

PENDING PETITION MEMO

Date: 5/8/2007

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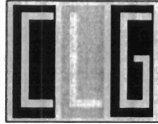
FROM: CENTRAL OPERATIONS

UTILITY: CAPITAL TELECOMMUNICATIONS, INC

SUBJECT: 07-C-0531

Petition of Capital Telecommunications, Inc. and U.S. Wireless Data,
Inc. for Approval of the Transfer of Control.

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2006 MAY -8 AM 10:34 The CommLaw Group

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May 7, 2007

Via Overnight Courier

Jaclyn A. Brilling
Secretary to the Commission
New York Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350

***Re: Capital Telecommunications, Inc. & U.S. Wireless Data, Inc.
Petition for Grant of Authority of Transfer of Control***

Ladies and Gentlemen:

Capital Telecommunications, Inc. and U.S. Wireless Data, Inc., through undersigned counsel, herewith files an original plus four (4) copies of their Petition for Grant of Authority of Transfer of Control.

An additional copy of this letter is also enclosed, to be date-stamped and returned in the postage-prepaid envelope provided.

Should there be any questions regarding this filing, kindly contact the undersigned.

Respectfully submitted,

A handwritten signature in cursive script that reads 'Jonathan S. Marashlian' followed by a small 'lsc' monogram.

Jonathan S. Marashlian

**STATE OF NEW YORK
PUBLIC SERVICE COMMISSION**

Petition of)	
)	
U.S. WIRELESS DATA, INC.,)	
)	
Transferee,)	Case No. _____
)	
CAPITAL TELECOMMUNICATIONS, INC.,)	
)	
Transferor,)	
)	
Notification of)	
Transfer of Control)	
)	

PETITION

U.S. Wireless Data, Inc. ("USWI") and Capital Telecommunications, Inc. ("CTI")(together "Petitioners"), through their undersigned counsel and pursuant to Section 100 of the Public Service Law of New York, N.Y. PUB. SERV. LAW § 100, hereby provide notice to advise the New York Public Service Commission ("PSC") of a transfer of control of the ownership interests in CTI's direct parent, StarVox Communications, Inc. ("StarVox"). On March 23, 2007, StarVox became a wholly owned subsidiary of USWI, a publicly traded shell holding company, pursuant to a merger agreement. As described below, this transaction serves the public interest and will be entirely transparent to CTI's customers. The merger did not involve changes in the management or operations of CTI, or of the authority to provide telecommunications services in New York held by CTI.

Petitioners state as follows:

I. DESCRIPTION OF THE TRANSFER OF CONTROL TRANSACTION

In order to gain access to public capital markets, on March 23, 2007, StarVox completed a merger with USWI pursuant to which a wholly owned subsidiary of USWI merged with and into StarVox, with StarVox surviving as a wholly owned subsidiary of USWI. In connection

with the merger, warrants issued pursuant to a late-2006 bridge financing to then-existing shareholders who chose to participate were exercised as a condition to and immediately prior to the consummation of the merger. The StarVox common stock issued in connection with such exercise was then converted into the right to receive shares of USWI Series A preferred stock in connection with the merger along with all other outstanding shares of StarVox common and preferred stock. The merger diluted the ownership interests of some individuals and entities that had previously held a cognizable interest in StarVox. Nonetheless, StarVox was privately held by substantially the same individuals and entities who now hold equity interests in USWI, the new parent corporation with 100% ownership of StarVox. StarVox's officers and management became the officers and management of USWI. CTI remains a direct, wholly owned subsidiary of StarVox.

II. DESCRIPTION OF THE ENTITIES INVOLVED IN THE TRANSACTION

A. CTI

CTI is authorized to provide telecommunications services in Connecticut, Delaware, Washington, D.C., Maryland, Massachusetts, New Jersey, New York, Pennsylvania, Rhode Island and Texas. CTI has authority to provide local and long distance telecommunications services in the State of New York pursuant to the authorization granted in Docket No. 02-C-1580. CTI is organized under the laws of the State of Pennsylvania, and its principal place of business is 200 West Market Street, York, Pennsylvania 17401.

B. USWI

Prior to the completion of the merger, USWI was a publicly traded shell company having no operations, employees or assets. Following the merger, USWI is no longer a shell, and intends to change its name to StarVox Communications, Inc. USWI is a Delaware corporation, with its principal place of business located at 2728 Orchard Parkway, San Jose, California 95134.

III. DESIGNATED CONTACT

Correspondence regarding this application should be addressed to:

Jonathan S. Marashlian, Esq.
HELEIN & MARASHLIAN, LLC
1483 Chain Bridge Road
Suite 301
McLean, VA 22101
Telephone: (703) 714-1313
Facsimile: (703) 714-1330
Counsel for Capital Telecommunications, Inc.

With a copy to:

Thomas E. Rowley
Chief Executive Officer and Director
U.S. Wireless Data, Inc.
2728 Orchard Parkway
San Jose, CA 95134
Telephone: 408-625-2701
Facsimile: 800-270-9380

And

Kyle Dickson, Esq.
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Capital Telecommunications, Inc.
8275 El Rio
Suite 110
Houston, TX 77054
Tel: 713-440-4100
Fax: 713-440-4139
E-mail: kdickson@starvox.com

IV. APPROVAL OF THE TRANSFER OF CONTROL IS IN THE PUBLIC INTEREST

CTI respectfully submits that the transfer of control effected through its parent's recent merger with USWI, a publicly-traded shell holding corporation, serves the public interest. CTI continues to operate under the same name and operating authorities as before the merger. All existing tariffs and rates will remain in place.

The transfer of control was entirely transparent to CTI customers and did not have any adverse impact on them. CTI continues to provide services under the CTI name and servicemarks. The transfer of control involved no change in the entity providing

telecommunications service directly to customers and the end user services, rates, terms and conditions of such services have not changed and CTI has no plans to make any changes in the near future. Lastly, the merger did not result in the transfer or disposition of CTI customers or New York authorization. In sum, consummation of the merger did not result in any perceivable changes to CTI's customers. The only change will be in the ultimate ownership of CTI's parent, StarVox, which now resides with USWI, a publicly traded shell holding corporation.

The transfer of control is also in the public interest and in the interest of current CTI customers, as it provides StarVox with access to the public financial market. CTI, as the subsidiary of a company in turn held by a publicly-traded holding corporation, USWI, will have access to additional sources of financing that will enhance its ability to continue providing reliable, technologically advanced and competitively priced services to customers and to grow its business and further broaden the diversity of services it can offer the public.

V. CONCLUSION

For the reasons stated above, Petitioners respectfully submit that the public interest, convenience and necessity are furthered by the transaction described herein.

VI. VERIFICATION

An executed Verification is attached hereto as Exhibit A.

VII. APPENDIX/EXHIBITS

The Telecommunications Carrier Critical Information Form is attached hereto as Exhibit B.

Respectfully submitted,

By: Jonathan S. Marashlian *lge*

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Counsel for StarVox Communications, Inc.

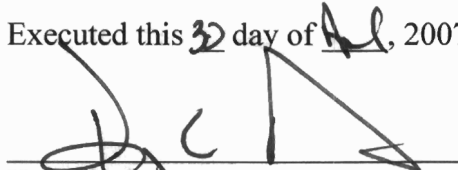
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Thomas E. Rowley
Chief Executive Officer and Director
U.S. Wireless Data, Inc.
2728 Orchard Parkway
San Jose, CA 95134
Telephone: 408-625-2701
Facsimile: 800-270-9380
E-mail: tomrowley@starvox.com

VERIFICATION

I, Kyle Dickson, acting on behalf of Capital Telecommunications, Inc., first being duly sworn upon oath depose and say I am General Counsel of Capital Telecommunications, Inc.; that I am authorized to make this statement on its behalf; that I have read the above and foregoing filing and know the contents thereof; and that said contents are true in substance and in fact, except as to those matters stated upon information and belief, and as to those, I believe same to be true.

Executed this 32 day of Feb, 2007



Kyle Dickson
General Counsel
Capital Telecommunications, Inc.

EXHIBIT A

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The following unaudited pro forma condensed consolidated financial statements gives effect to the Merger of U.S. Wireless Data, Inc. ("USWD") and StarVox Communications, Inc. ("StarVox") on February 28, 2007, to which a wholly owned subsidiary of USWD merged with and into StarVox, with StarVox surviving the merger and becoming our wholly-owned subsidiary.

The pro forma balance sheets and operating data presented are not necessarily indicative of the results that actually would have occurred if the Merger had been completed on the assumed date(s) nor are the statements necessarily indicative of future combined financial position or earnings. The data presented should be read in conjunction with the financial statements of StarVox and US Wireless.

The transaction is being treated as a reverse acquisition and a recapitalization. StarVox is the acquirer for accounting purposes. The pro forma financial data does not purport to be indicative of the results which actually would have been obtained had the acquisition been effected on the dates indicated or the results which may be obtained in the future. In connection with the merger, all issued and outstanding shares of StarVox common stock and preferred stock were exchanged for an aggregate of 301,594 shares of our preferred stock, which are convertible into 22,224,705 shares of our common stock. The shares of our preferred stock issued in connection with the merger will be automatically converted into our common stock upon the amendment of our certificate of incorporation to increase our authorized number of shares of common stock, contingent upon the approval of such amendment by our stockholders. In connection with the merger, we assumed all outstanding options and warrants to purchase StarVox capital stock. The total fully diluted effect of Starvox outstanding options and warrants would be a total of 503,849 shares of our preferred stock which then converts into 37,129,047 shares of common stock.

On June 15, 2006, StarVox acquired all of the capital stock of Capital Telecommunications, Inc. ("CTI"). The following unaudited pro forma condensed consolidated financial information, with explanatory notes, present how the condensed consolidated financial statements of USWD and StarVox may have appeared had USWD, StarVox and CTI been consolidated for the year ending August 31, 2006, and three months ending November 30, 2006.

The pro forma information has been prepared utilizing the historical financial statements of StarVox Communications, Inc. ("StarVox") and notes thereto for the three month period ended November 30, 2006 and years ended August 31, 2005 and 2006. The historical results of USWD are incorporated by reference to its historical financial statements since its emergence from bankruptcy in May 2005. The unaudited pro forma condensed consolidated financial information may not be indicative of the actual results of the combined business had the acquisitions occurred on September 1, 2005, nor are financial information indicative of future combined financial position or earnings. The accompanying unaudited pro forma condensed consolidated financial information presented should be read in conjunction with the historical financial statements and the related notes of StarVox, USWD and CTI.

This data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements, related notes and other financial information included in this Current Report on Form 8-K. The historical results are not necessarily indicative of results to be expected for any future period.

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StarVox Communications, Inc. **Unaudited Pro Forma Condensed Consolidated Statements of Operations** **For the Fiscal Year Ended August 31, 2006** *(in thousands except per share data)*

	Year Ended August 31, 2006 StarVox	September 1, 2005 through June 13, 2006 CTI	Year Ended June 30, 2006 USWD	Pro Forma Adjustments	Pro Forma Consolidated
Revenues	\$ 24,626	\$ 27,202	\$ —	\$ —	\$ 51,828
Operating expense:					
Cost of sales	20,674	19,576	—	—	40,250
Operating expenses	13,527	6,548	(1,105)	20 (1)	18,990
Impairment charge	1,200	—	—	—	1,200
Total Operating expenses	35,401	26,124	(1,105)	20	60,440
Loss from operations	(10,775)	1,078	(1,105)	(20) (1)	(8,612)
Interest (other) expense, net	(2,302)	(133)	—	(79) (2)	(2,514)
Net income (loss) before income taxes	(13,077)	945	(1,105)	(99) (3)	(11,126)
Provision for taxes	20	244	—	—	264
Net (loss)	\$ (13,097)	\$ 701	\$ (1,105)	\$ (99)	\$ (11,390)
Weighted average shares outstanding, basic and diluted	3,736		5,867		33,684
Basic and diluted net loss per share	\$ (3.51)		\$ (0.19)		\$ (0.34)

Unaudited pro forma condensed consolidated financial statements for the year ended August 31, 2006 as shown above include the operations and activities of each company as if the merger was complete for the entire time period.

Notes to the unaudited pro forma condensed consolidated financial statements for the fiscal year ended August 31, 2006 are as follows:

- 1 Elimination of the effect of \$20,000 USWD interest income related to the \$3,500,000 promissory notes between USWD and StarVox.
- 2 Eliminating the \$79,000 interest expense recorded by StarVox relating to the \$3,500,000 promissory notes between USWD and StarVox.
- 3 Eliminating the net effect of \$59,000 of other interest income/expense related to the two promissory notes totaling \$3,500,000 in principal between USWD and StarVox.

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StarVox Communications, Inc. **Unaudited Pro Forma Condensed Consolidated Balance Sheet** **November 30, 2006** *(in thousands except per share data)*

	November 30, 2006 StarVox	September 30, 2006 USWD	Pro Forma Adjustments	Pro Forma Consolidated
Assets				
Current Assets:				
Cash and cash equivalents	\$ 1,780	\$ 954	\$ —	\$ 2,734
Accounts receivable, net	6,608	—	—	6,608
Loans receivable	—	3,500	(3,500)(4)	—
Interest receivable	—	110	(20)(5)	90
Due from related parties	—	15	—	—
Prepays and other current assets	1,004	45	—	1,049
Total current assets	<u>9,392</u>	<u>4,624</u>	<u>(3,520)</u>	<u>10,481</u>
Property and equipment, net of accumulated depreciation	3,937	—	—	3,937
Goodwill and intangible assets	13,156	—	—	13,156
Other assets	1,393	—	—	1,393
Total assets	<u>\$ 27,878</u>	<u>\$ 4,624</u>	<u>\$ (3,520)</u>	<u>\$ 28,982</u>
Liabilities, Convertible Preferred Stock and Stockholders' Deficit				
Current Liabilities				
Accounts payable and accrued liabilities	\$ 7,506	\$ 134	\$ —	\$ 7,640
Notes payable	7,575	—	—	7,575
Convertible notes payable	18,296	—	(3,500)(4)	14,796
Related party note	198	—	—	198
Accrued interest on notes payable	1,298	—	(107)(6)	1,191
Deferred revenue	1,627	—	—	1,627
Total current liabilities	<u>36,500</u>	<u>134</u>	<u>(3,607)</u>	<u>33,027</u>
Total liabilities	<u>36,500</u>	<u>134</u>	<u>(3,607)</u>	<u>33,027</u>
Convertible preferred stock				
Series A	7,925	—	—	7,925
Series A - 1	950	—	—	950
Stockholders' Equity (Deficit)				
Common stock	4	95	—	99
Additional paid-in-capital	2,615	5,739	87(7)	8,441
Accumulated deficit	(20,068)	(1,344)	—	(21,412)
Treasury stock	(48)	—	—	(48)
Total stockholders equity (deficit)	<u>(8,622)</u>	<u>4,490</u>	<u>87</u>	<u>(4,045)</u>
Total Liabilities, Convertible Preferred Stock and Stockholders' (Deficit)	<u>\$ 27,878</u>	<u>\$ 4,624</u>	<u>\$ (3,520)</u>	<u>\$ 28,982</u>

StarVox Communications, Inc.
Unaudited Pro Forma Condensed Consolidated Statements of Operations
For the Three Months Ended November 30, 2006
(in thousands except per share data)

	Three Months Ended November 30, 2006 <u>StarVox</u>	Three Months Ended September 30, 2006 <u>USWD</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Consolidated</u>
Revenues	\$ 13,416	\$ —	\$ —	\$ 13,416
Operating expense:				
Cost of sales	8,738	—	—	8,738
Operating expenses	7,230	312	—	7,542
Total Operating expenses	<u>15,968</u>	<u>312</u>	<u>—</u>	<u>16,280</u>
Loss from operations	(2,552)	(312)		(2,864)
Interest (other) expense, net	1,971	98	(8)(8)	2,061
Net income (loss) before income taxes	(4,523)	(214)	8(8)	(4,729)
Provision for taxes	—	—	—	—
Net loss	<u>\$ (4,523)</u>	<u>\$ (214)</u>	<u>\$ 8</u>	<u>\$ (4,729)</u>
Weighted average shares outstanding, basic and diluted	3,561	9,500		33,684
Basic and diluted net loss per share	<u>\$ (1.27)</u>	<u>\$ (0.02)</u>		<u>\$ (0.14)</u>

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Unaudited pro forma condensed consolidated financial statements for the three months ended November 30, 2006 as shown above include the operations and activities of each company as if the merger was complete for the entire time period. The first quarter for USWD ends on September 30. We included the September 30, 2006 first quarter financial information from their 10Q filing in the pro forma statement of operations.

Notes for the three months ended November 30, 2006 pro forma schedules are as follows:

- 4 Elimination of principal amount of a \$3,200,000 note payable and a \$300,000 note payable for a total of \$3,500,000 in principal for notes between USWD and StarVox.
- 5 Elimination of \$20,000 interest receivable from the two promissory notes between USWD and StarVox that have a total principal balance of \$3,500,000.
- 6 Elimination of \$107,000 accrued interest from the two promissory notes between USWD and StarVox that have a total principal balance of \$3,500,000.
- 7 Eliminating the \$87,000 effect on retained earnings due to the interest income/expense resulting from the elimination of the two promissory notes between USWD and StarVox.
- 8 Elimination of the net effect of \$8,000 of other interest income/expense related to the interest on the promissory notes between USWD and StarVox.

Pro forma financial statements are to be used in combination with audited financial results and management commentary on the results of operations. Read this financial statement with the accompanying form 8-K, management's discussion and analysis, quarterly forms 10-Q and annual form 10-K as well as related financial data as described. Future results may be very different from the financial statements shown here.

This data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements, related notes and other financial information included in this Current Report on Form 8-K. The historical results are not necessarily indicative of results to be expected for any future period.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders
StarVox Communications, Inc.
San Jose, California

We have audited the accompanying consolidated balance sheets of StarVox Communications, Inc. ("the Company") as of August 31, 2005 and 2006, and the related consolidated statements of operations, convertible preferred stock and stockholders' deficit, and cash flows for the period from June 1, 2004 (inception) to August 31, 2004 and for the years ended August 31, 2005 and 2006. These consolidated statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of StarVox Communications, Inc. as of August 31, 2005 and 2006, and the results of its operations and its cash flows for the period ended August 31, 2004 and the two-year periods ended August 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company has incurred recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Managements' plans in regard to these matters are also described in Note 3. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 2 to the consolidated financial statements, the Company has restated its 2006 consolidated financial statements.

ARMANINO McKENNA LLP

San Ramon, California

October 31, 2006, except for the computation of net loss per share described in Note 1, the restatement described in Note 2, the Going Concern described in Note 3 and the subsequent events described in Note 16 to the Consolidated Financial Statements, as to which the date is February 15, 2007.

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StarVox Communications, Inc.

Consolidated Balance Sheets

(in thousands, except share and per share data)

	August 31,		November 30,
	2005	2006 (as Restated) (1)	2006 (Unaudited)
Assets			
Current assets:			
Cash	\$ 210	\$ 1,386	\$ 1,780
Accounts receivable, net of allowance of \$88 and \$664, respectively	1,658	7,018	6,608
Prepaid expenses and other current assets	399	882	1,004
Total current assets	2,267	9,286	9,392
Property and equipment, net of accumulated depreciation	1,273	4,308	3,937
Intangible assets	1,200	6,271	5,756
Goodwill	—	7,427	7,400
Restricted cash and other assets	140	1,392	1,393
Total assets	\$ 4,880	\$ 28,684	\$ 27,878

Liabilities, Convertible Preferred Stock and Stockholders' Deficit

Current liabilities:			
Line of credit	\$ 517	\$ 1,125	\$ 145
Accounts payable	671	5,639	4,815
Accrued liabilities and other	283	3,476	3,844
Notes payable	—	3,500	7,575
Convertible notes payable	4,600	17,126	18,296
Deferred revenue	—	1,627	1,627
Related party payables	1,200	250	198
Total current liabilities	7,271	32,743	36,500
Other long term liabilities	—	42	—
Total liabilities	7,271	32,785	36,500

Commitments and contingencies (see Note 14)

Preferred stock, \$0.001 par value; 25,000,000, 25,900,000 and 25,900,000 shares authorized at August 31, 2005, 2006 and November 30, 2006, respectively

Series A convertible preferred stock, 0, 24,000,000 and 24,000,000 shares designated at August 31, 2005, 2006 and November 30, 2006, respectively; 0, 18,835,688 and 18,835,688 shares issued and outstanding at August 31, 2005, 2006 and November 30, 2006, respectively (aggregate liquidation preference of \$9,418,000 at August 31, 2006 and November 30, 2006)

— 7,925 7,925

Series A-1 convertible preferred stock, 0, 1,900,000 and 1,900,000 shares designated at August 31, 2005, 2006 and November 30, 2006, respectively; 0, 1,900,000 and 1,900,000 shares issued and outstanding at August 31, 2005, 2006 and November 30, 2006, respectively (aggregate liquidation preference of \$950,000 at August 31, 2006 and November 30, 2006)

— 950 950

Stockholders' deficit:

Common stock, \$0.001 par value; 30,000,000, 30,000,000 and 30,000,000 shares authorized at August 31, 2005, 2006 and November 30, 2006, respectively; 3,580,000, 4,330,000 and 4,330,000 shares issued and outstanding at August 31, 2005, 2006 and November 30, 2006, respectively	4	4	4
Deferred stock compensation	(29)	(7)	—
Additional paid-in capital	82	2,619	2,615
Accumulated deficit	(2,448)	(15,545)	(20,068)
Treasury stock	—	(47)	(48)
Total stockholders' deficit	(2,391)	(12,976)	(17,497)

Total convertible preferred stock and stockholders' deficit	(2,391)	(4,101)	(8,622)
Total liabilities, convertible preferred stock and stockholders' deficit	<u>\$ 4,880</u>	<u>\$ 28,684</u>	<u>\$ 27,878</u>
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StarVox Communications, Inc. **Consolidated Statements of Operations** *(in thousands, except per share data)*

	June 1, 2004 (inception) through August 31, 2004	Fiscal Year Ended August 31,		Three Months Ended November 30,	
		2005	2006 (as Restated) (1)	2005	2006
				(Unaudited)	
Revenues	\$ —	\$ 3,938	\$ 24,626	\$ 3,867	\$ 13,416
Operating expenses:					
Cost of sales	—	4,575	20,674	3,724	8,738
Operating expenses	73	801	12,539	2,214	6,315
Depreciation and amortization	—	77	988	18	889
Impairment charge	—	675	1,200	—	26
Total operating expenses	73	6,128	35,401	5,956	15,968
Loss from operations	(73)	(2,190)	(10,775)	(2,089)	(2,552)
Other expense:					
Interest and amortization expense	—	(184)	(2,197)	(89)	(1,971)
Other expense	—	—	(105)	3	—
Net other expense	—	(184)	(2,302)	(86)	(1,971)
Net loss before income taxes	(73)	(2,374)	(13,077)	(2,175)	(4,523)
Provision for income taxes	—	(1)	(20)	—	—
Net loss	\$ (73)	\$ (2,375)	\$ (13,097)	\$ (2,175)	\$ (4,523)
Basic and diluted net loss per share	\$ (0.10)	\$ (0.76)	\$ (3.51)	\$ (0.58)	\$ (1.27)
Shares used in computing basic and diluted net loss per share	720	3,113	3,736	3,768	3,561
Basic and diluted net loss per share (unaudited pro forma) (See Note 1)			\$ (0.39)		\$ (0.03)
Shares used in computing basic and diluted net loss per share (unaudited pro forma) (See Note 1)			33,848		165,370

(1) See Note 2 — “Restatement of Consolidated Financial Statements” of the notes to our consolidated financial statements.

The accompanying notes are an integral part of these consolidated financial statements

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StarVox Communications, Inc.

Consolidated Statements of Convertible Preferred Stock and Stockholders' Deficit

(in thousands, except share and per share data)

	Convertible Preferred Stock				Common Stock		Deferred	Additional	Treasury Stock		Accumulated	Total	Total
	Series A		Series A-1		Common Stock		Stock	Paid-in	Treasury Stock		Deficit	Stockholders'	Convertible
	Shares	Amount	Shares	Amount	Shares	Amount	Compensation	Capital	Shares	Amount	Deficit	Deficit	Preferred Stock and Stockholders' Deficit
June 1, 2004 (inception)													
Common stock issued to founders					2,880,000	3		48				51	51
Net loss for period from June 1, 2004 (inception) through August 31, 2004											(73)	(73)	(73)
Balances at August 31, 2004					2,880,000	3		48			(73)	(22)	(22)
Common stock granted to employees					700,000	1	(35)	34					
Amortization of deferred stock compensation							6					6	6
Net loss											(2,375)	(2,375)	(2,375)
Balances at August 31, 2005					3,580,000	4	(29)	82			(2,448)	(2,391)	(2,391)
Conversion of convertible debt to Series A preferred stock	12,165,688	4,906											4,906
Issuance of Series A convertible preferred stock, net of issuance costs	6,670,000	3,019											3,019
Conversion of other liabilities to Series A-1 convertible preferred stock			1,900,000	950									950
Issuance of common stock for Zfone acquisition					100,000			5				5	5
Common stock granted to consultants					475,000			23				23	23
Common stock granted to employees					175,000		(9)	9					
Issuance of warrants to purchase common stock in conjunction with issuance of convertible notes payable								2,515				2,515	2,515
Repurchase of common stock									(932,500)	(47)		(47)	(47)
Amortization of deferred stock compensation							16					16	16
Reversal of unamortized deferred stock compensation for terminated employees							15	(15)					
Net loss (as Restated)											(13,097)	(13,097)	(13,097)
Balances at August 31, 2006 (as Restated) (1)	18,835,688	7,925	1,900,000	950	4,330,000	4	(7)	2,619	(932,500)	(47)	(15,545)	(12,976)	(4,101)
Repurchase of common stock									(12,500)	(1)		(1)	(1)
Reclassification of unamortized balance of deferred stock compensation upon adoption of FAS 123R							7	(7)					
Issuance of restricted shares previously awarded												3	3
Net loss											(4,523)	(4,523)	(4,523)
Balances at November 30, 2006 (Unaudited)	18,835,688	7,925	1,900,000	950	4,330,000	4		2,612	(945,000)	(48)	(20,068)	(17,497)	(8,622)

(1) See Note 2 — "Restatement of Consolidated Financial Statements" of the notes to our consolidated financial statements.

The accompanying notes are an integral part of these consolidated financial statements

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StarVox Communications, Inc. **Consolidated Statements of Cash Flows** *(in thousands)*

	Period From June 1, 2004 (inception) through August 31, 2004	Fiscal Year Ended August 31,		Three Months Ended November 30,	
		2005	2006 (as Restated) (1)	2005	2006
Cash flows from Operating Activities:					
Net loss	\$ (73)	\$ (2,375)	\$ (13,097)	\$ (2,192)	\$ (4,523)
Adjustments to reconcile net loss to net cash used in Operating Activities:					
Depreciation and amortization	—	77	987	84	2,059
Gain on sale of property and equipment	—	—	2	—	—
Impairment charge	—	675	1,200	—	109
Non-cash stock based compensation expense	—	6	39	—	3
Non-cash interest expense	—	—	1,321	—	676
Changes in operating assets and liabilities:					
Accounts receivable	—	(1,658)	(2,155)	(181)	410
Prepaid expenses and other current assets	—	(499)	(1,326)	(131)	(207)
Accounts payable	22	649	2,519	470	(829)
Accrued liabilities and other	—	283	1,354	(164)	(396)
Deferred Revenue	—	—	1,627	—	—
Net cash used in operating activities	(51)	(2,842)	(7,529)	(2,114)	(2,698)
Cash flows from Investing Activities:					
Purchase of property and equipment	—	(1,175)	(812)	(133)	(3)
Proceeds from sale of property and equipment	—	—	100	—	—
Cash paid for acquisitions, net of cash acquired	—	(850)	(16,058)	—	—
Net cash used in investing activities	—	(2,025)	(16,770)	(133)	(3)
Cash flows from Financing Activities:					
(Borrowings) repayments under line of credit	—	517	608	(365)	(980)
Proceeds from issuance of senior notes payable	—	—	3,500	—	—
Proceeds from issuance of convertible notes payable	—	4,560	18,420	—	4,075
Redemption of convertible notes payable	—	—	(25)	—	—
Proceeds from issuance of preferred stock, net of issuance costs	—	—	3,019	3,030	—
Proceeds from issuance of common stock	51	—	—	—	—
Repurchase of common stock	—	—	(47)	—	—
Net cash provided by financing activities	51	5,077	25,475	2,665	3,095
Net increase in cash and cash equivalents	—	210	1,176	418	394
Cash at beginning of period	—	—	210	210	1,386
Cash at end of period	\$ —	\$ 210	\$ 1,386	\$ 628	\$ 1,780
Supplemental cash flow disclosure:					
Cash paid during the periods for:					
Interest	\$ —	\$ 1	\$ 235	\$ —	\$ —
Income taxes	\$ —	\$ —	\$ 1	\$ —	\$ —

Noncash financing and investing activities:

Other accrued expenses for purchase of software licenses in advance of stock issuance	\$	—	\$	200	\$	—	\$	—	\$	—
Payable to related party for purchase of software licenses in advance of stock issuance		750		—		—		—		—
Note payable issued to related party for purchase of software licenses	\$	250	\$	—	\$	—	\$	—	\$	—

(1) See Note 2 — “Restatement of Consolidated Financial Statements” of the notes to our consolidated financial statements.

The accompanying notes are an integral part of these consolidated financial statements

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STARVOX COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Summary of Significant Accounting Policies

Summary of Business

StarVox Communications, Inc. ("StarVox" or "the Company"), a Delaware corporation founded June 1, 2004, was established to build a large base of business subscribers by acquiring the customer bases of Competitive Local Exchange Carriers or ("CLECs") that typically are concentrated in Tier 2 & Tier 3 markets and are serving their customer base with legacy voice communication technology – such as TDM (time division multiplexing) technology. StarVox will migrate the CLEC's legacy network to its VoIP (voice over internet protocol) network.

In addition, StarVox will migrate the customer base to new generation integrated voice and data products. StarVox currently offers a suite of both TDM and VoIP products designed to meet the voice and data communications needs of these acquired customers. StarVox's VoIP Integrated Voice and Data (IVAD) product allows local voice service, long distance service and data service (i.e. Internet Access) to be offered to a business site over an integrated voice and data access line. StarVox's IP Centrex product combines the IVAD offering with a StarVox network hosted office phone system, such that a business site can outsource all of its voice and data communications to a single supplier—StarVox.

The Company has incurred significant operating losses since inception. As a result, the Company has generated negative cash flows from operations, and has an accumulated deficit at August 31, 2006. The Company's primary source of funds through August 31, 2006 was the issuance of debt and equity securities (see Note 3).

Principles of Consolidation

The accompanying restated consolidated financial statements, (see Note 2), have been prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP). The consolidated financial statements include the accounts of StarVox Communications, Inc. and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Unaudited Interim Financial Statements

The consolidated financial statements as of November 30, 2006 and for the three months ended November 30, 2006 and 2005 are unaudited. All disclosures as of November 30, 2006 and for the three months ended November 30, 2006 and 2005, presented in the notes to the financial statements are unaudited. In the opinion of management, all adjustments (which include only normal recurring adjustments) considered necessary to state fairly the financial

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condition as of November 30, 2006, and the results of operations and cash flows for the three months ended November 30, 2006 have been made. The results of operations for the three months ended November 30, 2006 and 2005 are not necessarily indicative of the results that may be expected for the full year.

Use of Estimates

The preparation of the financial statements in accordance with U.S. GAAP requires management to make certain estimates and assumptions that affect the amounts reported and disclosed in our financial statements and the accompanying notes. Actual results could differ materially from these estimates.

On an ongoing basis, we evaluate the estimates including those related to the useful lives of property and equipment and software licenses, the valuation allowance for accounts receivable, goodwill and the value of common stock and stock warrants. We base our estimates on historical experience, available market information, appropriate valuation methodologies including the Black-Scholes option model ("Model"), and on various other assumptions that we believe to be reasonable, the results of which form the basis for making judgments about the carrying value of assets and liabilities. The inputs for the Model are stock price at valuation date and issuance date, strike price for the options, risk-free interest rate, life of the option in years and volatility.

Segment Information

The Company currently operates as one business segment. The Company is not organized by market and is managed and operated as one business. A single management team reports to the chief operating decision maker who comprehensively manages the entire business entity. The Company does not operate any separate lines of business or separate business entities with respect to its products. Accordingly the Company does not accumulate discrete financial information with respect to separate product lines and does not have separately reportable segments.

Fiscal Year

Our fiscal year ends on August 31st. References to fiscal 2006, for example, refer to the fiscal year ending August 31, 2006.

Revenue Recognition

We recognize revenue when telecommunication services and products are delivered, rates are fixed and determinable and collection is deemed probable. We invoice our customers weekly, semi-weekly and monthly and we defer revenue and costs for services and products that have not yet been provided.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investment instruments purchased with original maturities of three months or less. At August 31, 2005, 2006 and November 30, 2006, our cash consists of cash deposits with banks, recorded at cost, which approximates fair value.

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Restricted Cash and Letters of Credit

Restricted cash consists of certificates of deposit held as collateral for letters of credit issued on our behalf. Certain of our vendors that provide on-going services require letters of credit in the event we fail to meet our obligations. The amount of collateralized letters of credit is \$133,000, \$1,306,000, and \$1,309,000 at August 31, 2005, 2006, and November 30, 2006, respectively.

Concentration of Credit Risk

Our financial instruments that are exposed to concentrations of credit risk principally consist of cash and accounts receivable. We deposit our cash in accounts with major financial institutions and, at times, such investments may be in excess of federally insured limits. Much of our revenue and resulting accounts receivable, which are unsecured, is concentrated within a small number of large customers. In fiscal 2005, three customers each accounted for more than 10% of our total revenue. Combined, these three customers accounted for 52% of our total revenue. Four customers each accounted for more than 10% of our accounts receivable and combined account for 63% of accounts receivable at August 31, 2005. In fiscal 2006, one customer accounted for more than 10% of our total revenue at 22%. That same customer accounted for 16% of our accounts receivable at August 31, 2006. In the first quarter of fiscal 2007, two customers consisted for more than 20% of our total revenue. Those same customers consisted of approximately 18% of the total accounts receivable at November 30, 2006.

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Allowance for Doubtful Accounts

We continually monitor customer payment histories in order to maintain a reserve for estimated losses that are likely to result from our customers' inability to make required payments. In determining the reserve, we evaluate the collectibility of our accounts receivable based upon a variety of factors. When we become aware of circumstances that may impair a specific customer's ability to meet its financial obligations, we record a specific allowance against amounts due, and thereby reduce the net recognized receivable to the amount reasonably expected to be collected. We also record a general allowance for doubtful accounts based on factors that include our historical write-off experience, the length of time receivables are past due, customer creditworthiness, and the current business environment. Actual future losses from uncollectible accounts may differ from our estimates. Our allowance for doubtful accounts totaled \$88,000, \$664,000, and \$557,000 at August 31, 2005, 2006 and November 30, 2006, respectively.

Deferred Financing Costs

We account for legal, accounting and other advisory fees related to acquisition or capital fund raising as capitalizable acquisition costs or reductions in the proceeds of equity, respectively. Advisory fees related to debt financing are capitalized and amortized to interest expense over the term of the related debt instrument.

Long-Lived Assets

Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," requires that long-lived assets, including intangible assets, with definite lives be amortized over their estimated useful lives and reviewed for impairment whenever events or changes in circumstances indicate an asset's carrying value may not be recoverable. Recoverability of an asset is measured by comparison of its carrying amount to the expected future undiscounted cash flows that the asset is expected to generate. If it is determined that an asset is not recoverable, an impairment loss is recorded in the amount by which the carrying amount of the asset exceeds its fair value. Excluding goodwill and unamortized software, no impairments have been incurred to date.

Property and Equipment

Property and equipment includes acquired assets and those accounted for under capital leases and consist primarily of network equipment and computer hardware, a building, furniture and fixtures and software. Property and equipment are stated at cost less accumulated depreciation. Depreciation is computed using a straight-line method based on estimated useful lives as follows:

Software	3 to 5 years
Computers and equipment	3 to 5 years
Furniture and fixtures	5 years
Buildings & improvements	15 to 25 years

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Our network equipment and hardware, which consists of routers, gateways and servers that enable our telephony services and products, is subject to technological risks and rapid market changes due to the introduction of new products and services into our markets and changing customer demand. These changes may result in future adjustments to the estimated useful lives or the carrying value of these assets, or both.

Goodwill and Intangible Assets

We account for goodwill in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," which, among other things, establishes new standards for goodwill acquired in a business combination, eliminates the amortization of goodwill and requires the carrying value of goodwill and certain non-amortizing intangibles to be evaluated for impairment on an annual basis. As required by SFAS No. 142, we perform an annual impairment test on recorded goodwill by comparing the estimated fair value to its carrying value. Our estimation of the fair value requires making judgments concerning future cash flows and appropriate discount rates. The estimate of the fair value of goodwill could change over time based on a variety of factors, including our actual operating performance. If the carrying value of the assets and liabilities, including goodwill, were to exceed our estimation of the fair value, we would record an impairment charge in an amount equal to the excess of the carrying value of goodwill over the implied fair value of the goodwill.

Fair Value of Financial Instruments

The carrying amount of our financial instruments, which include cash and cash equivalents, restricted cash, net accounts receivable, accounts payable, and other accrued expenses, approximate their fair values due to their short maturities.

Income Taxes

We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." SFAS No. 109 requires the use of the asset and liability method, under which deferred income tax assets and liabilities are determined based upon the difference between the financial statement carrying amounts and the tax basis of assets and liabilities and are measured using the enacted tax rate expected to apply to taxable income in the years in which the differences are expected to be reversed. In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities and projected future taxable income in making this assessment. We record a valuation allowance to reduce our deferred tax assets when uncertainty regarding their realizability exists.

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Computation of net loss per share

Basic and diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period. Weighted-average shares include treasury stock. Potentially dilutive securities consisting of unvested restricted shares, stock purchase warrants and convertible preferred stock were not included in the diluted net loss per common share calculations for all periods presented because the inclusion of such shares would have had an anti-dilutive effect.

The following table sets forth the computation of basic and diluted net income loss per share for the periods indicated (in thousands, except share and per share amounts):

	2004	Years Ended August 31, 2005	2006	Three Months Ended November 30, 2006 (unaudited)
Numerator:				
Net Loss attributable to stockholders	\$ (73)	\$ (2,375)	\$ (13,097)	\$ (4,523)
Denominator:				
Weighted average number of shares outstanding used in computing basic and diluted net loss per share	<u>720,000</u>	<u>3,113,333</u>	<u>3,736,417</u>	<u>3,561,436</u>
Basic and diluted net loss per share	<u>\$ (0.10)</u>	<u>\$ (0.76)</u>	<u>\$ (3.51)</u>	<u>\$ (1.27)</u>

Unaudited Proforma

Numerator:				
Net loss attributable to stockholders			\$ (13,097)	\$ (4,523)
Denominator:				
Weighted average shares outstanding used in computing basic and diluted net loss per share (above)			3,736,417	3,561,436
Adjustment to reflect the weighted average effect of the assumed conversion of the convertible preferred shares and warrants			<u>30,111,340</u>	<u>161,808,687</u>
Proforma weighted average shares outstanding basic and diluted			<u>33,847,757</u>	<u>165,370,123</u>
Proforma basic and diluted net loss per share			<u>\$ (0.39)</u>	<u>\$ (0.03)</u>

The following convertible preferred stock and warrants to purchase common and preferred stock were excluded from the computation of diluted net loss per share for the periods presented because including them would have been anti-dilutive:

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	August 31,			November 30,	
	2004	2005	2006	2005	2006
Convertible preferred stock	—	—	20,735,688	18,835,688	20,735,688
Convertible notes payable	—	—	9,375,652	—	9,375,652
Warrants to purchase common stock	—	—	6,772,489	4,500,000	138,469,836
Warrants to purchase preferred stock	—	—	—	150,000	450,000

Stock-Based Compensation

We account for stock-based compensation in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations and elected to utilize the disclosure option of SFAS No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure." Under the provisions of APB No. 25 and related interpretations, compensation expense is to be recognized when options to purchase shares of common stock are issued below the fair market value of the underlying stock on the date of grant. The amount of compensation expense to be recognized is equal to the intrinsic value per share, which is the difference between the exercise price and the fair market value at the date of grant. The Company did not have any issued or outstanding stock options in fiscal year 2006 or 2005.

Stock Warrants Issued to Third Parties

We account for stock warrants issued to third parties in accordance with the provisions of the Emerging Issues Task Force ("EITF") issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." Under the provisions of EITF No. 96-18, because none of our agreements have a disincentive for nonperformance, we record and expense the fair value portion of the warrants earned from the point in time when vesting of the warrants becomes probable. Final determination of fair value of the warrants occurs upon final vesting.

Recently Issued Accounting Standards

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment." SFAS No. 123R requires compensation expense related to stock-based awards to be recognized in the financial statements. The amount of compensation expense will be measured based upon the fair value of the stock-based awards at the date of grant. We will adopt SFAS No. 123R in the first quarter of fiscal 2007. At that time, we will begin recognizing compensation expense related to unvested stock-based awards and newly granted awards.

Stock-based compensation expense recorded under SFAS No. 123R will increase operating expenses. The full impact is dependent upon, among other things, the timing of when additional employees that we hire commence employment, new long-term incentive strategies involving stock awards in order to attract and retain employees, the total number of stock awards granted, the fair value of the stock awards at the time of grant and the tax benefit that we may or may not receive from stock-based expenses.

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes: an interpretation of FASB statement no. 109." FIN No. 48 clarifies the

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accounting treatment for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes," by defining the minimum recognition threshold a tax position is required to meet before being recognized in our financial statements. FIN No. 48 is effective commencing with the Company's fiscal year 2007 annual financial statements. The Company is currently evaluating the effect that the adoption of Fin No. 48 will have on its financial position and results of operations.

2. Restatement of Consolidated Financial Statements

The Company is restating its consolidated balance sheet as of August 31, 2006, and the related consolidated statements of operations, convertible preferred stock and stockholders' deficit and cash flows for the year ended August 31, 2006.

In November 2006, the Company's finance and accounting department initiated a review of the Company's accounting policies for the recording of deferred revenue and related cost of sales (COS), capitalized and unamortized software licenses and certain prepaid expenses associated with current and future acquisitions.

The Company determined that deferred revenue and the associated deferred COS were not properly recorded for the acquisition of CTI (see Note 4). As of August 31, 2006, the accounting error resulted in an adjustment to record an additional \$1,336,000 in deferred revenue and \$452,000 in deferred COS, with an increase of \$884,000 to goodwill.

After considering revised information regarding the purchased and unamortized software licenses (see Note 6), Management of the Company determined that the unamortized software had no net realizable value at August 31, 2006. Accordingly, an impairment charge in the amount of \$1,200,000 was recorded to write off the full value of this asset.

The Company concluded that certain previously capitalized legal and accounting expenses incurred in connection with a planned private equity investment (see Note 4) had no net realizable value as of August 31, 2006. Accordingly, we have made an adjustment in the amount of \$399,000 to write off these legal and accounting expenses.

Management of the Company, after considering the quantitative and qualitative analysis prepared by the finance and accounting department relating to these issues, concluded that the Company should restate its previously issued financial statements. As a result of the above errors and adjustments, we have restated our financial statements for the year ended August 31, 2006.

The impact of the restatement on the consolidated statements of operations is an increase in the net loss of \$1.6 million.

The following table presents the effects of the adjustments to record deferred revenue and COS, to record an impairment charge for the value of unamortized software licenses, to write off certain prepaid expenses and the corresponding income tax effect of these adjustments made to the Company's previously reported consolidated balance sheet as of August 31, 2006 (in thousands, except share amounts):

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Year Ended August 31, 2006

	As Previously Issued	Adjustments	As Restated
<i>In thousands except share and per share data</i>			
Assets			
Current assets:			
Cash	\$ 1,386	\$ —	\$ 1,386
Restricted cash	1,306	—	1,306
Accounts receivable, net of allowance of \$88 and \$664, respectively	7,018	—	7,018
Prepaid expenses and other current assets	430	452	882
Total current assets	10,140	452	10,592
Property and equipment, net of accumulated depreciation	4,308	—	4,308
Intangible assets	7,471	(1,200)	6,271
Goodwill	6,669	758	7,427
Other assets	485	(399)	86
Total assets	\$ 29,073	\$ (389)	\$ 28,684

Liabilities, Convertible Preferred Stock and Stockholders' Deficit			
Current liabilities			
Line of credit	\$ 1,125	\$ —	\$ 1,125
Accounts payable	5,639	—	5,639
Accrued payroll	225	—	225
Notes payable	3,500	—	3,500
Convertible notes payable	17,126	—	17,126
Accrued taxes	1,329	(117)	1,212
Other accrued expenses	2,039	—	2,039
Deferred revenue	290	1,337	1,627
Related party payables	250	—	250
Total current liabilities	31,523	1,220	32,743
Other long term liabilities	42	—	42
Total liabilities	31,565	1,220	32,785

Commitments and contingencies (see Note 14)

Preferred stock, \$0.001 par value; 25,900,000 shares authorized at August 31, 2006,

Series A convertible preferred stock, 24,000,000 shares designated at August 31, 2006, 18,835,688 shares issued and outstanding at August 31, 2006, (aggregate liquidation preference of \$9,418,000 at August 31, 2006)	7,925	—	7,925
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Series A-1 convertible preferred stock, 1,900,000 shares designated at August 31, 2006, 1,900,000 shares issued and outstanding at August 31, 2006, (aggregate liquidation preference of \$950,000 at August 31, 2006)

950	—	950
-----	---	-----

Stockholders' deficit:

Common stock, \$0.001 par value; 36,000,000 shares authorized at August 31, 2006, 4,330,000 shares issued and outstanding at August 31, 2006,

August 31, 2006,	4	—	4
Deferred stock compensation	(7)	—	(7)
Additional paid-in capital	2,619	—	2,619
Accumulated deficit	(13,936)	(1,609)	(15,545)
Treasury stock	(47)	—	(47)
Total stockholders' deficit	(11,367)	(1,609)	(12,976)
Total convertible preferred stock and stockholders' deficit	(2,492)	(1,609)	(4,101)
Total liabilities, convertible preferred stock and stockholders' deficit	\$ 29,073	\$ (389)	\$ 28,684

The accompanying notes are an integral part of these consolidated financial statements

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The restatement had no net impact to our reconciliation of our net loss to the cash used in operating activities. The \$1.6 million increase in our net loss was off-set by an increase in the impairment of intangible assets. Additionally, certain items within net cash provided by/used in, investing or financing activities were minimally affected by the restatement adjustments.

3. Going Concern

The accompanying financial statements have been prepared on the basis of accounting principles applicable to a going concern, which contemplates the realization of assets and extinguishment of liabilities in the normal course of business. As shown in the accompanying balance sheet the Company has incurred a cumulative net loss of \$20,068,000 for the period from inception (June 14, 2004) to November 30, 2006. As of November 30, 2006, the Company will require significant additional equity or debt funding to sustain its operations and satisfy its contractual obligations. These factors, among others, may indicate that the Company may be unable to continue in existence. The Company's financial statements do not include any adjustments related to the realization of the carrying value of assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence. The Company's ability to establish itself as a going concern is dependent upon its ability to obtain additional financing, in order to fund its planned operations and ultimately, to achieve profitable operations. Management believes that they can be successful in obtaining equity and/or debt financing which will enable the Company to continue in existence and establish itself as a going concern. The Company has sold approximately \$25.9 million of convertible notes and common stock through November 30, 2006, and management believes that the Company will be successful in raising additional funding to have sufficient capital to meet its obligations for its planned operations. The Company has raised an additional \$1.8 million subsequent to November 30, 2006 in convertible debt (see Note 16).

4. Business Combinations

New Global Telecom's International Wholesale Business

On June 1, 2005, we acquired certain assets and certain customer and vendor relationships from New Global Telecommunication ("NGT"), a Delaware Corporation, for cash payments totaling \$850,000. We acquired the international wholesale business from NGT and routed the traffic onto our network to generate revenue and to defray a portion of the fixed network costs included in operating expenses.

The acquisition was accounted for as a purchase in accordance with SFAS No. 141, "Accounting for Business Combinations" (SFAS 141); accordingly, we allocated the purchase price to the fair value of assets acquired. No liabilities were assumed.

The final allocation of the purchase price, based on the fair value of each component, consisted of the following:

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	(in thousands)
Property and equipment	\$ 175
Goodwill	675
Total purchase price	\$ 850

The excess of the purchase price over the fair value of the underlying net tangible assets purchased from NGT was recorded as goodwill.

In August of 2005, we reduced the expected cash flows related to the NGT acquisition significantly. Our experience has shown the international wholesale business to be significantly more competitive than expected; putting pressure on the Company's expected profit margins. As a result, the associated goodwill was deemed impaired and a \$675,000 impairment charge was recorded in fiscal 2005.

ZFone VoIP Corporation

In January 2006 we acquired certain assets from ZFone VoIP Corporation ("ZFone"); an IPCentrex service provider headquartered in Orlando, Florida for cash payments totaling \$40,000 and 100,000 shares of our common stock.

The acquisition was accounted for as a purchase in accordance with SFAS 141. Accordingly, we allocated the purchase price to the fair value of assets acquired. No liabilities were assumed.

The final allocation of the purchase price, based on the fair value of each component, consisted of the following:

	(in thousands)
Accounts receivable	\$ 19
Goodwill	26
Total purchase price	\$ 45

The excess of the purchase price over the fair value of the underlying net tangible assets purchased from Zfone was recorded as goodwill. The recorded goodwill was written off in November 2006.

Capital Telecommunications, Inc.

On June 15, 2006 we acquired all the capital stock of Capital Telecommunications, Inc. ("CTI"), a registered CLEC headquartered in York, Pennsylvania. The aggregate purchase price was \$15,144,000. Purchase consideration consisted of \$12,000,000 in cash and the assumption of all liabilities. Additionally, we entered into a 16 month, \$500,000 consulting agreement with one of the founders. The acquisition was financed with a consortium of bridge loans that became callable in November 2006.

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The acquisition was accounted for as a purchase in accordance with SFAS 141. Accordingly, we allocated the purchase price to the fair value of assets acquired and liabilities assumed.

The preliminary allocation of the purchase price, based on the fair value of each component, consisted of the following:

	(in thousands)
Goodwill	\$ 7,400
Customer contracts	5,900
Trade names	800
Acquired tangible assets, net of liabilities assumed	1,801
Total purchase price	\$ 15,901

The value attributed to the customer contracts and trade names acquired from CTI contributed to a purchase price in excess of the fair value of tangible assets acquired. The remaining excess of the purchase price over the fair value of the acquired tangible and intangible assets purchased from CTI was recorded as goodwill.

The results of operations of CTI have been included in the Company's restated consolidated financial statements subsequent to the date of acquisition. The financial information in the table below summarized the combined results of operations of StarVox and CTI, on a pro forma basis, as though the companies had been combined as of the beginning of fiscal 2006 (in thousands, except per share amounts):

	August 31, 2006
Total pro forma revenue	\$ 51,760
Pro forma net loss	\$(13,610)
Pro forma net loss per share — basic and diluted	\$ (0.56)
Reported revenue	\$ 24,626
Reported net loss	\$(13,097)
Reported net loss per share — basic and diluted	\$ (0.54)

The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the merger had taken place at the beginning of each of the periods presented. The pro forma financial information for the year ended August 31, 2006 excludes merger related expenses of \$24,000 recorded by CTI.

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US Wireless Data, Inc.

In June 2006, we signed a reverse merger agreement with US Wireless Data, Inc. ("USWD"), a public Company. USWD is currently a "shell" company with virtually no operations. USWD effected a reorganization on March 18, 2004, thereby emerging from Chapter 11 Proceedings. Our business plan was to merge or effect a business combination with a domestic or foreign public entity thereby gaining access to public capital markets. Under the terms of the merger agreement we will contribute all of our assets and liabilities (including our CTI subsidiary) in exchange for approximately 72% of USWD's common stock. Our current officers and management will become the officers and management of USWD and following the completion of the reverse merger, USWD intends to change its name to StarVox Communications, Inc.

In connection with the negotiations and signing of the reverse merger agreement with USWD, we issued to USWD two senior secured promissory notes totaling \$3,500,000. As of August 31, 2006, the note for \$300,000 is callable and the note for \$3,200,000 is callable after September 30, 2006. See Note 8.

The following table outlines changes to the carrying amount of goodwill:

	(in thousands)
Balance at August 31, 2004	
Goodwill acquired — NGT	675
Impairment charge — NGT	(675)
Balance at August 31, 2005	—
Goodwill acquired — ZFone	26
Goodwill acquired — CTI	7,400
Balance at August 31, 2006	7,426
Impairment charge — ZFone	(26)
Balance at November 30, 2006 (unaudited)	\$ 7,400

5. Property and Equipment

Property and equipment consists of:

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	August 31,		November 30,
	2005	2006	2006
			(unaudited)
	(in thousands)		
Land	\$ —	\$ 30	\$ 30
Building	—	522	522
Network equipment	1,133	4,057	4,082
Computers and software	170	249	226
Furniture and fixtures	47	62	62
	1,350	4,920	4,922
Less accumulated depreciation and amortization	(77)	(612)	(985)
Property and equipment, net	<u>\$ 1,273</u>	<u>\$ 4,308</u>	<u>\$ 3,937</u>

6. Goodwill and Intangible Assets

Goodwill and intangible assets consist of:

	August 31,		November 30,
	2005	2006	2006
			(unaudited)
	(in thousands)		
Amortizable intangible assets:			
Acquired customer contracts	\$ —	\$ 5,900	\$ 5,900
Acquired trademarks / trade names	—	800	800
	—	6,700	6,700
Less: Accumulated amortization	—	(429)	(944)
Intangible assets, net	<u>\$ —</u>	<u>\$ 6,271</u>	<u>\$ 5,756</u>
Non-amortized intangible assets:			
Goodwill	<u>\$ —</u>	<u>\$ 7,427</u>	<u>\$ 7,400</u>

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Software Licenses

In 2004, we purchased a unified communications software license from our founder in exchange for a \$250,000 note payable and a future issuance of \$750,000 of preferred stock. The \$1,000,000 fair value of the software license was based on the amount our founder had previously paid in cash and notes for the license, an analysis of discounted cash flows, a comparison to similar licenses purchased by unrelated parties under similar terms and a value determined by a third party specialist. At August 31, 2006 the software was deemed impaired and fully written off. See Note 2. As of August 31, 2005, these obligations were recorded as related party payables. See Note 10. As of August 31, 2006, the \$250,000 note payable to our founder remains outstanding. As of November 30, 2006, \$100,000 of the note was repaid and the remaining \$150,000 plus accrued interest of \$48,000 was converted into unsecured demand promissory notes.

In 2005, we purchased certain software licenses and intellectual property from a group that included our Vice President of Marketing and our largest equity investor for a future issuance of \$200,000 of preferred stock. The \$200,000 fair value of the software was based on an analysis of discounted cash flows and recorded as a related party payable. At August 31, 2006 the software was deemed impaired and fully written off. See Note 2.

In October 2005, 1,900,000 shares of Series A-1 Convertible Preferred Stock was issued in satisfaction of \$950,000 of related party payables.

We evaluate our intangible assets for impairment whenever events and circumstances indicate its fair value may be less than its carrying value. Adjustments to record impairment of intangible assets could have a material adverse impact on our financial condition and results of operations in the period or periods in which such impairment is identified. Amortization expense associated with the acquired customer contracts and trade names was \$429,000 and \$515,000 in fiscal 2006 and the three months ended November 30, 2006, respectively.

The anticipated amortization schedule for intangible assets is as follows:

<u>Year ending August 31,</u>	<u>Acquired Customer Relationships</u>	<u>Acquired Trademarks / Trade Names</u> (In thousands)	<u>Total</u>
2007	\$ 1,260	\$ 633	\$ 1,893
2008	1,260	—	1,260
2009	1,260	—	1,260
2010	1,177	—	1,177
2011	681	—	681
	<u>\$ 5,638</u>	<u>\$ 633</u>	<u>\$ 6,271</u>

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7. Line of Credit

In August 2005, we entered into a one year financing agreement with a financial institution providing a line of credit of \$750,000 through August 2006 where we can borrow up to 70% of eligible accounts receivables at an effective interest rate of 24% per annum. In addition, certain of our other creditors agreed to subordinate their interest to this financial institution. In January 2006, the line of credit was amended to increase the borrowing limit to \$1,500,000.

As of August 31, 2005, 2006, and November 30, 2006, we had borrowed \$516,000 plus accrued interest of \$1,000, \$1,125,000 and \$145,000, respectively.

In September 2006, we finalized a two part credit facility with a financial institution. The first part is a \$6 million revolving line of credit where we can borrow up to 80% of eligible accounts receivable. Interest is calculated as prime rate plus 1.0% or prime rate plus 1.5% dependant upon our quick ratio. We intend to use some of the proceeds from this facility to retire our current accounts receivable credit line. The second part is a \$6 million general term facility that can grow to \$10 million as we achieve certain profitability targets. The interest rate is prime rate plus 2.25% and we will be required to issue to the bank up to 300,000 Series A preferred stock warrants, exercisable at \$0.50 per share depending upon the amount of credit extended. We must maintain a fixed debt service coverage ratio, and certain EBITDA targets, and obtain the bank's consent to enter into certain material agreements. Borrowings under both credit facilities are secured by all of our assets and are senior to all other debt holders.

8. Notes Payable

In fiscal 2006, we issued two senior secured promissory notes to USWD in connection with the contemplated reverse merger as follows:

Year ended August 31, 2006 and three months ended November 30, 2006

	Total (in thousands)
Senior secured promissory note maturing August 2006, interest at 10% per annum until maturity, then 15% per annum	\$ 300
Senior secured promissory note maturing September 2006, interest at 10% per annum until maturity, then 15% per annum	3,200
	3,500
Unsecured demand promissory notes bearing interest at 5% per annum	4,075
	\$ 7,575

Both notes payable are collateralized by all of our assets. In connection with the issuance of these notes, significant holders of our voting stock have entered into a stockholders voting agreement establishing the makeup of our board of directors. The stockholders voting agreement will terminate on the earlier of the closing of the merger with USWD or the repayment in full of the notes payable to USWD.

As of August 31, 2006, the \$300,000 senior secured promissory note has matured, is callable and bears interest at 15% per annum.

Between October 2006 and November 2006, we issued \$4,300,000 in unsecured demand promissory notes with simple interest of 5% per annum. In connection with these notes, non-detachable warrants were issued to purchase approximately 131,700,000 shares of common stock at a price of \$0.03 per share. Just prior to the merger (see Note 4), the principle of these notes was used to exercise the warrants.

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9. Convertible Notes Payable

The following schedule details all convertible notes payable and their respective terms:

	August 31,		November 30,
	2005	2006	2006
			(unaudited)
	(in thousands)		
Secured convertible notes payable maturing July through October 2005; interest at 13% per annum	\$ 4,500	\$ —	\$ —
Secured convertible promissory note, due upon demand; interest at 8% per annum	100	—	—
Secured convertible promissory notes, due upon demand; interest at 5% per annum until maturity, then 15% per annum	—	1,220	1,220
Secured convertible promissory notes maturing August and September 2006; interest at 5% per annum until maturity, then 15% per annum	—	3,100	3,100
Senior secured convertible promissory notes maturing November and December 2006; Interest at 12% per annum until maturity, then 15% per annum.	—	14,000	14,000
	4,600	18,320	18,320
Less: Unamortized issuance costs	—	(1,194)	(24)
	<u>\$ 4,600</u>	<u>\$17,126</u>	<u>\$ 18,296</u>

In connection with the \$4,500,000 convertible notes issued in fiscal 2005, note holders were also issued warrants to purchase 4,500,000 shares of common stock at an exercise price of \$0.525 per share. The warrants were fully vested and exercisable upon issuance and expire three years from the date of the note. The fair value of the warrants calculated using the Black-Scholes option pricing model was determined to be immaterial. As of August 31, 2006, and November 30, 2006 warrants to purchase 4,500,000 shares of common stock remained outstanding.

In October 2005, \$4,475,000 of the \$4,500,000 13% convertible notes payable plus \$231,000 in accrued interest was converted into 11,765,688 shares of Series A Preferred Stock. We retired the remaining \$25,000 convertible note payable by paying the note holder in cash. The convertible notes were converted into Series A Preferred Stock at a price of \$0.40 per share.

In September 2005, we issued an additional \$100,000 secured convertible demand promissory note bearing interest at 8% per annum. Then in October 2005, for cash and the conversion of the \$200,000 of convertible promissory notes, we issued 7,070,000 shares of Series A Preferred Stock at a price of \$0.50 per share.

Between February and June of 2006, we issued \$18,320,000 in secured and senior secured convertible promissory notes to serve as bridge financing for the acquisition of CTI and to fund continuing operating costs. Certain of the secured convertible promissory notes were

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callable upon issuance, with the balance callable upon maturity between August and December of 2006. As of August 31, 2006, \$2,820,000 of the outstanding promissory notes are callable. As of November 30, 2006, \$15,320,000 notes are callable.

In connection with \$14,000,000 senior secured convertible promissory notes issued in 2006, note holders were also issued warrants to purchase 6,772,489 shares of common stock at an exercise price of \$0.01 per share. The warrants were fully vested and exercisable upon issuance and expire three years from the date of the note. The fair value of the warrants calculated using the Black-Scholes option pricing model is \$2,515,000 and has been recorded as a note issuance discount and is being amortized to interest expense over the life of the notes. Interest expense associated with the amortization of the warrant discount was \$1,321,000 and \$1,170,000 in fiscal 2006 and the quarter ended November 30, 2006, respectively.

10. Related Party Payables and Transactions

In 2003 our founder purchased a perpetual unified communications software license for \$1,000,000. In 2004 we purchased this license from our founder in exchange for a demand promissory note in the amount of \$250,000 with interest at 12% per annum and a future issuance of preferred stock with a value of \$750,000. These obligations were recorded as related party payables.

In 2005, we purchased certain software licenses and intellectual property from a group that included our Vice President of Marketing and our largest equity investor for a future issuance of \$200,000 of preferred stock. The \$200,000 fair value of the software was based on an analysis of discounted cash flows and recorded as a related party payable.

In October 2005, 1,900,000 shares of Series A-1 Convertible Preferred Stock were issued in satisfaction of the \$950,000 of the future issuance of preferred stock obligation. As of August 31, 2006, the \$250,000 note payable to our founder remains outstanding.

In September 2006, notice was received demanding full payment of the note payable. See Note 6.

In November 2006, \$100,000 of the note was repaid. The remaining \$150,000 note and accrued interest of \$48,000 was converted in to a demand promissory note.

The following table represents future issuance of preferred stock and notes payable to founder.

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	August 31,		November 30,
	2005	2006	2006 (unaudited)
	(in thousands)		
Future issuances of preferred stock (See Note 5)			
To founder for acquisition of software license	\$ 750	\$ —	\$ —
To related group for acquired software licenses	200	—	—
Note payable to founder, due upon demand; interest at 12% per annum	250	250	—
Note payable to founder, due upon demand; interest at 5% per annum	—	—	198
	<u>\$ 1,200</u>	<u>\$ 250</u>	<u>\$ 198</u>

11. Convertible Preferred Stock

The rights, preferences, and privileges of the convertible preferred stock are as follows:

Dividends

The holders of Series A preferred stock are entitled to receive dividends out of any assets legally available prior and in preference to any declaration or payment of any dividend on Series A-1 preferred and common stock at a rate of 8% of the original issue price per annum, when and if declared by our Board of Directors. After payment of the dividend preference, outstanding shares of Series A preferred stock shall participate with shares of Series A-1 preferred and common stock as to any additional declaration or payment of any dividend. As of August 31, 2006, no dividends had been declared or paid.

Conversion

Each share of Series A and A-1 preferred stock is convertible, at the option of its holder, into the number of fully paid and non-accessible shares of common stock which results from dividing the applicable original issue price per share by the applicable conversion price per share at the time of conversion. The original issue prices per share of Series A and Series A-1 preferred stock are \$0.50. As of August 31, 2006 and November 30, 2006, the conversion prices per share of Series A and Series A-1 preferred stock were \$0.50, and the rate at which each share converted into common stock is one for one.

Each share of Series A and A-1 preferred stock will automatically convert into common stock, at the conversion rate then in effect, immediately on the earlier of (1) the affirmative election of the holders of a majority of the outstanding shares of Series A and A-1 preferred stock, or (2) the closing of the sale of our common stock in a firm commitment underwritten public offering with aggregate gross proceeds of at least \$20,000,000.

Liquidation Preferences

In the event of any liquidation, dissolution, or winding up of the Company, whether voluntary or involuntary, the holders of Series A preferred stock will be entitled to receive, prior

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and in preference to any distribution to Series A-1 and common stock shareholders, an amount equal to the original purchase price of \$0.50 per share, plus any declared but unpaid dividends. If, upon the occurrence of such event, the assets and funds available for distribution among the holders of Series A preferred stock are insufficient to permit the payment of these preferential amounts in full, the entire assets and funds legally available for distribution will be distributed ratably in proportion to the full amounts to which they would otherwise be respectively entitled.

After payment of the full liquidation preference to Series A preferred stock holders, the holders of Series A-1 preferred stock will be entitled to receive, prior and in preference to any distribution to Series A-1 and common stock shareholders, an amount equal to the original purchase price of \$0.50 per share, plus any declared but unpaid dividends. If, upon the occurrence of such event, the assets and funds available for distribution among the holders of Series A-1 preferred stock are insufficient to permit the payment of these preferential amounts in full, the entire assets and funds legally available for distribution will be distributed ratably in proportion to the full amounts to which they would otherwise be respectively entitled.

Voting Rights

Each share of Series A and A-1 preferred stock is entitled to the number of votes equal to the number of shares of common stock into which such shares of Series A and A-1 preferred stock could be converted on the record date for any vote, or effective date of any written consent, as applicable.

In addition to any other vote or consent required, a majority affirmative vote of the Series A preferred shareholders is required to affect or validate certain actions relating to the Certificate of Incorporation or changing our capitalization structure.

For as long as 13,000,000 shares of Series A preferred stock remain outstanding, the holders of Series A preferred stock, voting as a separate class, are entitled to elect three members of the Board of Directors. The holders of Series A-1 preferred stock and common stock, voting together as a single class, are entitled to elect one member of the Board of Directors. The holders of Series A and A-1 preferred stock and common stock, voting together as a single class on an as-if-converted basis, are entitled to elect all remaining members of the Board of Directors.

Anti-dilution Provisions

Each share of Series A and A-1 preferred stock has standard anti-dilution protection.

Warrants

In fiscal 2006, we issued a warrant to purchase 150,000 shares of Series A convertible preferred stock at an exercise price of \$0.525 per share to the financial institution providing our line of credit facility. The fair value of the warrants calculated using the Black-Scholes option pricing model was determined to be immaterial.

In fiscal 2006, we issued a warrant to purchase 250,000 shares of common stock at an exercise price of \$0.525 per share to consultants. The fair value of the warrants calculated using the Black-Scholes option pricing model was determined to be immaterial.

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In September 2006, we issued a warrant to purchase 300,000 shares of Series A convertible preferred stock at an exercise price of \$0.50 per share to the financial institution providing our line of credit facility. The fair value of the warrants calculated using the Black-Scholes option pricing model was determined to be immaterial.

Issuance of Series A and Series A-1 Preferred Stock

In October 2005, we issued 1,900,000 shares of Series A-1 preferred stock to satisfy \$950,000 of obligations to issue preferred stock resulting from the purchase of acquired technology. See Note 5.

In October 2005, \$4,475,000 of convertible promissory notes and \$231,000 in accrued interest were converted into 11,765,688 shares of Series A preferred stock. The convertible notes and accrued interest were converted into Series A preferred stock at a price of \$0.40 per share.

In October 2005, 7,070,000 shares of Series A preferred stock were issued in exchange for net cash of \$2,819,000 and \$200,000 of convertible promissory notes at a price of \$0.50 per share.

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12. Stockholders' Deficit

Restricted Stock

Since inception, we have issued 2,515,000 restricted shares of common stock. The restricted shares generally vest 50% on each of the first and second anniversaries following the award date. As of August 31, 2006, 1,172,500 shares were vested, repurchase rights had been exercised on 932,500 shares after employment termination and 410,000 shares of common stock were subject to repurchase rights upon termination of employment by the holders. As of November 30, 2006, there were still 1,172,500 shares vested, repurchased rights had been exercised on 945,000 shares after employment termination and 397,500 shares of common stock were subject to repurchase rights upon termination of employment by the holders

Treasury Stock

Between January and September of 2006 we repurchased 945,000 shares of unvested common stock for \$47,000 from employees that had left the Company.

Stock Based Compensation

For fiscal years 2005, 2006 and 2007, we recognized \$6,000, \$16,000, and \$3,000 respectively, of stock-based compensation expense in connection with the award of restricted stock to certain employees. The restrictions on the shares of restricted stock lapse 50% on each of the first two anniversaries following the award date. Compensation expense was measured on the award date and is being recognized over two years as these restrictions lapse. The unamortized balance of deferred stock based compensation was reclassified to additional paid in capital upon the Company's adoption of FAS 123(R) effective September 1, 2006.

Shares Reserved for Future Issuance

We have reserved shares of common stock for future issuance at August 31, 2005 and 2006, as follows:

	August 31,		November 30,
	2005	2006	2006 (unaudited)
Common stock warrants	4,500,000	11,522,489	143,219,836
Convertible preferred stock	—	20,735,688	20,735,688
Series A convertible preferred stock warrants	150,000	150,000	450,000
	<u>4,650,000</u>	<u>32,408,177</u>	<u>164,405,524</u>

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13. Income taxes

At August 31, 2006 and 2005, federal, state, and local tax expenses included in the accompanying financial statements are as follows:

	<u>2005</u>	<u>2006</u>
	(in thousands)	
Current Tax Expense		
Federal	\$ —	\$ 11
State and Local	1	9
Total	<u>\$ 1</u>	<u>\$ 20</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of August 31, 2006 and 2005 are as follows:

	<u>2005</u>	<u>2006</u>
	(in thousands)	
Deferred Tax Assets		
Accruals	\$ 54	\$ 308
Net operating losses	633	4,474
Depreciation and amortization	176	—
Other	—	180
	<u>863</u>	<u>4,962</u>
Less: Valuation allowance	<u>(863)</u>	<u>(2,293)</u>
Net deferred tax assets	—	2,669
Deferred Tax Liabilities		
Deferred Revenue	—	(454)
Depreciation and amortization	—	(2,215)
Total deferred tax liabilities	<u>—</u>	<u>—</u>
Net deferred tax assets	<u>\$ —</u>	<u>\$ —</u>

A reconciliation between the income tax provision at the federal statutory tax rate and the reported provision for income taxes is as follows:

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	2005	2006
	(in thousands)	
Provision at federal statutory rate of 35%	\$ (807)	\$ (4,427)
Provision for state income tax, net of federal benefit	(210)	(535)
Change in valuation allowance	863	1,430
Tax effects of acquisitions		2,419
Effect of nondeductible expenses		776
Other	155	357
Provision for income taxes	\$ 1	\$ 20

A valuation allowance must be established for a deferred tax asset if a tax benefit may not be realized from the asset. We have established a 100% valuation allowance to the extent our deferred tax assets exceed our deferred tax liabilities as it is more likely than not we will not realize the benefit from our deferred tax assets during fiscal 2007.

At August 31, 2006, we have approximately \$11,718,000 of net operating loss carryforwards, expiring at various dates through 2026, available to offset future federal taxable income. Additionally, we have approximately \$9,739,000 of net operating loss carryforwards, expiring at various dates through 2016, available to offset future state taxable income.

14. Commitments and Contingencies

Lease Commitments

Rental expenses under operating leases were \$125,000, \$325,000 and \$137,000 for fiscal 2005, 2006 and the three months ended November 30, 2006, respectively. We have future minimum rental commitments for non-cancelable operating leases on office spaces as of August 31, 2006, as follows:

Year ending August 31	(in thousands)
2007	\$ 463
2008	284
2009	213
2010	164
2011	52
	<u>\$ 1,176</u>

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In August 2006, we entered into a \$2,300,000, 36 month capital lease arrangement to acquire network equipment. Our bank issued an \$844,000 letter of credit in favor of the lessor and we will be required to make quarterly lease payments of \$218,000 once equipment has been delivered. As of November 30, 2006 we had not taken delivery of the equipment.

Letters of Credit

We have several outstanding letters of credit for the benefit of certain vendors that secure our obligations for leased space and telecommunications services. The terms of the letters of credit coincide with the terms of the leases or for the periods we continue to purchase these telecommunications services. The letters of credit are secured by certificates of deposit held by the issuing financial institution, are reported as restricted cash and are excluded from our operating cash.

15. Employee Benefit Plans

CTI has a 401(k) Plan (the "Plan") in which employees who have met certain service and eligibility requirements may participate. Each eligible employee may elect to contribute to the Plan, and CTI may make discretionary matching contributions. CTI made matching contributions of approximately \$73,000, \$62,000 and \$9,000 during fiscal 2005, 2006 and the three months ended November 30, 2006, respectively.

16. Subsequent Events

In September 2006, notice was received demanding payment of the related party \$250,000 demand promissory note. In November 2006, the Company repaid \$100,000 of the note payable. The remainder of the note and accrued interest of \$48,000 was converted into the unsecured demand promissory notes discussed below.

From October 2006 through March 2007, for the purpose of providing working capital, the Company issued to our current investors unsecured demand promissory notes and warrants for an aggregate principal amount of \$5,900,000 of which \$4,300,000 was received in the quarter ended November 30, 2006 (see Note 9). The promissory notes bear interest at 5 percent per annum and the warrants, with a 10 year term, would convert into 181,400,000 shares of our common stock or 50% of the Company, whichever is greater. The exercise price of the warrants would be equal to the cancellation value of the principal of the related notes.

In December 2006, the Company received equipment under the Cisco lease arrangement signed in August 2006 incurring a capital lease liability of \$2,300,000. This is a three year lease with interest at 9.37%.

In January 2007, the Company granted additional warrants to holders of the \$14,000,000 senior secured convertible promissory notes originally issued in fiscal 2006. The additional warrants enable the holders to purchase 64,783,506 shares of common stock at an exercise price of \$0.01 per share. The warrants were fully vested and exercisable upon issuance and expire three years from the date of the note. When the Company issues equity

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securities which are convertible into common stock at a discount from the common fair value at the commitment date, the difference between the fair value of the common stock and the conversion price multiplied by the number of shares issuable upon conversion is recognized as a beneficial conversion feature. The beneficial conversion feature is presented as a deemed dividend to the related security holders with an offsetting amount to additional paid in capital and will be amortized over the period from the issue date to the first conversion date. Since the warrants are immediately convertible into common stock by the holder at any time, the Company recorded and immediately amortized a beneficial conversion charge (deemed dividend) of approximately \$0.5 million in connection with its convertible subordinated debentures in February 2007.

In January 2007, the authorized shares of common stock was increased to 369,000,000 shares and the authorized preferred stock was increased to 31,000,000.

In January 2007, the Company issued Trinad a warrant to purchase 2,500,000 shares of common stock at an exercise price of \$0.525 per share. The warrant is consideration for management consulting services.

Peyton Chandler & Sullivan, Inc., an investor in the Company, was issued 50,000 shares of common stock at the fair market value of \$0.03 per share. This was done in January 2007 as consideration for work performed on a consulting contract.

In January 2007, an out of plan option was granted and exercised by a former employee for 50,000 shares of common stock at an exercise price equal to the fair market value of \$0.03 per share. This was completed as part of a severance agreement dated in August 2006. The fair value of the options calculated using the Black Scholes option pricing model was determined to be immaterial.

In January 2007, the Company approved the 2007 Stock Option Plan. The 2007 Stock Plan provides for the grant of incentive stock options, within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, to our employees and any parent and subsidiary corporations' employees, and for the grant of nonstatutory stock options to our employees, directors and consultants and any parent and subsidiary corporations' employees and consultants. The 2007 Stock Plan also allows for awards of restricted stock to our employees, directors and consultants and any parent and subsidiary corporations' employees, directors and consultants. The Company also authorized up to 64.5 million common shares to be issued under this plan.

In February 2007, all warrants issued and outstanding, with exercise prices equal to or greater than \$0.50 per share, were re-priced to a value equal to one tenth of the original exercise price. Warrants to purchase an aggregate of 7,700,000 shares of common stock were re-priced with exercise prices ranging from \$0.05 to \$0.053 per share. The fair value of the re-priced warrants, calculated using the Black Scholes option pricing model was determined to be less than the original fair value, accordingly no additional charge was recorded in connection with the repricing.

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In February 2007, the Company issued nonstatutory and incentive stock options under the 2007 Stock Option Plan totaling 55,227,500 options to purchase shares of common stock at an exercise price of \$0.03, which is determined to be the fair market value. The company also issued an out of plan option to purchase 400,000 shares of common stock at an exercise price of \$0.50. The fair value of the common stock calculated using the Black Scholes option pricing model was determined to be immaterial.

In January 2006 and March 2007, the USWD Merger Agreement was amended to account for the increased amount of the unsecured demand promissory notes and to extend the termination date of the agreement to the end of March 2007.

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Independent Auditor's Report

To the Board of Directors
Capital Telecommunications, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Capital Telecommunications, Inc. and Subsidiaries (Company) as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Capital Telecommunications, Inc. and Subsidiaries as of December 31, 2005 and 2004, and the results of their operations, and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Beard Miller Company LLP
York, Pennsylvania
May 5, 2006

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	<u>December 31,</u>		<u>March 31,</u>
	<u>2004</u>	<u>2005</u>	<u>2006</u>
			<u>(Unaudited)</u>
Assets			
Current Assets			
Cash	\$ 63,779	\$ 23,717	\$ 12,884
Investments	653,202	598,765	686,467
Accounts receivable, net of allowance for adjustments and uncollectible of \$205,000	3,957,150	3,562,263	3,277,318
Deferred income taxes	71,000	71,000	16,000
Other assets	92,776	61,704	112,456
Total Current Assets	<u>4,837,907</u>	<u>4,317,449</u>	<u>4,105,125</u>
Property and Equipment, net of accumulated depreciation of \$5,020,902, \$5,198,546, and \$5,439,989 (unaudited) respectively	<u>3,903,300</u>	<u>3,300,333</u>	<u>3,138,558</u>
Other Assets			
Customer base, net of accumulated amortization of \$1,654,773, \$2,139,249, and \$2,260,368 (unaudited), respectively	2,046,268	1,561,792	1,440,673
Deferred income taxes	250,000	36,000	19,000
Notes receivable — stockholders	60,000	—	—
Total Other Assets	<u>2,356,268</u>	<u>1,597,792</u>	<u>1,459,673</u>
Total Assets	<u>\$11,097,475</u>	<u>\$9,215,574</u>	<u>\$8,703,356</u>

See notes to consolidated financial statements.

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	<u>December 31,</u>		<u>March 31,</u>
	<u>2004</u>	<u>2005</u>	<u>2006</u>
			<u>(Unaudited)</u>
Liabilities and Stockholders' Equity			
Current Liabilities			
Line of credit	\$ 1,974,374	\$ 1,692,652	\$ 1,513,416
Current maturities of long-term debt	1,254,982	328,697	182,331
Accounts payable	4,071,404	3,233,684	3,105,397
Accrued line transmission costs	572,000	595,000	596,000
Accrued gross receipts taxes	657,780	642,461	419,646
Accrued corporate taxes	343,378	433,682	446,133
Accrued payphone surcharges	416,391	252,301	251,926
Other accrued liabilities	816,244	979,171	924,742
Deferred income taxes	—	—	29,000
Total Current Liabilities	10,106,553	8,157,648	7,468,591
Long-Term Debt	381,229	—	—
Deferred Income Taxes	—	24,000	26,000
Total Liabilities	10,487,782	8,181,648	7,494,591
Stockholders' Equity			
Controlling interest:			
Preferred stock (\$1.15 cumulative; no par value; authorized — 10,000 shares; issued and outstanding — 2,500 shares)	25,000	25,000	25,000
Common stock (no par value; authorized — 10,000,000 shares; issued — 60,000 shares; outstanding — 55,762, 54,922, and 54,992 (unaudited) shares, respectively)	50,000	50,000	50,000
Retained earnings	1,617,909	2,163,549	2,302,553
Accumulated other comprehensive income (loss):			
Net unrealized holding gains (losses)	19,779	(18,784)	17,051
Treasury stock, common — 4,238 shares, 4,908 shares, and 4,908 shares, respectively	(1,163,792)	(1,247,792)	(1,247,792)
Minority interest	60,797	61,953	61,953
Total Stockholders' Equity	609,693	1,033,926	1,208,765
Total Liabilities and Stockholders' Equity	\$11,097,475	\$ 9,215,574	\$ 8,703,356

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Capital Telecommunications, Inc. and Subsidiaries

Consolidated Statements of Income

	Years Ended December 31,			Three Months Ended March 31,	
	2003	2004	2005	2005	2006
				(Unaudited)	
Revenue					
Sales of communications services	\$43,871,172	\$ 34,281,107	\$35,409,423	\$8,666,303	\$8,375,728
Operating Expenses					
Line transmission costs, exclusive of depreciation	30,306,414	24,156,891	24,919,175	6,166,905	5,706,632
General and administrative	7,936,345	6,989,888	6,681,928	1,596,663	1,697,276
Selling	1,548,477	1,212,175	1,339,299	337,256	353,600
Depreciation	1,382,429	1,259,917	1,322,537	309,097	241,443
Customer base amortization	739,992	484,476	484,476	121,119	121,119
Total Operating Expenses	41,913,657	34,103,347	34,747,415	8,531,040	8,120,070
Operating Income	1,957,515	177,760	662,008	135,263	255,658
Other Income (Expenses)					
Gain on sale of equipment	—	—	300,000	100,000	—
Bad debt recovery	—	—	170,751	—	—
Write-off of note receivable	—	(1,722,418)	—	—	—
Investment income	39,197	51,915	10,125	2,498	27,909
Minority interest	(4,812)	—	(1,156)	—	—
Interest expense	(483,440)	(340,959)	(244,288)	(67,046)	(52,563)
Total Other Income (Expenses), Net	(449,055)	(2,011,462)	235,432	35,452	(24,654)
Income (Loss) before Provision for Income Taxes (Benefit)	1,508,460	(1,833,702)	897,440	170,715	231,004
Provision for Income Taxes (Benefit)	630,000	(780,000)	351,800	61,000	92,000
Net Income (Loss)	\$ 878,460	(\$1,053,702)	\$ 545,640	\$ 109,715	\$ 139,004

See notes to consolidated financial statements.

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Capital Telecommunications, Inc. and Subsidiaries

Consolidated Statements of Stockholders' Equity

	Controlling Interest						
	Preferred Stock	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss) - Net Unrealized Holding Gains	Treasury Stock, Common	Minority Interest	Total Stockholders' Equity
Balances —							
December 31, 2002	\$25,000	\$50,000	\$ 1,793,151	(\$123,846)	(\$704,678)	\$55,985	<u>\$ 1,095,612</u>
Net income	—	—	878,460	—	—	—	878,460
Unrealized holding gains, net of \$131,000 deferred income tax expense	—	—	—	192,855	—	—	<u>192,855</u>
Total Comprehensive Income	—	—	—	—	—	—	<u>1,071,315</u>
Purchase of treasury stock	—	—	—	—	(266,076)	—	(266,076)
Increase in minority interest	—	—	—	—	—	4,812	<u>4,812</u>
Balances —							
December 31, 2003	25,000	50,000	2,671,611	69,009	(970,754)	60,797	<u>1,905,663</u>
Net loss	—	—	(1,053,702)	—	—	—	(1,053,702)
Unrealized holding losses, net of \$34,000 deferred income tax benefit	—	—	—	(49,230)	—	—	<u>(49,230)</u>
Total Comprehensive Loss	—	—	—	—	—	—	<u>(1,102,932)</u>
Purchase of treasury stock	—	—	—	—	(193,038)	—	(193,038)
Balances —							
December 31, 2004	25,000	50,000	1,617,909	19,779	(1,163,792)	60,797	<u>609,693</u>
Net income	—	—	545,640	—	—	—	545,640
Unrealized holding losses, net of \$26,000 deferred income tax benefit	—	—	—	(38,563)	—	—	<u>(38,563)</u>
Total Comprehensive Income	—	—	—	—	—	—	<u>507,077</u>