapidly advance and will further the potential for the Internet to become the preferred medium of communication and commerce. Consequently, in fiscal 2005 and 2006 we expended a vast amount of our resources on the planning, development and implementation of our IP network. Although we allow individual users to purchase our broadband voice service on the VoX website at www.voxcorp.net, we have focused our efforts on becoming a wholesale provider of broadband voice services. As a wholesaler, we empower broadband service providers with the ability to sell a broadband voice product to their existing customers before the broadband voice retail companies, such as Vonage Holdings Corp. ("Vonage") and SunRocket, Inc. try to sell their broadband voice product. This wholesale model contains many cost advantages for us, especially with regard to customer acquisition costs. Companies that sell broadband voice services on a retail level typically experience significant customer acquisition costs because of the high marketing expenses and special promotions they use to attract an end-user who already has broadband service. We do not incur the expense of retail customer acquisitions, as these costs are borne by our wholesale customers. Our wholesale customers, however, often can attract retail customers in a more cost effective manner than we can because the wholesale customer already has a customer base of end-users who are utilizing broadband services.

4

Available Information

We maintain a corporate website with the address www.elec.net. We also maintain a corporate website with the address www.pervasip.com in anticipation of our shareholders approving a name change of our company from eLEC Communications Corp. to Pervasip Corp. We have not incorporated by reference into this Report on Form 10-K the information on any of our websites and you should not consider any of such information to be a part of this document. Our website addresses are included in this document for reference only. We make available free of charge through our corporate website our Annual Reports on Form 10-K or 10-KSB, Quarterly Reports on Form 10-Q or Form 10-QSB and Current Reports on Form 8-K, and amendments to these reports, through a link to the EDGAR database, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission.

Our Products and Services

Our broadband voice service offerings are tailored to meet the specific needs of unique wholesale customers. We focus on marketing to wholesale accounts that have an existing customer base of residential and small business users. We believe we provide compelling product offerings to Cable Operators, CLECs, Internet Service Providers ("ISPs"), and other broadband service providers, as we enable them to quickly roll out private-labeled broadband voice solutions to their residential and small business customers. We have identified approximately 3,000 U.S. independent cable companies that can use our product. Many of these companies are already providing high-speed Internet access to their customers. As a result, we believe upselling broadband voice services to their broadband subscribers is a natural fit. Under our private label program, we provide each reseller with its own customer support web site, allowing them to offer a transparent user experience for customers without risking their own capital on expensive switches and custom IP software. Our broadband voice solution offers each reseller:

- Rapid market entry in U.S. and eventually worldwide
- High-quality, reliable voice services
- Disruptive technology
- Free use of our softswitch and application servers
- Low priced services
- Flexibility to change platform to needs of individual carrier
- Customer service web site
- End user web site
- Automatic sign-up on the Internet

Our retail customers consist of small businesses and residential users.

These customers consist primarily of our landline customers. Our broadband voice services are available nationwide, while our landline services are limited to the states of New Jersey, New York and Pennsylvania. We primarily market our services through two distribution channels. We use third-party telemarketers to attract small business and residential accounts (typically less than three telephone lines for each account), and we use agents and direct marketing to attract small business and residential accounts (typically one to 10 lines in size for each account). To further help our customers manage their phone service, and to differentiate

ourselves from other service providers, we provide a secure customer web site with the tools to help our customers to manage their accounts. These tools include the following:

- Billing management: we provide customers with Web-based access to billing records, invoices, payment history and individual call records;
- Payment processing: we provide customers with the ability to process or change secure credit card information over the Web to make payments to us;
- Account provisioning: we provide customers with Web pages through which they can order new services, new phone numbers, including virtual numbers, and advanced features;
- Customer care: we provide customers with first tier customer care to explain how to use features, to perform simple diagnostic checks and repairs and to contact us via email.

The pricing and robust nature of our feature packages also help to differentiate us from our competitors. For landline customers, we offer the same calling features offered by the Incumbent Local Exchange Carrier ("ILEC") from which we are buying and reselling services, but we charge less for each of the features. We also bundle certain key features, such as Caller ID and Call Waiting, in an unlimited monthly calling plan. For our broadband voice customers, we offer differentiating features, such as fax lines and toll free numbers. The following features are offered to our broadband voice customers, at no extra charge:

- 911 Dialing
- Voicemail
- Caller ID
- Call Waiting
- Call Forwarding
- Three Way Calling
- Free In-Network Calls
- Call Return
- Caller ID Block
- International Call Blocking
- Directory Assistance Blocking
- Do Not Disturb
- Speed Dial
- Online Account Management

For an additional competitive charge, our broadband voice customers can receive additional premium features, such as:

- 411 Directory Assistance
- Virtual numbers
- Local number portability

Our Network

We operate a sophisticated IP network to deliver our broadband voice services. We carefully monitor the network as it automatically minimizes the route taken by packets carrying a voice conversation, and self-regulates traffic volumes to directly control the quality of service from the origination to the termination of a call. Calls are connected on our network with minimal post dial delay

and our G.729 compression yields virtually no jitter. When compared to other broadband voice carriers, or wireline connections, we deliver a high quality call. Our softswitch utilizes advanced SIP infrastructure on a cluster of SIP servers and has the ability to scale at a low cost. We believe the collective thought process of our SIP servers makes us unique, as our servers are capable of "thinking" about what they are doing and will perform self-healing functions when necessary to ensure a call is not dropped. Unlike many of our competitors, we do not rely on Microsoft to power our softswitch. By using our own open-source software platform, we are able to update the network as needed, avoid the delays of waiting for software upgrades from Microsoft and avert the problems associated with having too much reliance on one vendor in order to run our network.

We consider voice to be an application on an IP transport. Our network does not use the mainframe technology approach that Sonus Networks, Inc. or BroadSoft, Inc. promotes. Instead, we have a fully-scalable, redundant, power-backed stable platform with a server farm that contains no specifically designed telecom equipment. By not relying on the telecom equipment and related software of the larger equipment vendors, we are able to own and control our own proprietary source code and to scale without the limitations and delays associated with equipment financing, installation, integration and source code updates that equipment vendors impose on other broadband voice carriers. Our approach is very similar to the server cluster type of approach that has provided Google, Inc. substantial computing resources at a relatively low cost.

Business Strategy

Our objective is to build a profitable telephone company on a stable and scalable platform with minimal network costs. We want to be known for our high quality of service, robust features and ability to deliver any new product to a wholesale customer or a web store without delay. We believe that to achieve our objective we need to have "cradle to grave" automation of our back-office web and billing systems. We have written our software for maximum automation, flexibility and changeability.

We know from experience in provisioning complex telecom orders that back-office automation is a key factor in keeping overhead costs low. Technology continues to work for 24 hours a day and we believe that the fewer people a company has in the back office, the more efficiently it can run, which should drive down the cost per order.

Furthermore, our strategy is to grow rapidly by leveraging the capital, customer base and marketing strength of our wholesale customers. Many of our targeted wholesale customers and some of our existing wholesale customers have ample capital to market a private-labeled broadband voice product to their existing customer base or to new customers. We believe our strength is our technology-based platform. By providing our technology to cable companies, CLECs, ISPs, WiFi and fixed-wireless broadband providers, data integrators, value-added resellers, and satellite broadband providers and any other entity that desires to offer a broadband telephony product, we believe we will require significantly less cash resources than other providers will require to attract a similar number of subscribers.

By taking a wholesale approach, our goal is to obtain and manage 500 customers that have an average customer base of 1,000 end-users. We believe we will be more successful and more profitable taking this approach to reaching 500,000 end-users than we would be if we tried to attract and manage 500,000 individual end-users by ourselves.

7

Sales and Marketing

In establishing our broadband voice business, we do not want our selling price to be the only reason we win a wholesale customer. We do not intend to be the broadband voice carrier that sells services at the lowest price. We believe the price savings that broadband voice services offer our customers, when compared to traditional wireline telephone services, provides a significant monetary value that will help us attract customers. In addition to our price advantage over traditional wireline services, we believe we have a stable, high-quality, feature-rich service that allows us to distinguish ourselves from lower-priced alternatives. Our extensive pool of local telephone numbers that we offer broadband carriers in remote areas, coupled with the customization of our customer web portals, helps to create an attractive offering for broadband carriers. In addition to our in-house staff of sales professional, we partner with various resellers, wholesalers and referral channels to assist in the sale of our services.

Competition

The communications industry is highly competitive and the market for enhanced Internet and IP communications services is new and rapidly evolving. We believe the primary competitive factors that will determine our success in the Internet and IP communications market are:

- Quality of service
- Responsive customer care services
- Ability to provide customers with a telephone number in their local calling area
- Pricing levels and policies
- Ability to provide E911 and 911 service
- Bundled service offerings
- Innovative features
- Ease of use
- Accurate billing
- Brand recognition
- Quality of analog telephone adapter ("ATA") supported by us and used by our customer

Future competition could come from a variety of companies, both in the Internet and telecommunications industries. This includes major companies that have been in operation for many years and have greater resources and larger subscriber bases than we have, as well as companies operating in the growing market of discount telecommunications services, including calling cards and prepaid cards. In addition, some Internet service providers have begun to aggressively enhance their real- time interactive communications, and are focusing initially on instant messaging, with the intent to progress toward providing PC-to-Phone services and broadband telephony services.

We anticipate that competition will also come from several traditional telecommunications companies, including industry leaders, such as AT&T Inc., Sprint Nextel Corporation, Deutsche Telekom AG, and Qwest Communications International, Inc., as well as established broadband services providers, such as Time Warner Inc., Comcast Corporation and Cablevision Inc. These companies all have announced their intention to offer enhanced Internet and IP communications services in both the United States and internationally. All of these competitors are significantly larger than we are and have:

- o substantially greater financial, technical and marketing resources;
- o stronger name recognition and customer loyalty;
- o well-established relationships with many of our target customers;
- o larger networks; and
- o large existing user base to cross sell new services.

8

These and other competitors may be able to bundle services and products that are not offered by us together with enhanced Internet and IP communications services, which could place us at a significant competitive disadvantage. Many of our competitors enjoy economies of scale that can result in lower cost structure for transmission and related costs, which could cause significant pricing pressures within the industry.

Government Regulation

The FCC has jurisdiction over all U.S. telecommunications common carriers to the extent they provide interstate or international communications services, including the use of local networks to originate or terminate such services. The FCC also has jurisdiction over certain issues relating to interconnection between providers of local exchange service and the provision of service via fixed wireless spectrum.

Universal Service - In 1997, the FCC issued an order, referred to as the Universal Service Order, that requires all telecommunications carriers providing interstate telecommunications services to periodically contribute to universal service support programs administered by the FCC (the "Universal Service Fund"). These periodic contributions are currently assessed based on a percentage of each contributor's interstate and international end user telecommunications revenues reported to the FCC. We, and most of our competitors, pass through these Universal Service Fund contributions in the price of our services, either as a separate surcharge or as part of the base rate. In addition to the FCC universal service support mechanisms, state regulatory agencies also operate parallel universal service support systems. As a result, we are subject to state, as well as federal, universal service support contribution requirements, which vary from state to state.

Interconnection and Unbundled Network Elements - The Telecommunications Act requires ILECs to allow competitors to interconnect with their networks in a nondiscriminatory manner at any technically feasible point on their networks at cost-based prices, which are more favorable than past pricing based on the historic regulated costs of the ILEC. Since the FCC's 1996 "Local Competition Order," CLECs have enjoyed the right to lease unbundled network elements at rates determined by state public utility commission employing the FCC's TELRIC (Total Element Long Run Incremental Cost) forward looking, cost-based pricing model.

The FCC's rules governing availability of ILEC unbundled network elements to CLECs have been the subject of on-going litigation and rulemaking proceedings. In February 2005, the FCC eliminated the availability of unbundled local switching at TELRIC prices, and thereby eliminated the ability of CLECs to obtain a full "UNE Platform" that provides all elements of local dial-tone service at TELRIC prices. The FCC also limited the availability of high-capacity loops and dedicated transport elements at TELRIC prices; these elements will now be available only in particular markets that do not meet tests for the presence of competitive facilities as detailed in the FCC's rules.

The FCC's unbundling rules continue to be the subject of further litigation and could change in ways we cannot now predict, which could have a material affect on the cost of telephony services and the business strategy of carriers that use wirelines that are leased from the ILECs, as is the case with our subsidiaries, NRTC and TSI.

Pursuant to the FCC's rules, we negotiate interconnection arrangements with each ILEC, generally on a state-by-state basis, which allows us to sell local telephone service over leased wirelines. While current FCC rules and regulations require the incumbent provider to provide certain network elements necessary for us to provision end-user services on an individual and combined basis, we cannot assure you that the ILECs will provide these components in a manner and at a price that will support competitive operations. If we sell NRTC and TSI, as we have planned, we will no longer need interconnection agreements with the ILECs in order to operate. Our Internet telephony product does not require an interconnection agreement with the ILECs, as the Internet is our network.

Internet Telephony - The use of the Internet and private IP networks to provide a voice communications services is a relatively recent market development. Although the provision of such services is currently permitted by United States law and largely unregulated within the United States, several foreign governments have adopted laws and/or regulations that could restrict or prohibit the provision of voice communications services over the Internet or private IP networks. More aggressive regulation of the Internet in general, and Internet telephony providers and services specifically, may materially and adversely affect our business.

On March 10, 2004, the FCC initiated a broad rulemaking proceeding concerning the provision of voice and other services and applications utilizing IP technology. While the Commission has not released an order in this proceeding, it has addressed some of the questions raised by the rulemaking in subsequent proceedings. Although the Commission has not adopted a formal definition of broadband voice services, we use the term generally to include any IP-enabled services offering real-time, multidirectional voice functionality, including, but not limited to, services that mimic traditional telephony.

In June 2005, the FCC adopted rules requiring providers of broadband voice services to provide 911 emergency access. We believe we are in compliance with this order. In August 2005, the FCC adopted rules that these providers must design their systems to facilitate authorized wiretaps pursuant to the Communications Assistance to Law Enforcement Act. We anticipate that we will continue to develop technologies as required by governmental regulation that support emergency access and enhanced services.

In June 2006, the FCC announced that interconnected broadband voice providers, such as VoX, would be required to contribute to the USF on an interim basis, beginning October 2006. The Commission permitted interconnected broadband voice providers to determine their USF contribution according to one of three different calculation methods. Implementation of the regulatory requirements compelled by the Commission's action take considerable time and cost, and we cannot guarantee that we have implemented these requirements fully. If we fail to report our revenue and remit USF on that revenue accurately, we may be subject to late fees, penalties or other actions, which could negatively affect our business.

Recent action by the FCC has also expanded the possibility that our broadband voice services may become subject to state regulation, which will likely lead to higher costs and reduce some of the competitive advantage broadband voice services hold over traditional telecommunications services.

Regulation by state public utility commissions - Our telecommunications services that originate and terminate within the same state, including both local service and in-state long distance toll calls, are subject to the jurisdiction of that state's utility commission. The Telecommunications Act of 1996 generally preempts state statutes and regulations that prevent the provision of competitive services,

but permits state utility commissions to regulate the rates, terms and conditions of intrastate services, so long as such regulation is not inconsistent with the requirements of federal law. Our CLECs are certified to provide facilities-based and/or resold long distance service in the states in which we operate. In addition to requiring certification, state regulatory authorities may impose tariff and filing requirements, consumer protection measures, and obligations to contribute to universal service and other funds. Rates for intrastate switched access services, which we both pay to local exchange companies and collect from long-distance companies for originating and terminating in-state toll calls, are subject to the jurisdiction of the state commissions. State commissions also have jurisdiction to approve negotiated rates, or establish rates through arbitration, for interconnection, including rates for unbundled network elements. Changes in those access charges or rates for unbundled network elements could have a substantial and material impact on our business if we do not complete the sale of NRTC and TSI.

Employees

As of February 15, 2007, we employed 35 employees, of whom 34 were employed on a full-time basis and one was employed on a part-time basis. We are not subject to any collective bargaining agreement and we believe our relationship with our employees is good.

Item 1A. Risk Factors

This report contains forward-looking statements that involve risks and uncertainties, such as statements of our objectives, expectations and intentions. The cautionary statements made in this report are applicable to all forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed herein. Risk factors that could cause or contribute to such differences include those discussed below, as well as those discussed elsewhere in this report. In addition to the other information contained in this Form 10-K, the following risk factors should be considered carefully in evaluating our business. Our business, financial condition, or results of operations may be materially adversely affected by any of these risks. Please note that additional risks not presently known to us or that we currently deem immaterial may also impair our business and operations.

Risks Relating to Our Business

We have incurred operating losses since inception of our telephone business and we may be unable to achieve profitability or generate positive cash flow.

We have not generated operating profits since fiscal 1996. While we reported net income of $170,253 and $8,323,211 in fiscal 2004 and 2003, respectively, we reported losses from our telecommunications operations. Furthermore, in fiscal 2006 and 2005, we reported net losses of approximately $2,345,000 and $2,266,000, respectively. In fiscal 2004, net income of $170,253 resulted primarily from the gain of approximately $743,000 resulting from a settlement with creditors in the bankruptcy proceedings of a subsidiary. In fiscal 2003, net income of $8,323,211 resulted primarily from the gain on the disposition of a subsidiary and the disposition of property of approximately $11,306,000. In fiscal 2006, fiscal 2005 and fiscal 2004, we generated operating losses of approximately $2,287,000 $2,402,000 and $642,000, respectively, from our telecommunications operations. We expect to continue to incur operating losses until we develop our telecommunications operations to a level at which it generates sufficient revenues to cover operating expenses.

We have an unproven business model and our inability to scale our broadband voice business could delay or prevent our future profitability.

Our business strategy is unproven and we do not know whether our business model and strategy will be successful. We intend to sell wholesale broadband voice services to other carriers, primarily those carriers that already have broadband customers. We also plan to sell our wireline business by April 12, 2007, that has generated substantially all of our revenues since fiscal 2000. We have developed our own proprietary IP platform and for the first time in our operating history, we are a facilities-based carrier. We believe our network is robust and efficient, but it has not carried the hundreds of millions of minutes that we anticipate will eventually use our network. Our inability to scale our IP network and execute effectively as a broadband voice provider would significantly diminish our ability to generate

sufficient revenue to achieve profitability.

We have a need for additional financing and without such financing we may be forced to curtail or cease our operations or sell our business, which may cause the value of your investment to decline.

Due to our recent operating losses and our additional requirements for working capital to establish and grow our business, over the past several months we have sold debt and additional shares of capital stock to fund our working capital needs. We expect that we will continue to sell our capital stock, incur additional indebtedness or sell other assets we currently own to fund the anticipated growth of our telecommunications business and implement our business objectives. There can be no assurance that we will be able to obtain additional funding when needed, or that such funding, if available, will be available on terms we find acceptable. If we cannot obtain additional funds when needed, we may be forced to curtail or cease our activities, or sell our business, which may result in the loss of all or a substantial portion of your investment.

We depend on other carriers as a key component for our business and any failure of these carriers to continue service to us could damage our reputation and cause us to lose customers .

To limit our capital expenditures and support staff, we rely extensively on third parties. For our CLECs, we lease our local exchange network and our long distance network. As a result, we depend entirely on incumbent carriers for the transmission of customer telephone calls for our CLEC subsidiaries. The risk factors inherent in this approach include, but are not limited to, the following:

o the inability to negotiate and renew favorable wholesale agreements;

- o lack of timeliness of the ILEC in processing our orders for customers seeking to utilize our services;
- o dependence on the effectiveness of internal and external telemarketing services to attract new customers;
- o dependence on third-party contractors to install necessary equipment and wiring at our customers facilities; and
- o dependence on a facilities-based carrier to provide our customers with repair services and new installation services.

If we are successful in selling our CLECs this year, we will still be reliant on third party carriers in conjunction with the operations of our IP network.

We depend on a third-party billing system to bill our wireline customers and we are exposed to a loss of revenues and customers if we cannot generate timely and accurate invoices to our customers.

The accurate and prompt billing of our customers is essential to our operations and future profitability. Our CLECs utilize a third-party system for billing, tracking and customer service. Our former Chairman, who beneficially owns stock in our company, is the Chairman and CEO of our billing company, and we believe that all transactions with this company are at arms-length. The system is designed to provide us with a high degree of flexibility to handle custom rate plans that provide consumers discounts from the incumbent local carriers' rate plans or bundled plans that include various

12

features and long distance services. Although we believe the system is very functional, it is currently set up to support approximately 500,000 local lines in six states, and its ability to handle substantially more customers is not fully tested. In addition, the billing company we utilize competes with us as a CLEC and may terminate its billing services at any time. Furthermore, in the most recent quarterly financial statements of the billing company we utilize, the billing company reported a quarterly loss of $932,409 and negative working capital of $832,760, raising some doubt about its ability to continue as a going concern. This strategy exposes us to various risks that include, but are not limited to, the following:

- o the inability to adapt the billing system to process the number of customers we are targeting in our marketing plans;
- o the failure of the system to provide all of the billing services that we require;
- o the possibility that the billing company could hinder the anticipated sale of our CLECs;
- o the possibility that we may need to quickly engage a new billing company to process our invoices to our customers, and devote a large amount of internal resources at one time to work on this transition.

A portion of our business is dependent upon our ability to resell long distance services, for which we currently rely on only one third-party carrier, and any service disruption form this carrier could cause us to lose customers and revenues.

Our CLECs offer long distance telephone services as part of their service package. We currently have a wholesale agreement with only one long distance carrier to provide transmission and termination services for all of our long distance traffic. Recently, several long distance carriers have encountered financial difficulties, including the carrier utilized by us. Financial difficulties encountered by our current carrier or any other carrier with which we are negotiating could cause disruption to our operations and loss of customers and revenues.

We could be liable for breaches of security on our web site, fraudulent activities of our users, or the failure of third-party vendors to deliver credit card transaction processing services.

A fundamental requirement for operating a customer-friendly CLEC and an internet-based, worldwide voice service is the secure transmission of confidential information over public networks. Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches, failure to mitigate such fraud or breaches may adversely affect our operating results. The law relating to the liability of providers of online payment services is currently unsettled. We rely on third party providers to process and guarantee payments made by our customers up to certain limits, and we may be unable to prevent our users from fraudulently receiving goods and services. Any costs we incur as a result of fraudulent transactions could harm our business. In addition, the functionality of our current billing system relies on certain third-party vendors delivering services. If these vendors are unable or unwilling to provide services, we will not be able to charge for our services in a timely or scalable fashion.

We may face difficulties managing our anticipated rapid expansion, which would adversely affect our operations.

We are attempting to grow our business rapidly in terms of the number of services we offer, the number of customers we serve and the regions we serve. In particular, we are expending substantial sums to expand our broadband voice services, including the utilization of international routes. There can be no assurance that our marketing initiatives will proceed as expected or that they will be successful, particularly in light of the legal and regulatory and competitive uncertainties described elsewhere in this report. Furthermore, there is no assurance that we will successfully manage our efforts to:

- expand, train, manage and retain our employee base;
- expand and improve our customer service and support systems;
- introduce and market new products and services and new pricing plans;
- capitalize on new opportunities in the competitive marketplace; or
- control our expenses.

The strains posed by these new demands are magnified by the emerging nature of our operations. If we cannot manage our growth effectively, our results of operations could be adversely affected.

The failure of our customers to pay their bills on a timely basis could adversely affect our cash flow.

Our target customers consist primarily of broadband service providers. Although we required a deposit for most accounts, we give credit limits in excess of the deposited amounts and we offer payment terms. We may experience difficulty in collecting amounts due on a timely basis, especially if competition on the broadband services market becomes more intense. Our failure to collect accounts receivable owed to us by our customers on a timely basis could have a material adverse effect on our business, financial condition, results of operations and cash flow.

Acquisitions could divert management's time and attention, dilute the voting power of existing shareholders and have a material adverse effect on our business.

As part of our growth strategy, we may continue to acquire complementary businesses and assets. Acquisitions that we may make in the future could result in the diversion of time and personnel from our business. We also may issue shares of common stock or other securities in connection with acquisitions, which could result in the dilution of the voting power of existing shareholders and could dilute earnings per share. Any acquisitions would be accompanied by other risks commonly encountered in such transactions, including the following:

- difficulties integrating the operations and personnel of acquired companies;

- the additional financial resources required to fund the operations of acquired companies;

- the potential disruption of our business;

- our ability to maximize our financial and strategic position by the incorporation of acquired technology or businesses with our product and service offerings;

- the difficulty of maintaining uniform standards, controls, procedures and policies;

- the potential loss of key employees of acquired companies;

- the impairment of employee and customer relationships as a result of changes in management; and

- significant expenditures to consummate acquisitions.

As a part of our acquisition strategy, we may engage in discussions with various businesses respecting their potential acquisition. In connection with these discussions, we and each potential acquired business may exchange confidential operational and financial information, conduct due diligence inquiries, and consider the structure, terms and conditions of the potential acquisition. In certain cases, the prospective acquired business may agree not to discuss a potential acquisition with any other party for a specific period of time, may grant us certain rights in the event the acquisition is not completed, and may agree to take other actions designed to enhance the possibility of the acquisition. Potential acquisition discussions may take place over a long period of time, may involve difficult business integration and other issues, and may require solutions for numerous family relationship, management succession and related matters. As a result of these and other factors, potential acquisitions that from time to time appear likely to occur may not result in binding legal agreements and may not be consummated. Our acquisition agreements may contain purchase price adjustments, rights of set-off and other remedies in the event that certain unforeseen liabilities or issues arise in connection with an acquisition. These remedies, however, may not be sufficient to compensate us in the event that any unforeseen liabilities or other issues arise.

We need to retain key management personnel and hire additional qualified personnel. We are dependent on the efforts of our executive officers and senior management and on our ability to hire and retain qualified management personnel.

A small number of key management and operating employees and consultants manage our telecommunications business. Our loss of such employees or consultants or their failure to work effectively as a team could materially adversely impact our telecommunications business. Competition for qualified executives in the telecommunications and data communication industries is intense and there are a limited number of persons with applicable experience. We believe that our future success in the telecommunications business significantly depends on our ability to attract and retain highly skilled and qualified telecommunications personnel. We have not entered into employment agreements with any of our senior officers. The loss of any of Paul H. Riss, our Chief Executive Officer, or Mark Richards, our Chief Information Officer and the President of our Vox Communications subsidiary, or the loss of one or more programmers or engineers employed by Vox could adversely affect our business.

We may be unable to adapt to rapid technology trends and evolving industry standards, which would limit our growth.

The communications industry is subject to rapid and significant changes due to technology innovation, evolving industry standards, and frequent new service and product introductions. New services and products based on new technologies or new industry standards expose us to risks of technical or product obsolescence. We will need to use technologies effectively, continue to develop our technical expertise and enhance our existing products and services in a timely manner to compete successfully and grow our business. We may not be successful in using new technologies effectively, developing new products or enhancing existing products and services in a timely manner or that any new technologies or enhancements used by us or offered to our customers will achieve market acceptance.

15

The telecommunications industry is highly regulated and amendments to or repeals of existing regulations or the adoption of new regulations could adversely affect our business, financial condition or results of operations.

Federal, state and local regulation may affect our telecommunications business. Since regulation of the telecommunications industry is frequently changing, we cannot predict whether, when and to what extent new regulations will affect us. The following factors, among others, may adversely affect our business, financial condition and results of operations:

- delays in obtaining required regulatory approvals;
- new court decisions;
- the enactment of new adverse regulations; and
- the establishment of strict regulatory requirements.

The communications services industry is highly competitive and we may be unable to compete effectively, which could delay or prevent our future profitability.

The communications industry, including Internet and data services, is highly competitive, rapidly evolving and subject to constant technological change and intense marketing by providers with similar products and services. We expect that new competitors are likely to join existing competitors in the communications industry, including the market for broadband voice, Internet and data services. Many of our current competitors are significantly larger and have substantially greater market presence, as well as greater financial, technical, operational, marketing and other resources and experience, than we do. In the event that such a competitor expends significant sales and marketing resources in one or several markets, we may not be able to compete successfully in such markets. We believe that competition will continue to increase, placing downward pressure on prices. Such pressure could adversely affect our gross margins if we are not able to reduce our costs commensurate with such price reductions. In addition, the pace of technological change makes it impossible for us to predict whether we will face new competitors using different technologies to provide the same or similar services offered or proposed to be offered by us. If our competitors were to provide better and more cost effective services than ours, our business initiatives could be materially and adversely affected.

Industry consolidation could make it more difficult for us to compete and limit our growth.

Companies offering Internet, data and communications services are, in some circumstances, consolidating. We may not be able to compete successfully with businesses that have combined, or will combine, to produce companies with substantially greater financial, sales and marketing resources, larger client bases, extended networks and infra-structures and more established relationships with vendors, distributors and partners than we have. With these heightened competitive pressures, there is a risk that our financial performance could be adversely impacted and the value of our common stock could decline.

Our inability to adjust to new product developments and rapid technological changes would negatively impact our ability to grow our broadband voice business.

IP telephony is an emerging market that is characterized by rapid changes in customer requirements, frequent introductions of new and enhanced products, and continuing and rapid

technological advancement. To compete successfully in this emerging market, we must continue to design, develop and sell new and enhanced software products and services that provide increasingly higher levels of performance and reliability at lower cost. These new and enhanced products must take advantage of technological advancements and changes, and respond to new customer requirements. Our success in designing, developing and selling such products and services will depend on a variety of factors, including:

- the identification of market demand for new products;
- the scalability of our IP telephony software products;
- product and feature selection;
- timely implementation of product design and development;
- product performance;
- cost-effectiveness of products under development;

- effective distribution processes; and

- success of promotional efforts.

Additionally, we may also be required to collaborate with third parties to develop our products and may not be able to do so on a timely and cost-effective basis, if at all. We have in the past experienced delays in the development of new products and the enhancement of existing products, and such delays will likely occur in the future. If we are unable, due to resource constraints or technological or other reasons, to develop and introduce new or enhanced products in a timely manner, if such new or enhanced products do not achieve sufficient market acceptance, or if such new product introductions decrease demand for existing products, our operating results would decline and our business would not grow.

If broadband voice technology fails to gain acceptance among mainstream consumers, our ability to grow our business will be limited.

If the market for IP-based communications and the related services that we will make available does not grow at the rate we anticipate or at all, we will not be able to realize our anticipated revenues with respect to our broadband phone service. To be successful, IP-based communications require validation as an effective means of communication and as a viable alternative to traditional phone service. Demand and market acceptance for newly introduced services are subject to a high level of uncertainty. The Internet may not prove to be a viable alternative to traditional phone service for reasons including:

- inconsistent quality or speed of service;

- traffic congestion on the Internet;

- potentially inadequate development of the necessary infrastructure;

- lack of acceptable security technologies;

- lack of timely development and commercialization of performance improvements; and

- unavailability of cost-effective, high-speed access to the Internet.

Future legislation or regulation of the Internet and/or broadband voice services could restrict our business, prevent us from offering service or increase our cost of doing business.

At present there are few laws, regulations or rulings that specifically address access to or commerce on the Internet, including broadband voice services. We are unable to predict the impact, if any, that future legislation, legal decisions or regulations concerning the Internet may have on our business, financial condition or results of operations. Regulation may be targeted toward, among other things, assessing access or settlement charges, imposing taxes related to Internet communications, imposing tariffs or regulations based on encryption concerns or the characteristics and quality of products and services, imposing additional regulations and requirements related to the handling of emergency 911 services, any of which could restrict our business or increase our cost of doing business. The increasing growth of the broadband voice services market and popularity of a variety of new wireless IP products and services heighten the risk that governments or other legislative bodies will seek to further regulate IP telephony and the Internet. In addition, large, established telecommunication companies may devote substantial lobbying efforts to influence the regulation of the broadband IP telephony market, which may be contrary to our interests.

Many regulatory actions are underway or are being contemplated by federal and state authorities, including the FCC and other state regulatory agencies. There is risk that a regulatory agency may require us to conform to rules that are unsuitable for broadband voice communications technologies or rules that cannot be complied with due to the nature and efficiencies of IP routing, or are unnecessary or unreasonable in light of the manner in which we offer service to our customers. It is not possible to separate the Internet, or any service offered over it, into intrastate and interstate components. While suitable alternatives may be developed in the future, the current IP network does not enable us to identify the geographic nature of the traffic traversing the Internet.

Our emergency calling services are different from those offered by traditional wireline telephone companies and may expose us to significant liability.

Our 911 calling service is more limited, in certain areas, than the emergency calling services offered by traditional wireline telephone companies. In each case, those differences may cause significant delays, or even failure, in a caller's receipt of the emergency assistance he or she needs.

Traditional wireline telephone companies route emergency calls over a dedicated infrastructure directly to an emergency services dispatcher at the public safety answering point, or PSAP, in the caller's area. Generally, the dispatcher automatically receives the caller's phone number and actual location information. While our 911 service being deployed in the United States is designed to route calls in a fashion similar to traditional wireline services, our 911 capabilities may not reach the intended PSAP, although we do have procedures in place to ensure that a dispatcher somewhere is reached. In addition, the only location information that our E911 service can transmit to a dispatcher at a PSAP is the information that our customers have registered with us. A customer's registered location may be different from the customer's actual location at the time of the call because customers can use their enabled ATA device to make calls almost anywhere a broadband connection is available. In such cases, as described below, we offer customers alternative access to emergency services.

We are also providing E911 service that is comparable to the emergency calling services obtained by customers of traditional wireline telephone companies in the same area. For those customers, emergency calls are routed, subject to the limitations discussed below, directly to an emergency services dispatcher at the PSAP in the area of the customer's registered location. The dispatcher will have automatic access to the customer's telephone number and registered location information. However, if a customer places an emergency call using the customer's enabled ATA device and the device is in a location different from the one registered with us, the E911 system will still route the call to a dispatcher in the registered location, not the customer's actual location at the time of the call. Every time a customer moves his or her enabled ATA device to a new location, the customer's registered location information must be updated and verified. Until that takes place, the customer will have to verbally advise the emergency dispatcher of his or her actual location at the time of the call and wait for the call to be transferred, if possible, to the appropriate local emergency response center before emergency assistance can be dispatched.

In some cases, even under our E911 service, emergency calls may be routed to a local PSAP, designated statewide default answering point or appropriate local emergency authority that is not capable of receiving our transmission of the caller's registered location information and, in some cases, the caller's phone number. Where the emergency call center is unable to process the information, the caller is provided a service that is similar to the basic 911 services offered to some wireline telephone customers. In these instances, the emergency caller may be required to verbally advise the operator of his or her location at the time of the call and, in some cases, a call back number so that the call can be handled or forwarded to an appropriate emergency dispatcher. We are continuing our efforts to deploy our E911 service such that all relevant information is displayed and will be routed to the appropriate PSAP in the first instance.

Customers who are located in areas in which we are currently unable to provide either E911 or the basic 911 described above, as well as WiFi telephone and SoftPhone users, are supported by a national call center that is run by a third-party provider and operates 24 hours a day, seven days a week. When reaching the call center, a caller must provide his or her physical location and call back number, after which an operator will coordinate connecting the caller to the appropriate PSAP or emergency services provider.

Our softswitching platform and back office systems are technologically advanced and the essential service delivery of providing emergency call handling is of paramount importance to us. We have developed a web portal where subscribers can maintain the flexibility of providing us with a currently correct physical location should they take the ATA device away from the registered location. We cannot guarantee they will actually remember to enter this information in the web portal when they move their ATA device, and if they do not make this update, the emergency call will be routed to the address that was previously notified. This flexibility, along with the ability to call into our customer support call center to update the address, is compliant with the current requirements of the FCC regarding emergency calling.

If one of our customers experiences a broadband or power outage, or if a network failure were to occur, the customer will not be able to reach an emergency services provider.

Delays our customers encounter when making E911 or basic 911 calls and any inability of the answering point to automatically recognize the caller's location or telephone number can have devastating consequences. Customers may in the future attempt to hold us responsible for any loss, damage, personal injury or death suffered as a result. Some traditional telephone companies also may be

19

unable to provide the precise location or the caller's telephone number when their customers place emergency calls. However, while we are not covered by legislation exempting us from liability for failures of our emergency calling services, traditional telephone companies are covered. This liability could be significant. In addition, we have lost, and may in the future lose, existing and prospective customers because of the limitations inherent in our emergency calling services. Any of these factors could cause us to lose revenues, incur greater expenses or cause our reputation or financial results to suffer.

The success of our planned expansion is dependent upon market developments and usage patterns which are needed in order for us to efficiently utilize our network equipment.

Our purchase of network equipment and placement of our IP telephony software will be based in part on our expectations concerning future revenue growth and market developments. As we expand our network, we will be required to make capital expenditures, in addition to making financial commitments for DS-3 circuits and colocation space, and to add additional employees. If our traffic volume were to decrease, or fail to increase to the extent expected or necessary to make efficient use of our network, our costs as a percentage of revenues would increase significantly, which would have a materially adverse effect on our financial condition and results of operations.

Regulation of VoIP services is developing and therefore uncertain, and future legislative, regulatory or judicial actions could adversely impact our business and expose us to liability.

To date, the FCC has treated Internet service providers as information service providers. Information service providers are currently exempt from federal and state regulations governing common carriers, including the obligation to pay access charges. The FCC is currently examining the status of Internet service providers and the services they provide. If the FCC were to determine that Internet service providers, or the services they provide, are subject to FCC regulation, including the payment of access charges or other fees, it could have a material adverse effect on our business, financial condition and operating results.

If our network is unable to handle a large number of simultaneous calls, our growth will be limited.

We expect the volume of simultaneous calls to increase significantly as our broadband voice subscriber base grows. Our network hardware and software may not be able to accommodate this additional volume. If we fail to maintain an appropriate level of operating performance, or if our broadband voice service is disrupted, our reputation could be hurt and we could lose customers, which could have a material adverse effect on our business, financial condition and results of operations.

Our growth in our broadband voice business is dependent upon our ability to build new relationships with a wide range of other carriers and to bring on new customers.

Our ability to grow through quick and cost effective deployment of our broadband voice services is due, in part, to our ability to create new agreements with other carriers that can provide us with telephone numbers and termination service. We also will need to sign contracts with new customers, and, in many cases, to enter into joint venture or strategic agreements with local partners, as well as to satisfy newly enacted regulatory requirements to operate in emerging markets. While we pursue several opportunities simultaneously, we might not be able to create the necessary partnerships and interconnections, expand our customer base, deploy networks and generate profitable traffic over these networks within the time frame envisioned.

20

We are pursuing new business lines that require specialized skill sets. Our ability to effectuate our business plan is due, in part, to the roll out of new services.

Our ability to deploy new products and services may be hampered by technical and operational issues that could delay our ability to derive profitable revenue from these service offerings. These issues include our ability to competitively price such products and services. In addition, certain broadband voice service offerings are relatively new in our industry and their market potential is relatively untested. Additionally, our ability to market these products and service offerings may prove difficult. To date, our customers use only approximately 3,000,000 minutes per month on our IP network. As a result we have derived limited revenue from our broadband voice service offerings, and there can be no assurance that we will increase our current focus and/or derive significant revenue from such offerings.

We rely on third party equipment suppliers and the failure of such equipment could cause interruptions of our service, damage our reputation, cause us to lose customers and limit our growth.

We are dependent on third party equipment suppliers for equipment, IP phones and adapter devices, including companies such as UTStarcom Inc., and Cisco Systems, Inc. If these suppliers fail to continue product development or research and development or fail to deliver quality products or support services on a timely basis, or we are unable to develop alternative sources, if and as required, our financial condition or results of operations could be materially adversely impacted.

We may not be able to maintain adequate customer care during periods of growth or in connection with our addition of new and complex IP devices, which could adversely affect our ability to grow and cause our financial results to be negatively impacted.

Good customer care is important to acquiring and retaining customers. As we continue to grow our broadband voice business, we will need to expand our customer care operations quickly enough to meet the needs of our increased customer base. We may face additional challenges in training our customer care staff. If we are unable to hire, train and retain sufficient personnel to provide adequate customer care, we may experience slower growth, increased costs and higher churn levels, which would cause our financial results to be negatively impacted.

If we are unable to improve our process for local number portability provisioning, our growth may be negatively impacted.

We support local number portability for our customers, which allow our customers to retain their existing telephone numbers when subscribing to our services. Transferring numbers is a manual process that in the past could have taken us 20 business days or longer, although we have taken steps to automate this process to reduce the delay. A new VoX customer must maintain both VoX service and the customer's existing telephone service during the transferring process. By comparison, transferring wireless telephone numbers among wireless service providers generally takes several hours, and transferring wireline telephone numbers among traditional wireline service providers generally takes a few days. The additional delay that we experience is due to our reliance on the telephone company from which the customer is transferring and to the lack of full automation in our process. Further, because VoX is not a regulated telecommunications provider, it must rely on the telephone companies, over whom we have no control, to transfer numbers. Local number portability is considered an important feature by many potential customers, and if we fail to reduce related delays, we may experience increased difficulty in acquiring new customers.

Our failure to adequately protect our proprietary rights may adversely affect our business, increase our costs and limit our sales growth.

We rely on unpatented trade secrets and know-how to maintain our competitive position. Our inability to protect these secrets and know-how could have a material adverse effect on our business and prospects. We protect our proprietary information by entering into confidentiality agreements with employees and consultants and business partners. These agreements may be breached or terminated. In addition, third parties, including our competitors, may assert infringement claims against us. Any of such claims could result in costly litigation, divert management's attention and resources, and require us to pay damages and/or to enter into license or similar agreements under which we could be required to pay license fees or royalties.

Flaws in our technology and systems could cause delays or interruptions of service, damage our reputation, cause us to lose customers and limit our growth.

Our operations depend upon our ability to support a highly complex network infrastructure and avoid damage from fires, earthquakes, floods, power losses, excessive sustained or peak user demand, telecommunications failures, network software flaws, computer worms and viruses, transmission cable cuts and similar events. The occurrence of a natural disaster or other unanticipated interruption of service at our facilities could cause interruptions in our services. In addition, failure of a traditional telephone company, competitive telecommunications company or other service provider to provide communications capacity or other services that we require, as a result of a natural disaster or other unanticipated interruptions, operational disruption or any other reason, could cause interruptions in our services. Any damage or failure that causes sustained interruptions in our operations could have a material adverse effect on our business.

A breach of our network security could result in liability to us and deter customers from using our services

Our network may be vulnerable to unauthorized access, computer viruses and other disruptive problems. Any of the foregoing problems could result in liability to us and deter customers from using our service. Unauthorized access could jeopardize the security of confidential information stored in the computer systems of our customers. Eliminating computer viruses and alleviating other security problems may require interruptions, delays or cessation of service to our customers, cause us to incur significant costs to remedy the problem, and divert management's attention. We can provide no assurance that the security measures we have implemented will not be circumvented or that any failure of these measures will not have a material adverse effect on our ability to obtain and retain customers. Any of these factors could have a material adverse effect on our business and prospects.

We may not be able to obtain sufficient or cost-effective termination capacity to particular destinations, causing us to lose customers and limit our growth.

Most of our telecommunications traffic is terminated through third-party providers. In order to support our minutes-of-use demands and geographic expansion, we may need to obtain additional termination capacity or destinations. We may not be able to obtain sufficient termination capacity from high-quality carriers to particular destinations or may have to pay significant amounts to obtain such capacity. This could result in our not being able to support our minutes-of-use demands or in a higher cost-per-minute to particular destinations, which could adversely affect our revenues and margins.

We are subject to acts of God, war, sabotage and terrorism risk.

Acts of God, war, sabotage and terrorist attacks or any similar risk may affect our operations in unpredictable ways, including disruptions of the behavior of our customers, changes in the insurance markets and disruptions of markets. Acts of God, war and risk of war also have an adverse effect on the economy. Instability in the financial markets as a result of war, sabotage or terrorism could adversely affect our ability to raise capital, as well as adversely affect the industries in which we do business and restrict their future growth.

Risks Relating to Our Common Stock

Disappointing quarterly revenue or operating results could cause the price of our common stock to fall.

Our quarterly revenue and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. If our quarterly revenue or operating results fall below the expectations of investors or security analysts, the price of our common stock could fall substantially. Our quarterly revenue and operating results may fluctuate as a result of a variety of factors, many of which are outside our control, including:

- the amount and timing of expenditures relating to the rollout of our service offerings;
- our ability to obtain, and the timing of, necessary regulatory approvals;
- the rate at which we are able to attract customers within our target markets and our ability to retain these customers at sufficient aggregate revenue levels;
- our ability to deploy our network on a timely basis;
- the availability of financing to continue our expansion;
- technical difficulties or network downtime;
- the timing of the implementation of additional points of presence for our IP services; and
- the introduction of new services or technologies by our competitors and resulting pressures on the pricing of our service.

We do not intend to pay dividends on our common stock in the foreseeable future, which could cause the market price of our common stock and the value of your investment to decline.

We expect to retain earnings, if any, to finance the expansion and development of our business. Our Board of Directors will decide whether to make future cash dividend payments. Such decision will depend on, among other things, the following factors:

- our earnings;
- our capital requirements;
- our operating condition;
- our financial condition; and

- our compliance with various financing covenants to which we are or may become a party. Our agreement with our primary lender currently precludes the payment of dividends.

The market for our common stock is thinly traded, which could result in fluctuations in the value of our common stock.

Although there is a public market for our common stock, the market for our common stock is thinly traded. The trading prices of our common stock could be subject to wide fluctuations in response to, among other events and factors, the following:

- variations in our operating results;
- sales of a large number of shares by our existing shareholders;
- announcements by us or others;
- developments affecting us or our competitors; and
- extreme price and volume fluctuations in the stock market.

Our common stock price is likely to be highly volatile, which could cause the value of your investment to decline.

The market price of our common stock is likely to be highly volatile as the stock market in general, and the market for small cap and micro cap technology companies in particular, has been highly volatile. For example, during the last 12 months our common stock has traded at prices ranging from $0.16 to $0.50 per share. Investors may not be able to resell their shares of our common stock following periods of volatility because of the market's adverse reaction to volatility. We cannot assure you that our common stock will trade at the same levels of our stocks in our industry or that our industry stocks in general will sustain their current market prices. Factors that could cause such volatility may include, among other things:

- actual or anticipated fluctuations in our quarterly operating results;
- large purchases or sales or our common stock;
- announcements of technological innovations;
- changes in financial estimates by securities analysts;
- investor perception of our business prospects;
- conditions or trends in the telecommunications industry;
- changes in the market valuations of other industry-related companies;

- the acceptance of market makers and institutional investors of our business model and our common stock; and
- worldwide economic or financial conditions.

Effect of certain charter provisions could cause the value of your investment to decline.

Authority of Board of Directors to Issue Preferred Stock. Pursuant to the terms of our charter, our Board of Directors has the authority to issue up to 1,000,000 shares of preferred stock in one or more series. Our Board of Directors may also determine the prices, rights, preferences, privileges and restrictions, including voting rights, of the shares within each series without any further shareholder vote or action. The rights of the holders of our preferred stock may adversely affect the rights of the holders of common stock. While the issuance of such preferred stock could facilitate possible acquisitions and other corporate activities, it could also impede a third party's ability to acquire control of our company.

Limitation of Liability of Directors. Pursuant to the terms of our charter and to the extent New York law permits, we and our shareholders may not hold our directors personally liable for monetary damages in the event of a breach of fiduciary duty.

Provisions of New York law may discourage a takeover attempt even if doing so may be beneficial to our shareholders.

Certain anti-takeover provisions of New York law could delay or hinder a change of control of our company. While such provisions generally facilitate our Board of Directors' ability to maximize shareholder value, they may discourage takeovers that could be in the best interest of certain shareholders. Such provisions could adversely affect the market value of our stock in the future.

We are exposed to potential risks from recent legislation requiring companies to evaluate internal controls under Section 404 of the Sarbanes Oxley Act of 2002 which could adversely affect our financial results and cause or stock price to decline.

We are evaluating and documenting our internal controls systems so that when we are required to do so, our management will be able to report on, and our independent auditors to attest to, our internal controls, as required by this legislation. We will be performing the system and process evaluation and testing (and any necessary remediation) required in an effort to comply with the management certification and auditor attestation requirements of Section 404 of the Sarbanes Oxley Act. As a result, we expect to incur additional expenses and diversion of management's time. We have reported material weaknesses and significant deficiencies in our disclosure controls and procedures and our internal control over financial reporting because of a deficiency in the number of qualified personnel in our accounting department. While we anticipate being able to rectify this weakness and to fully implement the requirements relating to internal controls and all other aspects of Section 404 in a timely fashion, we cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations. If we are not able to implement the requirements of Section 404 in a timely manner or with adequate compliance, we might be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission. Any such action could adversely affect our financial results and could cause our stock price to decline.

Item 1B. Unresolved Staff Comments

None.

Item 2. - Properties

The following table sets forth pertinent facts concerning our office leases at February 15, 2006.

Location	Use	Approximate Square Feet	Annual Rent
75 South Broadway White Plains, NY 10601	Office	4,000	$79,000
118 Celebration Avenue Celebration, FL 34747	Office	2,000	$54,000

The lease for our office space in White Plains, New York is a five-year lease that began on December 1, 2003 and our lease for our office space in Celebration, Florida is a three-year lease that began on February 1, 2005. We also lease colocation space in two locations in Orlando that are subject to written agreements that are renewable each year. We believe we will need to lease additional office space of between 6,000 and 10,000 square feet to meet our operating needs in fiscal 2007. We have been considering leases in Orlando, Florida with annual rentals between approximately $100,000 and $150,000.

Item 3. - Legal Proceedings

We are subject to legal proceedings and claims that arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability, if any, is not likely to have a material effect on our financial condition, results of operations or liquidity. However, as the outcome of litigation or legal claims is difficult to predict, significant changes in exposures could occur.

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

None.

PART II

Item 5. - Market for Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock currently trades on The OTC Bulletin Board(R) ("OTCBB") under the symbol ELEC. The high and low closing price for each quarterly period of our last two fiscal years are listed below:

	High	Low
Fiscal 2005		
1st Quarter	$0.74	$0.28
2nd Quarter	0.69	0.35
3rd Quarter	0.58	0.36
4th Quarter	0.53	0.35
Fiscal 2006		
1st Quarter	$0.48	$0.37
2nd Quarter	0.50	0.35
3rd Quarter	0.40	0.25

4th Quarter	0.27	0.17

The quotations set forth in the table above reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions. As of February 15, 2007, there were 190 holders of record of our common stock and approximately 3,000 beneficial holders.

We have never paid dividends on our common stock and do not expect to do so in the foreseeable future. Our loan agreements with Laurus do not allow us to directly or indirectly declare or pay any dividends so long as certain amounts of our secured convertible term notes to Laurus remain outstanding.

The following table provides information as of November 30, 2006 with respect to shares of our common stock that are issuable under equity compensation plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of remaining a future iss equity co plans (e securities colum (
Equity compensation plans approved by security holders:			
1995 Stock Option Plan(1)	810,500	$0.28	
1996 Restricted Stock Plan(2)	-		
Subtotal	810,500		
Equity compensation plans not approved by security holders:			
Employee stock options	1,900,000	0.24	
2004 Equity Incentive Plan(3)	708,000	0.39	
Laurus Master Fund, Ltd.(4)	5,837,434	0.20	
Source Capital Group, Inc.(4)	1,347,234	0.36	
Institutional Marketing Services, Inc. (5)	100,000	0.63	
Capital TT, LLC(6)	150,000	0.63	
Subtotal	10,042,668		
Total	10,853,168		

----

(1) Options are no longer issuable under our 1995 Stock Option Plan.

(2) Our Restricted Stock Plan provides for the issuance of restricted share grants to officers and non-officer employees.

(3) Our 2004 Equity Incentive Plan allows for the granting of share options to members of our board of directors, officers, non-officer employees and consultants.

(4) Warrants were issued in conjunction with financings provided by Laurus Master Fund, Ltd.

(5) Warrants were granted for investor relation services.

(6) Warrants were issued for consulting services.

Item 6. - Selected Financial Data

The following selected financial information has been taken from our consolidated financial statements. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements and related notes included elsewhere in this Report.

(In thousands, except per share amounts)	Fiscal Years Ended November 30,				
	2006	2005	2004	2003	2002
Selected Income Statement Data					
Net Sales	$ 8,357	$ 15,881	$ 9,558	$ 5,568	$ 14,2
Gross Profit	3,227	7,279	4,820	2,802	5,2
Earnings (Loss)	(2,345)	(2,266)	170	8,323	(3,3
Earnings (Loss) per Common Share:					
Basic	(0.14)	(0.14)	0.01	0.53	(0.
Diluted	(0.14)	(0.14)	0.01	0.53	(0.
Cash Dividends	--	--	--	--	
Selected Balance Sheet Data					
Working Capital Deficiency	$ (5,087)	$ (974)	$ (1,939)	$ (1,938)	$(11,2
Property, Plant and Equipment	903	594	192	25	1,8
Total Assets	4,188	4,385	1,904	1,637	4,8
Long-Term Debt (Less Current Maturities)	215	2,722	--	--	1,1
Stockholders' Equity Deficiency	(4,249)	(2,364)	(1,696)	(1,864)	(10,1

Item 7. - Management's Discussion and Analysis of Financial Condition and Results of Operation

Certain statements set forth below under this caption constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Please refer to page 1 of this Report for additional factors relating to such statements.

Overview

We have operated as a telephone service provider since 1998. We built our telephony business by leasing lines from incumbent local exchange carriers and reselling their services, while maintaining the vision of becoming a carrier that provides voice services over the Internet. We have succeeded in our efforts to transition to a facilities-based broadband voice provider, and we currently offer telephony services over the Internet or over a wireline. We offer our Internet services throughout the United States and in many foreign countries, whereas our wireline services are offered only in the States of Pennsylvania, New Jersey and New York. Our IP technology enables voice communications over the Internet through the conversion of voice signals into data packets. In order to use our broadband voice service, customers must have access to a high-speed Internet connection. We believe broadband voice services utilize a technology that is so invasive, that we have entered into a definitive purchase agreement to sell our wireline business.

The roll-out of our broadband voice product has taken significantly longer than we anticipated. A key reason for the delay was the extensive effort required for us to become a customized wholesale service provider. Because of the intense competition on the retail level and the high marketing costs that broadband voice providers have incurred to acquire a subscriber, we decided that we should not compete in the retail arena. Our goal is to obtain 500 customers that will private label and resell our broadband voice services to their customer base. We target cable operators that already are providing broadband Internet services, Internet service providers, WiFi and fixed wireless broadband providers, data integrators, value-added resellers, and satellite broadband providers. We anticipate that our wholesale customers will be able to obtain an average of at least 1,000 broadband voice end-users. We believe our approach, in which we are seeking 500 customers that we will manage, and a total of at least 500,000 end users, which our customers will manage, will provide us with the quickest and least expensive way of leveraging our technology. Under our approach, we will avoid the expensive customer acquisition costs that other broadband voice carriers are experiencing as they try to find a broadband end-user to try their product. Instead of us incurring this cost, our customer, who should be able to incur a reduced marketing expense because it has an imbedded customer base already buying broadband service, incurs it. We believe we can empower small and medium-sized broadband providers with the ability to take customers away from the traditional telephone companies.

Through February 15, 2007, we have signed agreements with 59 wholesale customers. We categorize them as 22 resellers, 14 agents, seven CLECs, five cable operators, four ISPs, four data integrators and three ASPs. The resellers include other broadband voice carriers that use our platform and the agents include CompUSA, which is selling our product in its stores in Puerto Rico. We do not anticipate large volumes of traffic from the CLECs, at least not initially, because they are the least likely to market our product to their existing customer bases. If a CLEC sells broadband voice services to an existing telephone customer, it will reduce the sales dollars and gross margin dollars that its existing customer is generating. We find that CLECs try to market the broadband voice services to end-users who are not existing customers, and thus they incur significantly higher marketing costs, similar to the way Vonage has to incur these costs, in order to sign up a new subscriber that had no prior relationship with the company. In general, we anticipate that our customers who are cable operators, resellers and ISPs will be more successful in generating sales of our broadband voice product without overspending to complete the sale.

Some of our wholesale accounts experience delays before they develop and execute their marketing plans. We provide the technology and the technical assistance they need to offer a broadband voice product. We also give them suggested marketing information and customer service training to encourage them to begin selling the broadband voice product immediately, but we cannot control the marketing budget, the personnel resources or the timing of the launch of their broadband voice services. As of February 15, 2007, we have billed 31 of our 59 accounts. 28 accounts had not yet turned up our service. We anticipate that some of our wholesale customers will never actually sell our service. We are optimistic that our broadband voice services are beginning to generate the rapid sales growth we have been anticipating, as we have one account that is sending us orders for approximately 20 new lines a day and we have similar accounts testing our services. We have completed a successful trial agreement in which a restaurant chain with 11,000 locations used our broadband voice service, and we are negotiating to add them as a customer. We are also attracting customers who do not require an ATA, but are using our services for minutes only, which we can provide at competitive rates for certain routes. Furthermore, we recently secured a wholesale customer who sells broadband over power lines.

Revenues

Revenues consist of telephony services revenue and customer equipment revenue.

Telephony services revenue. Substantially all of our operating revenues are telephony services revenue. We offer several bundled plans, unlimited plans and basic plans for residential and business customers. Each of our unlimited plans offers unlimited domestic calling, subject to certain restrictions, and each of our basic plans offers a limited number of calling minutes per month. Under our basic plans, we charge on a per minute basis when the number of calling minutes included in the plan is exceeded for a particular month. For all of our U.S. plans, we charge on a per minute basis for international calls to destinations other than Canada. These per minute fees are not included in our monthly subscription fees. Any plan we offer to individual end-users is also available to our wholesale customers at a reduced rate.

We derive most of our telephony services revenue from monthly subscription fees we charge our customers under our service plans. We also offer a fax service over broadband, virtual phone numbers, toll free numbers and other services, for each of which we may charge an additional monthly fee. We automatically charge service fees monthly in advance to the credit cards of all of our broadband voice retail customers and approximately 10% of our wireline customers. We automatically charge the per minute fees not included in our monthly subscription fees to our customers' credit cards monthly in arrears unless they exceed a certain dollar threshold, in which case they are charged immediately.

By collecting monthly subscription fees in advance and certain other charges immediately after they are incurred, we are able to reduce the amount of accounts receivable we have outstanding, which lowers our working capital requirements. Collecting fees and charges in this manner also helps us mitigate bad debt exposure and is one of the industry-accepted practices for broadband voice services. Approximately 90% of our leased wireline customers do not pay by credit card and are mailed an invoice that is due within 25 days. We have experienced growth periods with significant bad debts from wireline customers. We do not anticipate the same level of bad debt exposure in our broadband voice service offerings, as our wholesale customers are required to place a one-month deposit and our retail customers are required to pay by credit card. If a customer's credit card is declined, we generally suspend international calling capabilities as well as the customer's ability to incur domestic usage charges in excess of its plan minutes. Historically, in most cases, we are able to correct the problem with the

customer within the current monthly billing cycle. If a customer's credit card cannot be successfully processed during the current month's billing cycle, we generally terminate the account.

We also generate revenue by charging a fee for activating service. Further, we generally charge a disconnect fee to customers who do not return their ATA to us upon termination of service, if the length of time between activation and termination is less than one year. Disconnect fees are recorded as revenue and are recognized at the time the customer terminates service. These revenues were nominal in fiscal 2006.

Telephony services revenue is offset by the cost of certain customer acquisition activities, such as rebates and promotions.

Customer equipment revenue. Customer equipment revenue consists of revenue from sales of customer equipment to our wholesalers or directly to customers. In addition, customer equipment revenue includes the fees we charge our customers for shipping any equipment to them. These revenues were nominal in fiscal 2006.

Cost of Revenues

Direct cost of telephony services. Direct cost of telephony services primarily consists of fees that we pay to third parties on an ongoing basis in order to provide our services. These fees include:

o Usage charges and line and port costs from reselling wireline service of incumbent carriers.

o Access charges we pay to other telephone companies to terminate broadband voice calls on the public switched telephone network ("PSTN"). When a VoX subscriber calls another VoX subscriber, we do not pay an access charge, as the call routes through our network without touching the PSTN.

o The cost of leasing interconnections to route calls over the Internet and transfer calls between the Internet and the PSTN of various long distance carriers.

o The cost of leasing from other telephone companies the telephone numbers we provide to our customers. We lease these telephone numbers on a monthly basis.

o The cost of co-locating our connection point equipment in third-party facilities owned by other telephone companies.

o The cost of providing local number portability, which allows customers to move their existing telephone numbers from another provider to our service. Only regulated telecommunications providers have access to the centralized number databases that facilitate this process. Because VoX is not a regulated telecommunications provider, we must pay other telecommunications providers to process our local number portability requests.

o The cost of complying with the new FCC regulations regarding emergency services, which require us to provide enhanced emergency dialing capabilities to transmit 911 calls for all of our customers. This cost may increase in future periods.

o Taxes we pay on our purchases of telecommunications services from our suppliers.

32

Direct cost of customer equipment and shipping. Direct cost of goods sold primarily consists of costs we incur when a customer first subscribes to our service. These costs include:

o The cost of the equipment we provide to customers who subscribe to our service through our direct sales channel, in each case in excess of activation fees.

o The cost of shipping and handling for customer equipment, together with the installation manual, we ship to customers.

Results of Operations

Fiscal Year 2006 Compared to Fiscal Year 2005

Our revenues for fiscal 2006 decreased by approximately $7,524,000, or approximately 47%, to approximately $8,357,000 as compared to approximately $15,881,000 reported for fiscal 2005. The decrease in revenues was directly related to the cessation of our marketing program for new wireline customers, as we did not have new wireline customers to replace the normal monthly churn of our existing wireline customers. In conjunction with our decision to become a wholesale broadband voice provider, almost all of our marketing efforts are focused on attracting broadband voice customers. We anticipate we will be able to sell our wireline business, as planned, in April 2007. Thereafter, all of our revenue will come from IP telephony services. As noted above, we are beginning to experience more rapid month-to-month sales growth in this area. We do not control, however, the marketing dollars of our wholesale customers or the timing of their marketing efforts. Consequently, we are unable to model or predict the future sales growth in our broadband telephony business.

Our gross profit for fiscal 2006 decreased by approximately $4,052,000 to approximately $3,227,000 from approximately $7,279,000 reported in fiscal 2005, while our gross profit percentage of 38.6% in fiscal 2006, as compared to 45.8% in fiscal 2005, decreased by 7.2 percentage points primarily due to the higher fees we were charged for leasing lines and ports from Verizon Services Corp. ("Verizon"). The decrease in our dollars of gross profit resulted from the decrease in our customer base in fiscal 2006 over fiscal 2005. Our gross profit percentage of approximately 38.6% included fixed network costs for our IP telephony network that we were not able to recover based upon the limited sales dollars we achieved for broadband voice services in fiscal 2006. If we are successful in selling our wireline business in fiscal 2007, we anticipate that our gross margins will be significantly lower because we employ a wholesale model for our broadband voice business. As a wholesaler, we will not be able to enjoy the same mark-up that a retail seller can achieve. However, on an operating basis, the lower margin should be offset by significantly lower customer service and customer acquisition costs.

Selling, general and administrative expenses ("SG&A") decreased by approximately $1,079,000, or approximately 18.4%, to approximately $4,794,000 for fiscal 2006 from approximately $5,873,000 reported in the prior year fiscal period. Of this decrease, approximately $935,000 was for marketing expense, approximately $339,000 was for billing costs, offset by increased personnel costs of approximately $117,000. Bad debt expense decreased by approximately $3,440,000, or approximately 95%, to approximately $172,000 in fiscal 2006 from approximately $3,612,000 in fiscal 2005. From January 2005 until mid-April 2005, our CLECs attracted an unusually high number of residential consumers that did not pay our invoices, and for which we subsequently terminated services, even though such customers had qualifying credit scores. We discontinued most of our marketing efforts for new CLEC customers and concentrated on attracting broadband voice customers in fiscal 2006. With our existing CLEC customer base and with our broadband voice customers, we anticipate minimal bad debt expense, as our CLEC customers are an embedded customer base that has historically paid its bills, and

our broadband voice customers are primarily wholesale accounts, which are credit checked and required to pay us a deposit for future services.

Depreciation and amortization expense increased by approximately $351,000 to approximately $547,000 for fiscal 2006 as compared to approximately $196,000 for the prior fiscal year. Approximately $241,000 of the increase was for deferred financing costs related to the Laurus financings we completed in November 2005 and May 2006 (See Note 8) and approximately $102,000 related to an increase in depreciation of our IP platform.

Interest expense increased by approximately $474,000 to approximately $1,156,000 for the year ended November 30, 2006 as compared to approximately $682,000 for the prior fiscal year, primarily as a result of increased borrowings under our financing agreements (See Note 8).

Other income amounted to approximately $108,000 for the year ended November 30, 2006 as compared to $66,000 for the prior fiscal year. In both years, other income resulted primarily from commission income. For fiscal 2006, other income also included approximately $36,000 for the reduction of a liability previously accrued and $13,000 of miscellaneous refunds.

For the year ended November 30, 2006, we recorded income of approximately $990,000, an increase of approximately $813,000 over fiscal 2005 amounts of approximately $177,000, which resulted from the change in the market value of the warrants issued to Laurus as part of the Laurus financing (See Note 8). The increase in income in fiscal 2006 was a direct result of a larger decrease in the market value of our common stock at the end of fiscal 2006, as compared to the decrease in fiscal 2005.

For the fiscal year ended November 30, 2005, we recorded a gain on the sale of investment securities and other investments of approximately $378,000. No gains were recorded in fiscal 2006. In fiscal 2005, the gain resulted from the sale of shares of Cordia Corporation of approximately $160,000 and Talk America Holding, Inc. warrants of approximately $218,000.

In fiscal 2005, we reversed liabilities related to our discontinued luggage business in the amount of approximately $198,000. No such adjustment was made in fiscal 2006.

Fiscal Year 2005 Compared to Fiscal Year 2004

Our revenues for fiscal 2005 increased by approximately $6,323,000, or approximately 66%, to approximately $15,881,000 as compared to approximately $9,558,000 reported for fiscal 2004. The growth in revenues was directly related to the increased number of leased local access lines we served in fiscal 2005.

The bulk of our marketing dollars in fiscal 2005 were expended to generate new customers for our wireline telephony business.

Our gross profit for fiscal 2005 increased by approximately $2,459,000 to approximately $7,279,000 from approximately $4,820,000 reported in fiscal 2004, while our gross profit percentage of 45.8% in fiscal 2005, as compared to 50.4% in fiscal 2004, decreased by 4.6 percentage points primarily due to the higher fees we were charged for leasing lines and ports from Verizon. The increase in our dollars of gross profit resulted from the increase in our customer base in fiscal 2005 over fiscal 2004. Our gross profit percentage of approximately 45.8% reflected our sales strategy of selling only in those states in which we believe we will be able to achieve a gross margin of over 40%.

SG&A increased by approximately $1,474,000, or approximately 33.5%, to approximately $5,873,000 for fiscal 2005 from approximately $4,399,000 reported in the prior year fiscal period. Of this increase, approximately $816,000 was for increased personnel costs, of which approximately $403,000 was related to VoX, approximately $230,000 was for billing costs, approximately $144,000 was for non-employee option costs and approximately $187,000 was for other VoX operating costs. Bad debt expense increased by approximately $2,563,000, or approximately 244%, to approximately $3,613,000 for fiscal 2005 from approximately $1,049,000 reported in the prior year fiscal period. From January 2005 until mid-April 2005, our CLECs attracted an unusually high number of residential consumers that did not pay our invoices and for which we subsequently terminated services, even though such customers had qualifying credit scores.

Depreciation and amortization expense increased by approximately $182,000 to approximately $196,000 f