9278 COMMUNICATIONS INC
Form 10-Q
December 30, 2002

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

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2002

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ________________ TO ________________

COMMISSION FILE NUMBER: 333-37654

9278 COMMUNICATIONS, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	13-4165136
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

1942 WILLIAMSBRIDGE ROAD, BRONX, NEW YORK 10461
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(718) 887-9278
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

NOT APPLICABLE

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

INDICATE BY CHECK MARK WHETHER THE REGISTRANT: (1) HAS FILED ALL REPORTS

required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 after the distribution of securities under a plan confirmed by a court.

Yes [ ] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date:

Common Stock, $.001 par value -23,932,912 shares issued and outstanding as of December 20, 2002

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

9278 Communications, Inc. and Subsidiaries

INDEX TO FINANCIAL STATEMENTS

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

	September 30 2002 (UNAUDITED)
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	$ 4,817,3
Restricted cash	1,012,9
Accounts receivable, net of allowance of $835,000 at September 30, 2002 and $760,000 at December 31, 2001	10,682,5
Accounts receivable-related party	2,604,6
Inventories	13,927,1
Prepaid expenses and other current assets	268,3
Total current assets	33,312,9

PROPERTY AND EQUIPMENT, NET	1,736,1
GOODWILL, NET	3,624,0
OTHER ASSETS	649,5
	$ 39,322,7

The accompanying notes are an integral part of these statements.

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

	September 30, 2002 (UNAUDITED)
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES	
Accounts payable and accrued expenses	$ 41,089,553
Accounts payable - related party	16,595
Current maturities of notes and advances payable, Shareholder	-
Current maturities of capital lease obligations	52,924
Current maturities of convertible notes payable	47,375
Income taxes payable	33,813
Total current liabilities	41,240,260

CAPITAL LEASE OBLIGATIONS, less current maturities	59,830
CONVERTIBLE NOTES PAYABLE, less current maturities	100,206
COMMITMENTS AND CONTINGENCIES	
SHAREHOLDERS' EQUITY	
Common stock - $.001 par value; 40,000,000 shares authorized; 23,932,912 shares issued and outstanding at September 30,2002 and 22,932,912 at December 31,2001	23,933
Additional paid-in capital	8,247,458
Accumulated deficit	(10,348,915
	(2,077,524
Total Shareholders' Equity	$ 39,322,772

The accompanying notes are an integral part of these statements.

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30, 2002	Three Months Ended September 30, 2001 RESTATED	
Net sales	$ 53,763,541	$ 55,736,568	$
Cost of sales	50,169,944	52,904,546	
Gross profit	3,593,597	2,832,022	
Operating expenses			

Selling	2,634,145	675,852	
General and administrative	2,627,315	1,543,151	
Depreciation and amortization	100,937	133,500	
Provision for bad debts	361,434	(48,277)	
Litigation Settlement	-	207,000	
	5,723,831	2,511,226	
Operating profit/(loss)	(2,130,234)	320,796	
Other income/(expenses)			
Realized gain on investment securities	-	-	
Interest expense, net	(19,732)	(28,454)	
	(19,732)	(28,454)	
Earnings/(loss) before income taxes	(2,149,966)	292,342	
Income tax provision	15,000	46,275	
Net income/(loss)	$ (2,164,966)	$ 246,067	$
Earnings/(loss) per common share per 10K			
Basic and diluted	$(0.09)	$0.01	
Weighted-average shares			
Basic and diluted	23,932,912	23,942,982	

The accompanying notes are an integral part of these statements.

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

Nine months ended September 30, 2002

	Common stock	Additional paid-in	Ac

	Shares	Amount	capital	
Balance at January 1, 2002	22,932,912	$ 22,933	$ 8,248,458	$ (
Issuance of common stock upon acquisition of Reliable Networks Inc.	1,000,000	1,000	(1,000)	
Net loss for the nine months ended September 30, 2002				(
Balance at September 30, 2002	23,932,912	$ 23,933	$ 8,247,458	$(1

The accompanying notes are an integral part of this statement.

9278 Communications, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	September 30, 2002
Cash flows from operating activities	
Net income (loss)	(4,199,898)
Adjustments to reconcile net income to net cash provided by operating activities	
Depreciation and amortization	271,595
Provision for doubtful accounts	75,000
Changes in assets and liabilities, net of assets acquired and liabilities assumed	
Restricted cash	38,280
Accounts receivable	1,011,604
Inventories	(718,467)
Prepaid expenses and other current assets	(119,342)
Other assets	(342,357)
Accounts payable and accrued expenses	6,196,896
Income taxes payable	(25,437)

Net cash provided by operating activities	2,187,874
Cash flows from investing activities	
Acquisition of property and equipment	(700,868)
Acquisition of businesses	(388,351)
Disposition of marketable securities	-
Net cash used in investing activities	(1,089, 219)
Cash flows from financing activities	
Notes and advances payable, shareholder, net	(570,100)
Notes payable - other	-
Principal payments on capital lease obligations	(18,769)
Principal payments on convertible notes payable	(28,389)
Repurchase of shares and retired	-
Net cash used in financing activities	(617,256)
Net increase in cash and cash equivalents	481,399
Cash and cash equivalents, beginning of period	4,335,935
Cash and cash equivalents, end of period	$ 4,817,334

9278 Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(UNAUDITED)

	September 30, 2002	September 3 2001
Supplemental disclosures of cash flow information:		
Cash paid during the period for		
Interest	$ 36,411	$ 98,792
Income taxes	$ 70,437	$ 31,406
Noncash investing and financing activities:		
Conversion of preferred stock to common stock		$ 505,000

The accompanying notes are an integral part of these statements.

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTION

The accompanying consolidated unaudited financial statements of 9278 Communication Inc. and subsidiaries (collectively, the "Company") have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for quarterly reports on Form 10-Q and do not include all of the information and footnote disclosures generally required by accounting principles generally accepted in the United States and should be read in conjunction with our consolidated financial statements and notes thereto for the fiscal year ended December 31, 2001, included in the Company's Form 10-K as filed with the SEC. The accompanying condensed consolidated unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States and reflect all adjustments (consisting of normal recurring accruals) which are, in the opinion of the management, considered necessary for a fair presentation of results for these interim periods. Operating results for the nine month periods ended September 30, 2002 and 2001 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2002.

NOTE 2 - NATURE OF BUSINESS

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

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of

9278 Communications, Inc. and its wholly owned subsidiaries, 9278 Distributors, Inc., 9278 Dot Com Inc., E-Store Solution, Inc., 9278 Distributors Illinois, Inc., 9278 Distributors Maryland Inc., 9278 Distributors New Jersey Inc. and Reliable Acquisition Corp. (hereinafter, the "Company"). All significant intercompany transactions and balances have been eliminated in consolidation.

CASH AND CASH EQUIVALENTS

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

INVENTORIES

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

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation and amortization are provided for, using straight-line and accelerated methods, in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives. Leased property under capital leases is amortized over the shorter of the service lives of the assets or the term of the lease. Repairs and maintenance are charged to operations as incurred.

INCOME TAXES

Income taxes are accounted for under the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 109 ("SFAS No. 109"), "Accounting of Income Taxes." Under SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The company has made provision for various minimum state and local taxes. The provision, in 2001, for federal taxes has been offset against the company's net operating losses carried forward from prior years. A valuation allowance has been established as the likelihood of realizing net deferred tax benefits is presently doubtful.

EARNINGS/LOSS PER SHARE

Basic earnings per share are determined by dividing the Company's net earnings/loss by the weighted-average shares outstanding. Diluted earnings per share include the dilutive effects of outstanding stock option and warrants. Excluded from the calculation of diluted earnings per share are warrants issued in March 2001 to purchase 210,000 shares of the Company's common stock, as their inclusion would have been antidilutive.

GOODWILL

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141 ("SFAS No. 141"), "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). For all business combinations initiated after June 30, 2001, SFAS No. 141 eliminates the pooling-of-interests method of accounting and requires the purchase method of accounting, including revised recognition criteria for intangible assets other than

goodwill. Under SFAS No. 142, which is effective for years beginning after December 15, 2001, goodwill and indefinite-lived intangible assets are no longer amortized but are reviewed annually, or more frequently if impairment indicators arise, for impairment. Intangible assets that have finite lives will continue to be amortized over their useful lives and reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets ."

The Company has adopted SFAS No. 142 for the year beginning January 1, 2002. Therefore, annual and quarterly amortization of goodwill of approximately $267,000 and $67,000 are no longer recognized. The Company has performed a transitional fair value based impairment test and has determined that no impairment of goodwill exist as of January 1, 2002.

The following table presents a reconciliation of net income (loss) and earnings (loss) per share amounts, as reported in the financial statements, to those amounts adjusted for goodwill and intangible asset amortization determined in accordance with the provisions of SFAS No. 142.

	Three Months Ended September 30, 2002	Three Months Ended September 30, 2001	Ni 20
Reported net income (loss)	$(2,164,966)	$246,067	$(4,199
Add back: goodwill amortization	-	66,689	
Income tax effect	-	-	
Adjusted net income (loss)	$(2,164,966)	$312,756	$(4,199

BASIC AND DILUTED EARNINGS (LOSS) PER SHARE:			
Reported net income (loss)	$(0.09)	$0.01	$(
Goodwill amortization	-	-	
Income tax effect	-	-	
Adjusted net income (loss)	$(0.09)	$0.01	$(

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or group of assets may not be fully recoverable. If an impairment indicator is present, we evaluate recoverability by a comparison of the carrying amount of the assets to future undiscounted net cash flows that we expect to generate from these assets. If the assets are impaired, we recognize an impairment charge equal to the amount by which the carrying amount exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying values or fair values, less estimated costs of disposal.

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 143 ("SFAS No. 143"), "Accounting for Asset Retirement Obligations," which is effective for years beginning after June 15, 2002. SFAS No. 143 addresses legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development or normal operation of a long-lived asset. The standard requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. Any associated asset retirement costs are to be capitalized as part of the carrying amount of the long-lived asset and expensed over the life of the asset. The Company will adopt SFAS No. 143 for the year beginning January 1, 2003. The impact of adopting SFAS No. 143 will have no impact to the consolidated financial statements.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets," which is effective for fiscal years beginning after December 15, 2001. SFAS No. 144 clarifies accounting and reporting for assets held for sale, scheduled for abandonment or other disposal, and recognition of impairment loss related to the carrying value of long-lived assets. The Company has adopted SFAS No. 144 for the year beginning January 1, 2002. There has been no impact of adopting SFAS No. 144 to the consolidated financial statements.

REVENUE RECOGNITION

Revenue is recognized from sales when a product is shipped and title passes to the customer.

ADVERTISING

Advertising costs are expensed as incurred and totaled $2,351,100 and $467,661 for the nine months ended September 30, 2002 and 2001, respectively.

SHIPPING AND HANDLING FEES AND COSTS

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

USES OF ESTIMATES AND FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

RECLASSIFICATIONS

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

NOTE 4 - ACQUISITIONS

On August 31, 2002, the Company acquired certain assets its distributor in an asset purchase transaction, wherein it acquired inventories and customer lists of the distributor. The Company paid $149,000 in excess of the tangible assets, which has been allocated to the estimated value of acquired customer lists. The assets acquired were recorded at estimated fair market value. The consolidated statements of operations include the results of this acquisition beginning September 1, 2002.

A summary of the transactions is as follows:

Assets purchased	
Inventory purchased	239,351
Customer lists	149,000
Net assets acquired	$ 388,351
Cash paid	$ 388,351

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

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - RESTRICTED CASH

Restricted cash consists of the following at September 30, 2002:

Amounts invested in certificate of deposit, which is pledged as collateral for a letter of credit issued by the bank	$ 1,012,935

NOTE 6 - PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	Estimated useful life (years)	September 30, 2002	De
Furniture and equipment	5 - 7	$ 905,962	$
Automobiles	5 - 7	245,165	
Computer equipment	5	927,537	
Leasehold improvements	3 - 8	307, 349	
		2,386,013	
Less accumulated depreciation and amortization		649,855	
		$ 1,736,158	$

Depreciation and amortization expense for property and equipment for the nine months ended September 30, 2002 and 2001 was approximately $271,595 and $168,008, respectively.

NOTE 7 - NOTES PAYABLE - SHAREHOLDER

On December 10, 1999, the Company declared $3,000,000 in dividends, of which $1,000,000 was paid. On December 13, 1999, the Company executed a promissory note for $2,000,000 for the declared but unpaid dividends, payable to the Company's chief executive officer, who is also a shareholder. A principal payment of $1,000,000 was originally due on June 13, 2000, and the second payment originally payable on December 13, 2001. On March 22, 2001, the Company amended the terms of these promissory notes to defer both payments to June 30, 2002 and December 31, 2002, respectively. The final payment is accelerated if the Company's gross revenue exceeds $10 million in each of any nine consecutive calendar months or exceeds $60 million in any six-month period. During the nine months ended September 30, 2002, the Company made principal payments aggregating $570,100. Interest is payable at a rate of 8%. For the nine months ended September 30, 2002, interest expense on this note was $12,017 and was paid in full as of that date.

9278 Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - RELATED PARTY TRANSACTIONS

Sales of inventory to a customer who is related to an officer of the Company were approximately $19,297,000 and $18,953,000 for the nine months ended September 30, 2002 and 2001, respectively. The Company also purchased inventory from this customer in the amount of $3,630,000 and $8,865,000 during the nine months ended September 30, 2002 and 2001, respectively.

NOTE 9 - CONTINGENCIES

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

NOTE 10 - RESTATEMENT

The Operating results for the three and nine month periods ended September 30, 2001 have been restated to reflect an accrual for officers' compensation and to reclassify certain expenses.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto set forth in Item 1of this Quarterly Report. In addition to historical information, this discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions, which could cause actual results to differ materially from Management's expectations. Factors that could cause differences include, but are not limited to, expected market demand for the Company's products, fluctuations in pricing for products distributed by the Company and products offered by competitors, as well as general conditions of the telecommunications marketplace.

OVERVIEW

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

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

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

Private label cards are generally designed and produced by us, utilizing card numbers and PINs provided by the telecommunications carrier or reseller providing the long distance service for the card. We incur the upfront expense of printing the phone cards. However, we do not pay the long distance carrier until it activates the cards, which occurs upon our sale to the distributor. Accordingly, through the use of private label cards, our cost of inventory is significantly reduced, as purchases are effectively made on an as-needed basis. In addition, private label cards generally provide us with the ability to achieve a greater gross margin percentage, typically ranging from 3% to 8%. During the past two years, we have continued to increase our sales of private label cards, both on an absolute dollar volume and as a percentage of our sales. During the year ended December 31, 2001, we sold over 120 varieties of private label cards, which accounted for in excess of 70% of our total revenues.

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

We are seeking to develop and acquire rights to additional prepaid telecommunications services and other prepaid products or services to diversify our product offerings and increase our overall gross margin. In the short-term, additional costs related to the development or acquisition of such products may have an impact on our net profits.

RESULTS OF OPERATIONS

The following table sets forth certain financial data as a percentage of net revenues for the periods indicated:

	For the three months ended September 30, 2002	2001	For th ended 2002
Net revenues	100.00%	100.00%	100.00%
Cost of services	93.32	94.92	94.39
Gross margin	6.68	5.08	5.61
Selling expenses	4.90	1.21	3.07
General and administrative expenses	4.89	2.77	4.31
Depreciation and amortization	0.18	0.24	0.15
Provision for bad debts	0.67	(0.08)	0.41
Interest expense, net	0.04	0.05	0.02
Litigation settlement	-	0.37	-
Earnings (loss) before income taxes	(4.00)%	0.52%	(2.35)%

THREE MONTHS ENDED SEPTEMBER 30, 2002 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2001

NET REVENUES. Net revenues for the three months ended September 30, 2002 decreased $2.0 million, or 3.54%, to $53.7 million from $55.7 million for the same period in 2001. Except for the NY Metro area offices, same location sales in each other location increased during the three months ended September 30, 2002 as compared to the same period in 2001. Sales for our Los Angeles, California office increased 98% over previous year, whereas Internet sales recorded a 146% increase over its previous year levels. The Company, in August 2001, added its office in Chicago, IL, which recorded 142% increase over previous year sales. The Company opened its Poughkeepsie, NY office in December 2001, which accounted for 2.26% of the sales for the three months ended September 30, 2002. The Same store revenues increased primarily as a result of extensive marketing efforts and continued expansion of market share for our private label cards. However, sales in some of the NY Metro area offices have declined by as much as 46% over the same period in 2001. The Company has primarily been focusing its sales efforts outside the NY Metro area during the past one year. Intense competition and slowing economy in the region have also contributed to this decline.

The Company, in October 2002, opened two new offices, one in Charlotte, NC and the other in Miami, FL. These offices will enable the Company to gain additional market share.

GROSS MARGIN. Gross margin increased by $0.76 million, or 26.9%, to $3.59 million, or 6.68% of net revenues, for the three months ended September 30, 2002, from $2.83 million, or 5.08% of net revenues, for the same period in 2001.

SELLING EXPENSES. Selling expenses for the three months ended September 30, 2002 increased $1.96 million or 290% to $2.64 million from $0.68 million for the three months ended September 30, 2002. Of this, $683,000 was attributable to increase in advertising and promotion costs incurred to promote our new private label cards in new markets and to promote sales over the Internet. Commission expense increased by $1,200,000 as we hired commissioned salespersons to promote sales, starting in 2001.

Selling expenses as a percentage of net revenues increased to 4.90% for the three months ended September 30, 2002, from 1.21%, for the same period in 2001.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses for the three months ended September 30, 2002, increased by $1.09 million or 70% to $2.63 million from $1.54 million for the same period in 2001. This increase was primarily due to the increase in salaries and related taxes by $524, 000 in 2002 as compared to 2001. Included in the general and administrative expenses is the cost of processing credit card sales over the Internet which increased by $72,000 in 2002. Rent expense increased by $172,000 and telephone expense increased by $89,000 in 2002 as compared to 2001 as the Company continued to add new locations and expand existing facilities. We opened additional offices during the past one-year, for which we had to incur start-up and establishment expenses that resulted in the increase.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization for the three months ended September 30, 2002 totaled $101,000; a decrease of $32,500 as compared to the same period in 2001. The decrease is due to the fact that we no longer amortize goodwill as a result of the adoption, effective January 1, 2002, of SFAS No. 142 of the Financial Accounting Standards Board. This decrease was offset by an increase in depreciation expense of $32,000 due to acquisition of fixed assets for our new locations.

NET INCOME (LOSS) FROM OPERATIONS. We had a net loss of $2,165,000 for the three months ended September 30, 2002 as compared to a net profit of $246,000 for the three months ended September 30, 2001. The decrease in net income was due to the increase in selling expenses and operating expenses. Our geographical expansion by opening up new offices nationwide has led to increase in selling, general and administrative costs. We also adopted an aggressive pricing policy by discounting our cards and giving away promotional cards in these new locations to gain market share. We believe that our loss from operations is a temporary phenomenon and that there should be a turnaround once these new offices are established.

NINE MONTHS ENDED SEPTEMBER 30, 2002 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2001

NET REVENUES. Net revenues for the nine months ended September 30, 2002 increased $34.3 million, or 24.0% to $177.1 million from $142.8 million for the same period in 2001. During 2002, the Company introduced several new calling cards in its bid to take market share from its competitors. The increase in revenues was also due to our acquisitions and geographic expansion since the third quarter of calendar year 2000 and continuing during the fiscal year ended 2001 and 2002. In May 2001, we opened a new office in Los Angeles, California, which accounted for 58.6% of the increase in sales for the nine months ended September 30, 2002. In August 2001, we opened two new locations, one in Brooklyn, New York, which accounted for 15.7% of the increase in sales, and the second in Chicago, Illinois, which accounted for 26.0 % of the increase in sales for the nine months ended September 30, 2002. Starting July 2001, we began actively selling phone cards over the Internet. Internet sales accounted for 35.6% of the increase in sales for the nine months ended September 30, 2002. In November 2001, we opened a new office in Poughkeepsie, New York, which accounted for 9.2% of the increase in sales for the nine months ended September 30, 2002. For the nine months ended September 30, 2002, same location sales for our Bronx office declined 9.8%, Queens Office declined by 33.0%, Yonkers office declined by 12%. The decline is attributable to the intense competition in these markets. Maryland office accounted for 7.9% of the increase in sales, Connecticut office accounted for 2.5% of the increase in sales. During the three months ended September 30, 2002, the Company opened its new offices in New Jersey and acquired the business of a distributor in Virginia. Though the sales from these offices were nominal, the Company expects sales to rise in the next three months.

GROSS MARGIN. For the nine months ended September 30, 2002, gross margin increased by $1.19 million, or 13.6%, to $9.94 million, or 5.61% of net revenues, from $8.75 million, or 6.13% of net revenues, for the same period in 2001. The decrease in gross margin percentage was attributable to the Company's aggressive sales efforts to increase its market share by selling cards at a reduced gross margin during this period . Our gross margin varies from period to period depending upon discounts and promotions employed from time to time to stimulate sales.

SELLING EXPENSES. Selling expenses for the nine months ended September 30, 2002 increased by $3,996,000 or 278% to $5,431,000 from $1,436,000 for the nine months ended September 30, 2001. Of this, $1,900,000 was increase in advertising costs incurred to promote our new private label cards in new markets and sales over the Internet. Included in selling expenses are costs related to sales, marketing and promotion campaigns organized to build our brand in new markets. Commission expenses increased by $1,947,000 as the Company hired commissioned salespersons to promote sales, starting in 2001. Trade show expenses increased by $313,000, as we participate in more trade shows.

Selling expenses as a percentage of net revenues increased to 3.07% for the nine months ended September 30, 2002, from 1.01% for the same period in 2001.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses for the nine months ended September 30, 2002, increased by $3,339,000, or 78.0% to $7,622,000 from $4,283,000 for the same period in 2001. This increase was primarily due to the increase in salaries and related taxes by $1,722,000 to $3,846,000 in 2002 as compared to $2,124,000 in 2001. Included in the general and administrative expenses is the cost of processing credit card sales over the Internet which increased by$461,000 to $546,000 for the nine months ended September 30, 2002 as compared to $85,000 for the same period in 2001. Rent expense increased by $350,000 to $512,000 in 2002 as compared to $162,000 in 2001 and telephone expense increased by $257,000 to $361,000 in 2002 as compared to $104,000 in 2001 as we continued to add new locations and expand our existing facilities. Other general and administrative expenses increased due to our opening additional locations and expenses related to increase in sales volume.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization for the nine months ended September 30, 2002 totaled $272,000; a decrease of $96,000 as compared to the same period in 2001. The decrease is attributable to the fact that the Company no longer amortizes goodwill as a result of its adoption of SFAS No. 142 of the Financial Accounting Standards Board effective January 1, 2002. This decrease was offset by an increase in depreciation expense of $104,000 due to acquisition of fixed assets on opening new locations.

NET INCOME (LOSS) FROM OPERATIONS. We had a net loss of $4,200,000 for the nine months ended September 30, 2002 as compared to a net profit of $2,244,000 for the nine months ended September 30, 2001. The decrease in net income was due to the increase in operating expenses coupled by a decrease in gross profit margins. Our geographical expansion by opening up new offices nationwide has led to increase

in selling, general and administrative costs. We also adopted an aggressive pricing policy by discounting our cards and giving away promotional cards in these new locations to gain market share. We believe that our loss from operations is a temporary phenomenon and we expect a turnaround once these new offices are established.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2002, we had total current assets of $33,313,000. This included $4,817,000 in cash, $1,013,000 in restricted cash, $13,927,000 in inventories and $13,287,000 in accounts receivable. Our cash balances vary significantly from day-to-day due to the large volume of purchases made by us from the various prepaid phone cards companies and sales to numerous distributors to whom we sells cards.

We provided $2,188,000 in cash from operating activities during the nine months ended September 30, 2002 as compared to $5,897,000 during the same period in 2001. Decreases in cash flows during the nine months ended September 30, 2002 are related to net loss incurred in 2002 and increase in inventories, offset by increase accounts payable and decrease in accounts receivables. Our decrease in working capital is attributable to our net loss from operations and to a lesser extent to our opening of new offices, which involve carrying of additional inventories and accounts receivable. We believe our working capital shortfalls will decline once these offices are established and profitable.

Investing activities used $1,089,000 during the nine months ended September 30, 2002 to acquire additional fixed assets and acquisition of business of a distributor in Virginia. Financing activities used $617,000 during the nine months ended September 30, 2002 to pay down notes payable and principal on debt obligations.

We believe that existing cash and cash equivalents, cash flow from operations and available vendor credit, including recently negotiated more favorable payment terms will be sufficient to meet its planned working capital and capital expenditure budget through the remainder of 2002 and 2003. We are largely dependent upon the credit granted to us by our vendors. In the event sufficient vendor credit is not available to us we would require other sources of financing. If we are required to seek other financing, there can be no assurance that we will be able to obtain such financing on commercially reasonable terms, or otherwise, or that we will be able to otherwise satisfy our short-term cash flow needs from other sources in the future which would have a material adverse effect on our operations.

CRITICAL ACCOUNTING POLICIES

Financial Reporting Release No. 60, published by the SEC, recommends that all companies include a discussion of critical accounting policies used in the preparation of their financial statements. The Company's significant accounting policies are summarized in Note 3 of its financial statements. While all these significant accounting policies impact its financial condition and results of operations, the Company views certain of these policies as critical. Policies determined to be critical are those policies that have the most significant impact on the Company's financial statements and require management to use a greater degree of judgment and/or estimates. Actual results may differ from those estimates.

The Company believes that given current facts and circumstances, it is unlikely that applying any other reasonable judgments or estimate methodologies would cause a material effect on the Company's consolidated results of operations, financial position or liquidity for the periods presented in this report.

The accounting policies identified as critical are as follows:

REVENUE RECOGNITION. The Company recognizes revenues in accordance with generally accepted accounting principles as outlined in SAB No. 101 which requires that four basic criteria be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists, (2) product delivery, including customer acceptance, has occurred or services have been rendered, (3) the price is fixed or determinable and (4) collectibility is reasonably assured. The Company believes that its revenue recognition policy is critical because revenue is a very significant component of its results of operations. Decisions relative to criteria (4) regarding collectibility are based upon management judgments and should conditions change in the future and cause management to determine these criteria are not met, the Company's recognized results may be affected.

INCOME TAXES. In preparing the Company's consolidated financial statements, income tax expense is calculated for each of the jurisdictions in which the Company operates. This process involves estimating actual current taxes due plus assessing temporary differences arising from differing treatment for tax and accounting purposes which are recorded as deferred tax assets and liabilities. Deferred tax assets are periodically evaluated to determine their recoverability, and where their recovery is not likely, a valuation allowance is established and a corresponding additional tax expense is recorded in the Company's statement of operations. In the event that actual results differ from the Company's estimates given changes in assumptions, the provision for income taxes could be materially impacted. As of September 30, 2002, the company had a deferred tax asset of approximately $5,600,000 and a full valuation allowance due to uncertainty surrounding the company's ability to realize its deferred tax asset.

INVENTORIES. Inventories, which are composed of prepaid calling cards, are valued at the lower of cost (first in, first out) or market. On a periodic basis, we compare the amount of inventory on hand and under commitment with our latest forecasted requirements to determine whether write-downs for excess or obsolete inventory are required. Although we consider the amounts on hand at quarter-end to be realizable, there can be no assurance that these amounts will prove to be realizable over time.

GOODWILL AND OTHER INTANGIBLES. Purchase accounting requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair market value of the assets and liabilities purchased, with the excess value, if any, being classified as goodwill. In addition, as described in Notes 3 of the Company's financial statements, as a result of the Company's acquisitions, values were assigned to intangible assets for customer lists and related relationships. Finite useful lives were assigned to these intangibles and they will be amortized over their remaining life. As with any intangible asset, future write-downs may be required if the value of these assets become impaired.

ALLOWANCE FOR DOUBTFUL ACCOUNTS. The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current credit worthiness, as determined by a review of their current credit information. The Company continuously monitors collections and payments from customers and a provision for estimated credit losses is maintained based upon its historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been within the Company's expectations and the provisions established, the Company cannot guarantee that the same credit loss rates will be experienced in the future. Concentration risk exists relative to the Company's accounts receivable, as 19.6% of the Company's total accounts receivable balance at September 30, 2002 is concentrated in one affiliated customer. While the accounts receivable related to this customer may be significant, the Company does not believe the credit loss risk to be significant given the consistent payment history by this customer.

RECENT ACCOUNTING PRONOUNCEMENTS.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 143, (SFAS No. 143), "Accounting for Asset Retirement Obligations". This standard addresses the financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard is effective for fiscal years beginning after June 15, 2002. We will adopt this standard effective January 1, 2003. We do not expect the adoption of SFAS No. 143 to have a material impact on the company's financial results.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This statement eliminates the requirement under SFAS 4 to aggregate and classify all gains and losses from extinguishment of debt as an extraordinary item, net of related income tax effect. This statement also amends SFAS 13 to require that certain lease modifications with economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. In addition, SFAS No. 145 requires reclassification of gains and losses in all prior periods presented in comparative financial statements related to debt extinguishment that do not meet the criteria for extraordinary item in Accounting Principles Board Opinion ("APB") 30. The statement is effective for fiscal years beginning after May 15, 2002 with early adoption encouraged. The Company will adopt SFAS No. 145 effective January 1, 2003. The Company is currently evaluating the requirements and impact of this statement on our consolidated results of operations and financial position.

On July 30, 2002, The Financial Accounting Standards Board ("FASB") issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The statement requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the statement include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company is currently evaluating the requirements and impact of this statement on our consolidated results of operations and financial position.

ITEM 3. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURES. The Company maintains disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in the reports filed with the SEC is recorded, processed, summarized and reported within the time periods specified in the rules of the SEC. Within 90 days prior to the filing of this Quarterly Report on Form 10-Q, an evaluation, was completed under the supervision and participation of management, including the Chief Executive Officer and Chief Financial Officer, of the design and operation of this disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to the company (including the Company's consolidated subsidiaries) required to be included in the periodic SEC filings.

CHANGES IN INTERNAL CONTROLS. There were no significant changes in internal controls or other factors that could significantly affect the Company's internal controls subsequent to the date of our evaluation.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

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

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

None.

ITEM 5. OTHER INFORMATION.

None.

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

(a) Exhibits.

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
3.1	Certificate of Incorporation of the Company(1)
3.2	Bylaws of the Company(1)
4.1	2001 Stock Option Plan of the Company(2)

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(1) Incorporated by reference from the Company's report on Form 10-Q for the three-month period ended March 31, 2000

(2) Incorporated by reference from the Company's report on Form 10-KSB for the year ended December 31, 2000

(b) Reports on Form 8-K.

None.

SIGNATURES

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

9278 COMMUNICATIONS, INC.

Date: December 20, 2002

By /s/ Sajid Kapadia

Sajid Kapadia

Chief Executive Officer/
Principal Accounting Officer

CERTIFICATIONS

I, Sajid B. Kapadia, Chief Executive Officer of 9278 Communications, Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of 9278 Communications, Inc.;

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

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

Date: December 20, 2002

/s/ Sajid B. Kapadia

Sajid B. Kapadia
Chief Executive Officer/
Principal Accounting Officer

CERTIFICATION(1)

Pursuant to Section 906 of the Public Company Accounting Reform and Investor Protection Act of 2002 (18 U.S.C.ss. 1350, as adopted), Sajid B. Kapadia, Chief Executive Officer of 9278 Communications, Inc. (the "Company"), and Jim Scigliano, the Chief Financial Officer of the Company, each hereby certifies that, to the best of his or her knowledge:

1. The Company's Quarterly Report on Form 10-Q for the period ended September 30, 2002, and to which this Certification is attached as Exhibit 99.1 (the "PERIODIC REPORT") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Periodic Report and results of operations of the Company for the period covered by the Periodic Report.

Dated: December 20, 2002

/s/ Sajid B. Kapadia

Sajid B. Kapadia
Chief Financial Officer
Principal Accounting Officer

(1) THIS CERTIFICATION ACCOMPANIES THIS REPORT PURSUANT TO SS. 906 OF THE SARBANES-OXLEY ACT OF 2002 AND SHALL NOT BE DEEMED "FILED" BY THE COMPANY FOR PURPOSES OF SECTION 18 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.