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YP NET INC
Form 10KSB
December 31, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-KSB

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 2003

TRANSITION REPORT UNDER SECTION 13 OR 15 (d)
OF THE
SECURITIES EXCHANGE ACT OF 1934
For the Transition period from _____ to _____

Commission File Number: 0-24217

YP.NET, INC.

(Name of Small Business Issuer in its Charter)

NEVADA 85-0206668
(State or other jurisdiction of incorporation (IRS Employer Identification No.)
or organization)

4840 EAST JASMINE STREET, SUITE 85205
105, MESA, ARIZONA
(Address of principal executive offices) (Zip Code)

(480) 654-9646
(Issuer's telephone number)

Securities registered under Section 12(b) of the Exchange Act: NONE

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

COMMON STOCK, \$.001 PAR VALUE
(Title of Class)

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB .

Registrant's revenues for its most recent fiscal year were \$30,767,444.

The aggregate market value of the common stock held by non-affiliates computed based on the closing price of such stock on December 26, 2003 was approximately \$29,600,000.

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The number of shares outstanding of the registrant's classes of common stock, as of December 26, 2003 was 48,560,802.

Transitional Small Business Disclosure Format: Yes [] No [X]

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Registrant's 2004 Annual Meeting of Shareholders to be held on April 2, 2004 are incorporated by reference in Part III of this Form 10-KSB.

PART I

Forward-Looking Statements

Part I of this Annual Report on Form 10-KSB, includes statements that constitute "forward-looking statements." These forward-looking statements are often characterized by the terms "may," "believes," "projects," "expects," or "anticipates," and do not reflect historical facts. Specific forward-looking statements contained in Part I of this Annual Report include, but are not limited to: (i) our expected continued success in our direct mail marketing program; (ii) the expected success of our branding strategy; (iii) our anticipated entry into other countries; and (iv) our strategy to begin marketing to national accounts.

Forward-looking statements involve risks, uncertainties and other factors, which may cause our actual results, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. Factors and risks that could affect our results and achievements and cause them to materially differ from those contained in the forward-looking statements include those identified in the section below titled "Certain Risk Factors Affecting Our Business" in Part II, as well as other factors that we are currently unable to identify or quantify, but may exist in the future.

In addition, the foregoing factors may affect generally our business, results of operations and financial position. Forward-looking statements speak only as of the date the statement was made. We do not undertake and specifically decline any obligation to update any forward-looking statements.

ITEM 1. DESCRIPTION OF BUSINESS

General

YP.Net, Inc., a Nevada corporation (the Company, "we," "us," or "our") is a national Internet Yellow Page publisher. Through our wholly-owned subsidiary, Telco Billing, Inc. ("Telco"), we only publish our Yellow Pages online at or through the following URL's: www.Yellow-Page.Net, www.YP.Net and www.YP.Com.

Any information contained on the foregoing websites or any other websites referenced in this Annual Report are not a part of this Annual Report.

We use a business model similar to print Yellow Page publishers. We publish

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basic directory listings ("Basic Listings"), free of charge. Like Yellow Page publishers, we generate revenues from those advertisers ("Advertisers") that desire increased exposure for their businesses. Our Basic Listings contain the business name, address and phone number for almost 18 million U.S. businesses. We strive to maintain a listing for almost every business in America in this format.

As described below, Advertisers pay us monthly fees in the same manner that advertisers pay additional fees to traditional print Yellow Page providers for enhanced advertisement font, location or display. The users ("Users") of our website(s) are prospective customers for our Advertisers.

We offer several different upgrades to our advertising customers:

Internet Advertising Package(TM) ("IAP"). Under this package, the Advertiser pays for additional exposure by purchasing a Mini-WebPage(TM). This Mini-WebPage contains, among other useful information, a 40-word description of the business, hours of operation and detailed contact information. This product is easily searched by Users on their personal computers, as well as cellular phones and other hand-held devices. In order to provide search traffic to the Advertiser's Mini-WebPage, we elevate the Advertiser to a preferred listing ("Preferred Listing") status, at no additional charge. As such, the preferred Advertiser enjoys the benefit of having its advertisement displayed in a primary position before all Basic Listings in that particular category when Users perform searches on our site(s). The Mini-WebPage is easily accessed and modified by Advertisers. We also provide our Internet Advertising customers with enhanced presentation and additional unique products:

- larger font;
 - bolded business name;
 - map directions;
 - a Click2Call feature, whereby a User can place a telephone call to the Internet Advertising customer by clicking the icon that is displayed on the Mini-WebPage. This call is free of charge to both the User and the Internet Advertising customer;
 - a link to the Internet Advertiser's own webpage; and
-
- additional distribution network for Preferred Listings. This feature gives additional exposure to our Internet Advertising customers by placing their Preferred Listing on several online directory systems. This service is currently free of charge to our Advertisers.

The Internet Advertising Package currently costs the Advertiser \$24.95 per month (\$21.95 for new Advertisers). As of September 30, 2003, we had signed up approximately 250,000 Internet Advertising Packages. Currently, this product accounts for over 95% of our revenue.

Online QuickSite Package(TM) ("QuickSite(TM)"). For those IAP Advertisers that do not have their own website and that desire to provide more information than is offered through the IAP Mini-WebPage, we will design and create an eight page, template-driven, website for the Advertiser, a QuickSite. We charge the Advertiser a set-up fee of \$200.00 and an additional \$39.95 per month for hosting services for their QuickSite. Once set up, the Advertiser can access their new QuickSite online and make modifications at their discretion. This essentially serves the same function as do display advertisements in the print Yellow Page books, except that it can be changed more often to meet Advertisers' needs. Users can access these QuickSites on the World Wide Web or from the Advertisers Preferred Listing or Mini-WebPage. As of September 30, 2003, we had created and currently host approximately 265 QuickSites.

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Internet Dial-Up Package(TM) ("IDP"). We offer our Internet Advertising customers a cost-effective and efficient Internet dial-up package to take advantage of the benefits offered by on-line access. This allows our Advertisers who do not have Internet access to take full advantage of the IAP and QuickSite packages that we offer. In certain geographical areas, we have offered a bundled product whereby the IAP Advertiser can either pay for the advertising or the IDP, in which case they will receive the other service free. To date, approximately 40,000 Internet Advertising customers utilize the service without charge. However, we intend to expand and market this package to new Advertisers in the next fiscal year at a cost of \$34.95 per month for a bundled product. Those Advertisers that already have the free service will retain their current bundled pricing.

Marketing. Unlike most print Yellow Page companies that sell advertising space by visiting or calling potential advertisers in their area, we solicit advertisers for our Internet Advertising Package exclusively by direct mail. We believe this enables us to offer our products and services at more affordable rates than our competitors. Moreover, we believe direct mail is a less expensive form of marketing than visiting or calling potential customers. Currently, our direct mail marketing program includes a promotional incentive, generally in the form of a \$3.50 activation check that a solicited business simply deposits to activate the service and become an Internet Advertising customer on a month-by-month basis. As a method of third-party verification, the depositing bank verifies that the depositing party is in fact the solicited business. Upon notice of activation by a depositing bank, we immediately contact the business to confirm the order and obtain the information necessary to build their Mini-WebPage. Within 30 days of

activation, we also send a confirmation card to the business. To ensure our goal of 100% customer satisfaction, we offer a cancellation period of 120 days and a full refund. Our direct mail marketing program complies with and, in many instances, exceeds the United States Federal Trade Commission ("FTC") requirements as established by agreement signed between the Company and the FTC in September 2001.

Billing. Similar to the local Regional Bell Operating Companies, we are approved to bill our products and services directly on most of our Advertisers' local phone bill. We believe that this is a significant competitive advantage as few independent Yellow Page companies are authorized to do business in this fashion.

Benefits to Advertisers. For advertisers, we believe that online Yellow Pages provide significant competitive advantages over existing print directories. For example, the ability of online advertisers to access and modify their displays and advertisements often results in more current information. Additionally, online advertisers can more readily advertise temporary or targeted specials or discounts. We provide added value to our Advertisers who have purchased our Internet Advertising Packages through promotion and branding of our website to bring customers to our Advertisers. We believe that the large number of Internet Advertising Packages, that includes the Mini-WebPages, provides Users with more information, which is more readily available on our sites, compared to our competitors. We believe that we provide Users with what they are looking for, more quickly and more efficiently. We believe the attraction of such Users will, over the long-term, result in more sales for our Internet Advertisers.

Moreover, we provide additional value through our relationships. We provide the vast majority of the Preferred Listings on a number of competitors' websites, including www.switchboard.com, www.myareaguide.com, as well as on www.go2.com.

The go2 site has exclusive contracts with providers like Verizon Wireless, AT&T

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Wireless, ALLTEL, Nextel and Sprint to also provide this information to their cellular phone and hand-held device subscribers.

From a User's Standpoint. A national, online Yellow Pages allows the User to access information nationally rather than relying exclusively on local listings like those provided in print Yellow Page directories. In addition, our product offerings allow Users to find and take advantage of advertisers' current special offerings and discounts. We also provide easy access to such information through desktop or laptop computers, cellular phones or hand-held devices, such as personal digital assistants. We believe our offering of a national online Yellow Pages service meets the growing demand for immediate access and the increasing need and trend of Users who are more frequently traveling to areas outside the areas serviced by their local print directories.

Directory Service and Search Engine. We also believe that our products offer many competitive advantages over standard search engines. Our directory service and search engine format allows the User to search by location using either a business name or business category. Unlike popular commercial search engines, our search engine does not

search the Internet to provide results. Instead, it searches our defined database, resulting in a more focused, refined and, oftentimes, quicker and more accurate search.

Growth Strategies and Initiatives

Internet Advertising Package. We currently derive almost all of our revenue from selling IAPs. During fiscal 2003, we continued our direct mail marketing program to acquire additional Internet Advertising customers. We regularly solicit potential advertisers from a database of approximately 18 million U.S. businesses. This database is continually updated to account for new or closed businesses, as well as updated contact information. As a result of this program, we have increased our IAP customer count from 113,565 at September 30, 2002 to 255,376 at September 30, 2003. This total represents less than 2 % of the total available market of 18 million U.S. businesses according to Acxiom USA. During fiscal 2004 and beyond, we plan to continue aggressively marketing additional IAPs using our direct mail marketing program.

Branding. We plan to further embark upon a substantial campaign to brand our YP.Com name and our products. We seek to become the "internet Yellow Pages of choice" to advertisers and Users performing searches. We plan to use various forms of media, which may include print, television, radio, billboard and movie-theater advertising in select markets or nationally. We believe such branding will help to attract Users to our websites, as well as advertisers to sign-up for our IAP and/or other service offerings. The goal of our branding is to obtain instant customer recognition of our offerings that, over time, may enhance the response rate of our direct mail marketing program.

Expansion of Service Offerings to Other Countries. We are currently exploring our ability to offer our services in other English-speaking countries, which we believe we could accomplish without hiring a significant number of additional people or incurring additional training costs.

Marketing of QuickSite. Until recently, we have not focused our marketing efforts on the QuickSite service offering. As a part of a test market, we maintained three full-time sales people and experimented with less traditional lines of selling, such as through third party agents like EZsitemaster, Inc. Through these efforts, we acquired 265 QuickSite customers during fiscal 2003. In fiscal 2004, we will continue these efforts, as well as test marketing the

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use of our direct mail marketing program tailored for this product. We believe that this marketing effort may produce additional revenues.

Internet Dial-Up Package. We will test market this product at \$16.95 per month in fiscal 2004. We also plan to begin charging new Advertisers for our bundled product, consisting of the IAP and IDP, in certain geographical areas. Initially, this bundled product will cost the new Advertiser \$34.95 per month, or \$5 more per month than the IAP alone. This pricing will save the Advertiser approximately 40% over the individual stand alone prices. We believe this offering will enhance revenue by raising the price to the Advertiser for each ISP/IDP sold at very little additional cost to us.

National Accounts Marketing. Currently, we have limited our marketing efforts to individual business units, rather than national accounts such as hotel chains, automobile dealers, etc. We believe a significant opportunity exists to offer our IAP and other service offerings to such national accounts on a bulk basis, which, if successful, may result in additional revenues. We plan to hire or contract with a dedicated sales force, as well as customer account set-up/maintenance personnel.

The Internet Yellow Page Market

According to The Kelsey Group and the Yellow Pages Integrated Media Association (YPIMA), while there are approximately 200 major U.S. Yellow Page print publishers, an increasingly mobile and computer-sophisticated population is accessing the Yellow Pages by way of the Internet at a sharply increasing rate.

Approximately 13% of Yellow Page directory inquiries were conducted online in 2002 compared with 2% in 2000. According to a Kelsey Group report, the total Yellow Pages directory industry is expected to grow at an annual rate of seven percent through 2008, resulting in an increase in total spending from approximately \$15 billion in 2003 to an estimated \$21.3 billion in 2008. However, the vast majority of this anticipated growth is expected to be in the online Yellow Pages advertising industry rather than traditional print advertising. Specifically, the Kelsey Group forecast estimates the online Yellow Pages advertising market to grow at an annual rate of 59% per year through 2008 or from approximately \$500 million in 2003 to an estimated \$5.2 billion in 2008. This is compared to an expected 2.5% annual rate of growth in the traditional print Yellow Pages market from approximately \$14.5 billion in 2003 to an estimated \$16.1 billion in 2008. These anticipated rates of growth would result in the online Yellow Pages advertising industry achieving a market share of 25% of the total Yellow Pages advertising industry in 2008 compared to a current market share of just three percent.

Based upon our revenues of approximately \$30 million of the currently estimated \$500 million online Yellow Page market, we believe that we have approximately six percent of the fragmented online Yellow Page market and is therefore one of the leading online Yellow Page companies in terms of revenue.

Internet usage provides the User with the following major advantages over print Yellow Pages:

- More current and extensive listing information.
- Immediate access to business listings across the nation from any location.
- Broad accessibility via computers and hand-held devices, such as mobile phones and personal digital assistants.
- Features such as mapping, direct calling to the advertiser and e-mail at the click of a button may also be available.

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There are also a number of advantages that an Internet Yellow Pages listing offers to our Advertisers:

- Lower costs for a given level of content.
- The ability to easily access and modify their displays and advertisements, which allows for temporary or targeted specials or discounts.

This market information is summarized in chart form below.

ADVERTISING REVENUE					
\$ BILLIONS (1)					
	2003	MARKET SHARE	2008	% GROWTH PER YEAR	MARKET SHARE
Print	14.5	97%	16.1	2.5%	75%
ONLINE	0.5	3%	5.2	59%	25%
TOTAL	15	100%	21.3	7%	100%