

FULLNET COMMUNICATIONS INC

Form 10KSB

April 15, 2005

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-KSB

(Mark One)

**ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004**

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number: 000-27031

FULLNET COMMUNICATIONS, INC.

(Name of small business issuer in its Charter)

OKLAHOMA

73-1473361

**(State or other jurisdiction of
incorporation or organization)**

(I.R.S. Employer Identification No.)

201 Robert S. Kerr Avenue, Suite 210

Oklahoma City, Oklahoma 73102

(Address of principal executive offices)

(405) 236-8200

(Issuer's telephone number)

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

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

Title of class

Common Stock, \$0.00001 Par Value

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities 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 is not contained in this form, and no disclosure will be contained, to the best of the 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.

The Registrant's revenues for its most recent fiscal year were \$2,260,768

The aggregate market value of the registrant's common stock, \$0.00001 par value, held by non-affiliates of the Registrant as of March 28, 2005 was \$386,677 based on the closing price of \$.07 per share on that date as reported by the OTC Bulletin Board. As of March 28, 2005, 6,723,135 shares of the registrant's common stock, \$0.00001 par value, were outstanding.

Transitional Small Business Disclosure Format (check one): Yes No

FULLNET COMMUNICATIONS, INC.
FORM 10-KSB
For the Fiscal Year Ended December 31, 2004

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This Annual Report on Form 10-KSB and the information incorporated by reference may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). In particular, we direct your attention to Item 1. Description of Business, Item 2. Description of Property, Item 3. Legal Proceedings, Item 6. Management's Discussion and Analysis or Plan of Operation, and Item 7. Financial Statements and Supplementary Data. We intend the forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding our expected financial position and operating results, our business strategy, our financing plans and the outcome of any contingencies are forward-looking statements. These statements can sometimes be identified by our use of forward-looking words such as may, believe, plan, will, anticipate, estimate, expect, intend and other phrases of similar meaning. Known and unknown risks, uncertainties other factors could cause the actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and was derived using numerous assumptions.

Although we believe that our expectations that are expressed in these forward-looking statements are reasonable, we cannot promise that our expectations will turn out to be correct. Our actual results could be materially different from our expectations, including the following:

We may lose subscribers or fail to grow our subscriber base;

We may not successfully integrate new subscribers or assets obtained through acquisitions;

We may fail to compete with existing and new competitors;

We may not be able to sustain our current growth;

We may not adequately respond to technological developments impacting the Internet;

We may experience a major system failure;

We may not be able to find needed financing.

This list is intended to identify some of the principal factors that could cause actual results to differ materially from those described in the forward-looking statements included elsewhere in this report. These factors are not intended to represent a complete list of all risks and uncertainties inherent in our business, and should be read in conjunction with the more detailed cautionary statements included in this Report under the caption Item 1. Description of Business-Additional Factors to Consider, our other Securities and Exchange Commission filings and our press releases.

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PART I

Item 1. Description Of Business

General

We are an integrated communications provider offering integrated communications and Internet connectivity to individuals, businesses, organizations, educational institutions and government agencies. Through our subsidiaries, we provide high quality, reliable and scalable Internet access, web hosting, and equipment co-location. Our overall strategy is to become the dominant integrated communications provider for residents and small to medium-sized businesses in Oklahoma.

References to us in this Report include our subsidiaries: FullNet, Inc. (FullNet), FullTel, Inc. (FullTel), and FullWeb, Inc. (FullWeb). Our principal executive offices are located at 201 Robert S. Kerr Avenue, Suite 210, Oklahoma City, Oklahoma 73102, and our telephone number is (405) 236-8200. We also maintain an Internet site on the World Wide Web (WWW) at www.fullnet.net. Information contained on our Web site is not, and should not be deemed to be, a part of this Report.

Company History

We were founded in 1995 as CEN-COM of Oklahoma, Inc., an Oklahoma corporation, to bring dial-up Internet access and education to rural locations in Oklahoma that did not have dial-up Internet access. We changed our name to FullNet Communications, Inc. in December 1995, and shifted our focus from offering dial-up services to providing wholesale and private label network connectivity and related services to other Internet service providers. During 1995 and 1996, we furnished wholesale and private label network connectivity services to Internet service providers.

In 1997 we continued our focus on being a backbone provider by upgrading and acquiring more equipment. We also started offering our own Internet service provider brand access and services to our wholesale customers. As of September 30, 2004, there was one Internet service provider in Oklahoma that used the FullNet brand name for whom we provide the backbone to the Internet. There was also one Internet service provider that used a private label brand name, for whom we are its access backbone and provide on an outsource basis technical support, systems management and operations. Additionally, we provide high-speed broadband connectivity, website hosting, network management and consulting solutions to over 100 businesses in Oklahoma.

In 1998 our gross revenues exceeded \$1,000,000 and we made the Metro Oklahoma City Top 50 Fastest Growing Companies list. In 1998 we commenced the process of organizing a competitive local exchange carrier (CLEC) through FullTel, and acquired Animus Communications, Inc. (Animus), a wholesale Web-service company, which enabled us to become a total solutions provider to individuals and companies seeking a one-stop shop in Oklahoma. Animus was renamed FullWeb in January 2000.

With the incorporation of FullTel and the acquisition of FullWeb, our current business strategy is to become the dominant integrated communications provider in Oklahoma, focusing on rural areas. We expect to grow through the acquisition of additional customers for our carrier-neutral co-location space, the acquisition of Internet service providers, as well as through a FullNet brand marketing campaign. During 2000 and 2001, we completed eight separate acquisitions of Internet service provider companies. We completed one acquisition of an Internet service provider during 2004.

During February 2000, our common stock began trading on the OTC Bulletin Board under the symbol FULO. While our common stock trades on the OTC Bulletin Board, it is very thinly traded, and there can be no assurance that

our stockholders will be able to sell their shares should they so desire. Any market for the common stock that may develop, in all likelihood, will be a limited one, and if such a market does develop, the market price may be volatile.

In June 2000, we began providing co-location services to KMC Telecom V, Inc. (KMC), a facilities-based competitive local exchange carrier pursuant to an agreement that will terminate on December 31, 2005. Under the terms of this agreement, we receive \$42,275 per month to provide co-location and support services for KMC 's telecommunications equipment at our network operations center in Oklahoma City, Oklahoma. We completed our network operations center during the first quarter of 2001. KMC moved into our network operations center and began making payments during the third quarter of 2000. We plan to market additional carrier neutral co-location solutions in our network operations center to other competitive local exchange carriers, Internet service providers and web-hosting companies.

Our co-location facility is carrier neutral, allowing customers to choose among competitive offerings rather than being restricted to one carrier. Our network operations center is Telco-grade and provides customers a high level of operative reliability and security. We offer flexible space arrangements for customers, 24-hour onsite support with both battery and generator backup.

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Through FullTel, our wholly owned subsidiary, we are a fully licensed competitive local exchange carrier or CLEC in Oklahoma.

The FullTel data center telephone switching equipment was installed in March 2003. At which time, FullTel began the process of activating local access telephone numbers for every city in which we will market, sell and operate our retail FullNet Internet service provider brand, wholesale dial-up Internet service and our business-to-business network design, connectivity, domain and Web hosting businesses. At December 31, 2004 FullTel provided us with local telephone access in approximately 229 cities.

Mergers and Acquisitions

Our acquisition strategy is designed to leverage our existing network backbone and internal operations to enable us to enter new markets in Oklahoma, as well as to expand our presence in existing markets, and to benefit from economies of scale.

Our Business Strategy

As an integrated communications provider, we intend to increase shareholder value by continuing to build scale through both acquisitions and internal growth and then leveraging increased revenues over our fixed costs base. Our strategy is to meet the customer service requirements of retail, business, educational and government Internet users in our target markets, while benefiting from the scale advantages obtained through being a fully integrated backbone and broadband provider. The key elements of our overall strategy with respect to our principal business operations are as follows:

Target Strategic Acquisitions

The goal of our acquisition strategy is to accelerate market penetration by acquiring Internet service providers in Oklahoma communities and to acquire strategic Internet service providers in Oklahoma City and Tulsa. Additionally, we will continue to build upon our core competencies and expand our technical, customer service staff and sales force in Oklahoma communities. We evaluate acquisition candidates based on their compatibility with our overall business plan of penetrating rural and outlying markets as well as Oklahoma City and Tulsa. When a candidate is acquired, we will integrate our existing Internet, network connectivity and value-added services with the services offered by the acquired company and use either the local sales force or install our own dealer sales force to continue to increase market share. The types of acquisitions targeted by us include Internet service providers located in markets into which we want to expand or to which we may already provide private-label Internet connectivity. Other types of targeted acquisitions include local business-only Internet service providers in markets where we have established points of presence and would benefit from the acquired company's local sale and network solutions sales and technical staff and installed customer base through the potential increase in our network utilization. When assessing an acquisition candidate, we focus on the following criteria:

- o Potential revenue and subscriber growth;
- o Low subscriber turnover or churn rates;
- o Density in the market as defined by a high ratio of subscribers to points of presence (POPs);
- o Favorable competitive environment;
- o Low density network platforms that can be integrated readily into our backbone network; and

- o Favorable consolidation savings.

Generate Internal Sales Growth

We intend to expand our customer base by increasing our marketing efforts. At December 31, 2004, our direct sales force consisted of one individual in our Oklahoma City office coordinating all our business-to-business solutions sales. We currently have independent re-sellers responsible for their individual markets. Our sales force is supported in its efforts by technical engineers and our senior management. We intend to increase our phone directory advertising to include all cities in which we provide local telephone access. In addition, we are exploring other strategies to increase our sales, including other marketing partners such as electric cooperatives. We currently have one of the 20 local Oklahoma electric cooperatives as a marketing partner.

Grow Subscriber Base

We intend to grow our subscriber base through a combination of internal and acquisition driven growth. We anticipate that this growth will increase the density of our subscriber base within a service area utilizing our available network operations, customer support, back office functions and management overhead without further cost increase or with minimal cost increase. We expect our local markets to generate internal subscriber growth primarily by enhancing subscribers' online experience, providing a sense of a national presence while maintaining local community content and developing a consumer recognized regional FullNet brand.

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Increase Rural Area Market Share

We believe that the rural areas of Oklahoma are underserved by Internet service providers, and that significant profitable growth can be achieved in serving these markets by providing reliable Internet connectivity at a reasonable cost to the residents and businesses located in these areas. We believe we can obtain a significant Internet service provider and business-to-business market share in Oklahoma. To that end, we, through our wholly-owned subsidiary, FullTel, became a licensed competitive local exchange carrier in Oklahoma. Since March 2003 when we installed our telephone switch, FullTel, as a competitive local exchange carrier, is able to provide local telephone numbers for Internet access.

Enhance Subscribers Online Experience

We intend to maximize our subscriber retention and add new subscribers by enhancing our services in the following ways:

- o Ease of Use During the first quarter of 2001, we implemented a common, easy to use CD ROM based software package that automatically configures all of the individual Internet access programs after a one time entry by the user of a few required fields of information such as, name, user name and password.
- o New Products and Services Offer subscribers new products and services. We recently began offering call waiting modem on hold, Postini e-mail spam and virus protection and a dial-up accelerator.

Internet Access Services

Our core business is the sale of Internet access services to individual and small business subscribers located in Oklahoma on both a retail and wholesale basis. Through FullNet, we provide our customers with a variety of dial-up and dedicated connectivity, as well as direct access to a wide range of Internet applications and resources, including electronic mail. FullNet's full range of services includes:

- o Private label retail and business direct dial-up connectivity to the Internet and
- o Secure private networks through our backbone network

Our branded and private label Internet access services are provided through a statewide network with points-of-presence in 229 communities throughout Oklahoma. Points-of-presence are local telephone numbers through which subscribers can access the Internet. Our business services consist of high-speed Internet access services and other services that enable wholesale customers to outsource their Internet and electronic commerce activities. We had approximately 3,300 subscribers at December 31, 2004. Additionally, FullNet sells Internet access to other Internet service providers, who then resell Internet access to their own customers under their private label or under the FullNet brand name.

We intend to expand our subscriber base through a marketing campaign and through acquisitions. We are focusing our acquisition efforts on companies with forward-looking sales and marketing, high-quality customer service and a solid local market dominance. See Item 1. Description of Business Mergers and Acquisitions. Additionally, we are expanding our phone directory advertising in an effort to increase our subscriber base in the markets in which we currently operate.

Currently, we offer the following two types of Internet connections:

o Dial-Up Connections

The simplest connection to the Internet is the dial-up account. This method of service connects the user to the Internet through the use of a modem and standard telephone line. Currently, FullNet users can connect via dial-up at speeds up to 56 Kbps. We support these users through the use of sophisticated modem banks located in our facility in Oklahoma City that send data through a router and out to the Internet. We support the higher speed 56K, V.92 MOH and Integrated Services Digital Network connections with state-of-the-art digital modems. With a dial-up connection, a user can gain access to the Internet for e-mail, the World Wide Web, file transfer protocol, news groups, and a variety of other useful applications.

o Leased Line Connections

Many businesses and some individuals have a need for more bandwidth to the Internet to support a network of users or a busy Web site. We have the capacity to sell a leased line connection to users. This method of connection gives the user a full-time high-speed (up to 1.5 mbps) connection to the Internet. The leased line solution comes at greater expense to the user. These lines are leased through the telephone companies at a high installation and monthly fee.

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We believe that our Internet access services provide customers with the following benefits:

Fast and Reliable Internet Access-We have implemented a network architecture providing exceptional quality and consistency in Internet services, making us the recognized backbone leader in the Oklahoma Internet service provider industry. We offer unlimited, unrestricted and reliable Internet access at a low monthly price. We have designed our network such that our users never have to worry about busy signals due to a lack of available modems. Dial-up access is available for the following modem speeds: 14.4K, 28.8K, 33.6K, K56Flex, 56K V.90, v.92 MOH, ISDN 64K and ISDN 128K. Our dial-up access supports all major platforms and operating systems, including MS Windows, UNIX®, Mac OS, OS/2 and LINUX. This allows simplified access to all Internet applications, including the World Wide Web, email, and news and file transfer protocol.

Cost-Effective Access-We offer high quality Internet connectivity and enhanced business services at price points that are generally lower than those charged by other Internet service providers with national coverage. Additionally, we offer pre-bundled access services packages under monthly or prepaid plans.

Superior Customer Support-We provide superior customer service and support, with customer care and technical personnel available by telephone and on-line 24 hours per day, 365 days per year.

CLEC Operations

Through FullTel, our wholly owned subsidiary, we are a fully licensed competitive local exchange carrier or CLEC in Oklahoma. CLECs are new phone companies born out of the Telecommunications Act of 1996 (Telecommunications Act), which requires the incumbent local exchange carriers or ILECs, generally the regional Bell companies including SBC, to provide CLECs access to their local facilities, and to compensate CLECs for traffic originated by ILECs and terminated on the CLECs network. By adding our own telephone switch and infrastructure to the existing telephone network in March 2003, we are now able to offer certain local Internet access for dial-up services in most of Oklahoma. As a CLEC, we may subscribe to and resell all forms of local telephone service in Oklahoma. We intend to build our own network infrastructure, which we believe will reduce our current reliance upon the infrastructures of the ILECs. We believe that our CLEC status, combined with the efficiencies inherent in operating our own network, should result in lower overhead costs and a more predictable infrastructure, both of which should be to the benefit of our customers.

While Internet access is the core focus of growth for us, we plan to also provide traditional telephone service throughout Oklahoma.

A core piece of our marketing strategy is the cross pollination between our Internet activities and FullTel's local dial-up service. By organizing and funding FullTel, we expect to gain local dial-up Internet access to approximately 80% of Oklahoma. In return, FullTel will gain immediate access to our entire Internet service provider customer base.

The FullTel data center telephone switching equipment was installed in March 2003. At which time, FullTel began the process of activating local access telephone numbers for every city in which we will market, sell and operate our retail FullNet Internet service provider brand, wholesale dial-up Internet service and our business-to-business network design, connectivity, domain and Web hosting businesses. At December 31, 2004 FullTel provided us with local telephone access in approximately 229 cities. However, our ability to fully take advantage of these opportunities will be dependent upon the availability of additional capital.

Sales and Marketing

Although we expect that the bulk of our new subscribers will come through acquisition of Internet service providers, our expanded local sales system is also an integral part of our growth plan. We believe local sales and marketing will develop further recognition of our name brand that will lead to increased subscriber revenues.

The 15 largest metropolitan areas in the United States comprise only 38% of the U.S. population, leaving the majority of the country's population in hundreds of smaller markets as potential subscribers. More specifically, predominantly smaller metropolitan and rural markets may have penetration rates of 22% and lower, versus larger markets with penetration rates of around 40%. In addition, in many cases national providers are a long distance phone call in our markets. Finally, since there is not as much competition in the smaller metropolitan and rural markets, monthly churn rates are lower and word-of-mouth referrals are a significant generator of new subscribers. We believe that we have significant opportunities for acquisition and internal sales growth in these market areas.

We focus on marketing our services to two distinct market segments: enterprises (primarily small and medium size businesses) and consumers. By attracting enterprise customers who use the network primarily during the daytime, and consumer customers who use the network primarily at night, we are able to utilize our network infrastructure more cost effectively.

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Competition

The market for Internet connectivity and related services is extremely competitive. We anticipate that competition will continue to intensify as the use of the Internet grows. The tremendous growth and potential market size of the Internet access market has attracted many new start-ups as well as existing businesses from a variety of industries. We believe that a reliable network, knowledgeable salespeople and the quality of technical support currently are the primary competitive factors in our targeted market and that price is usually secondary to these factors.

Our current and prospective competitors include, in addition to other national, regional and local Internet service providers, long distance and local exchange telecommunications companies, cable television, direct broadcast satellite, wireless communications providers and online service providers. While we believe that our network, products and customer service distinguish us from these competitors, most of these competitors have significantly greater market presence, brand recognition, financial, technical and personnel resources than us.

Internet Service Providers

Our current primary competitors include other Internet service providers with a significant national presence that focuses on business customers, such as Cox Communications and SBC. These competitors have greater market share, brand recognition, financial, technical and personnel resources than us. We also compete with regional and local Internet service providers in our targeted markets.

Telecommunications Carriers

The major long distance companies, also known as inter-exchange carriers, including AT&T, MCI WorldCom, and Sprint, offer Internet access services and compete with us. Reforms in the federal regulation of the telecommunications industry have created greater opportunities for ILECs, including the Regional Bell Operating Companies or RBOCs, and other competitive local exchange carriers, to enter the Internet connectivity market. In order to address the Internet connectivity requirements of the business customers of long distance and local carriers, we believe that there is a move toward horizontal integration by ILECs and CLECs through acquisitions or joint ventures with, and the wholesale purchase of, connectivity from Internet service providers. The MCI/WorldCom merger (and the prior WorldCom/MFS/UUNet consolidation), GTE's acquisition of BBN, the acquisition by ICG Communications, Inc. of Netcom, Global Crossing's acquisition of Frontier Corp. (and Frontier's prior acquisition of Global Center) and AT&T's purchase of IBM's global communications network are indicative of this trend. Accordingly, we expect that we will experience increased competition from the traditional telecommunications carriers. These telecommunication carriers, in addition to their greater network coverage, market presence, financial, technical and personnel resources also have large existing commercial customer bases.

Cable Companies, Direct Broadcast Satellite and Wireless Communications Companies

Many of the major cable companies are offering Internet connectivity, relying on the viability of cable modems and economical upgrades to their networks, including Media One and Time Warner Cablevision, Inc., Cox Communications and Tele-Communications, Inc. (TCI).

The companies that own these broadband networks could prevent us from delivering Internet access through the wire and cable connections that they own. Our ability to compete with telephone and cable television companies that are able to support broadband transmissions, and to provide better Internet services and products, may depend on future regulation to guarantee open access to the broadband networks. However, in January 1999, the Federal Communications Commission declined to take any action to mandate or otherwise regulate access by Internet service providers to broadband cable facilities at this time. It is unclear whether and to what extent local and state regulatory

agencies will take any initiatives to implement this type of regulation, and whether they will be successful in establishing their authority to do so. Similarly, the Federal Communications Commission is considering proposals that could limit the right of Internet service providers to connect with their customers over broadband local telephone lines. In addition to competing directly in the Internet service provider market, both cable and television facilities operators are also aligning themselves with certain Internet service providers who would receive preferential or exclusive use of broadband local connections to end users. If high-speed, broadband facilities increasingly become the preferred mode by which customers access the Internet and we are unable to gain access to these facilities on reasonable terms, our business, financial condition and results of operations could be materially adversely affected.

Online Service Providers

The dominant online service providers, including Microsoft Network, America Online, Incorporated and Earthlink, have all entered the Internet access business by engineering their current proprietary networks to include Internet access capabilities. We compete to a lesser extent with these service providers, which currently are primarily focused on the consumer marketplace

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and offer their own content, including chat rooms, news updates, searchable reference databases, special interest groups and shopping.

However, America Online's merger with Time-Warner, its acquisition of Netscape Communications Corporation and related strategic alliance with Sun Microsystems enable it to offer a broader array of Internet-based services and products that could significantly enhance its ability to appeal to the business marketplace and, as a result, compete more directly with Internet service providers like us. CompuServe has also announced that it will target Internet connectivity for the small to medium sized business market.

We believe that our ability to attract business customers and to market value-added services is a key to our future success. However, there can be no assurance that our competitors will not introduce comparable services or products at similar or more attractive prices in the future or that we will not be required to reduce our prices to match competition. Recently, many competitive ISPs have shifted their focus from individual customers to business customers.

Moreover, there can be no assurance that more of our competitors will not shift their focus to attracting business customers, resulting in even more competition for us. There can be no assurance that we will be able to offset the effects of any such competition or resulting price reductions. Increased competition could result in erosion of our market share and could have a material adverse effect on our business, financial condition and results of operations.

Government Regulations

The following summary of regulatory developments and legislation is not complete. It does not describe all present and proposed federal, state, and local regulation and legislation affecting the Internet service provider and telecommunications industries. Existing federal and state regulations are currently subject to judicial proceedings, legislative hearings, and administrative proposals that could change, in varying degrees, the manner in which our businesses operate. We cannot predict the outcome of these proceedings or their impact upon the Internet service provider and telecommunications industries or upon our business.

Both the provision of Internet access service and the provision of underlying telecommunications services are affected by federal, state, local and foreign regulation. The Federal Communications Commission or FCC exercises jurisdiction over all facilities of, and services offered by, telecommunications carriers to the extent that they involve the provision, origination or termination of jurisdictionally interstate or international communications. The state regulatory commissions retain jurisdiction over the same facilities and services to the extent they involve origination or termination of jurisdictionally intrastate communications. In addition, as a result of the passage of the Telecommunications Act, state and federal regulators share responsibility for implementing and enforcing the domestic pro-competitive policies of the Telecommunications Act. In particular, state regulatory commissions have substantial oversight over the provision of interconnection and non-discriminatory network access by ILECs. Municipal authorities generally have some jurisdiction over access to rights of way, franchises, zoning and other matters of local concern.

Our Internet operations are not currently subject to direct regulation by the FCC or any other U.S. governmental agency, other than regulations applicable to businesses generally. However, the FCC continues to review its regulatory position on the usage of the basic network and communications facilities by Internet service providers. Although in an April 1998 Report, the FCC determined that Internet service providers should not be treated as telecommunications carriers and therefore should not be regulated, it is expected that future Internet service provider regulatory status will continue to be uncertain. Indeed, in that report, the FCC concluded that certain services offered over the Internet, such as phone-to-phone Internet telephony, may be functionally indistinguishable from traditional telecommunications service offerings, and their non-regulated status may have to be reexamined.

Changes in the regulatory structure and environment affecting the Internet access market, including regulatory changes that directly or indirectly affect telecommunications costs or increase the likelihood of competition from RBOCs or other telecommunications companies, could have an adverse effect on our business. Although the FCC has decided not to allow local telephone companies to impose per-minute access charges on Internet service providers, and the reviewing court has upheld that decision, further regulatory and legislative consideration of this issue is likely. In addition, some telephone companies are seeking relief through state regulatory agencies. The imposition of access charges would affect our costs of serving dial-up customers and could have a material adverse effect on our business, financial condition and results of operations.

In addition to our Internet service provider operations, we have recently focused attention on acquiring telecommunications assets and facilities, which is a regulated activity. Fulltel, our subsidiary, has received competitive local exchange carrier or CLEC certification in Oklahoma, and an important part of our growth strategy is obtaining CLEC certification in certain other states. The Telecommunications Act requires CLECs not to prohibit or unduly restrict resale of their services; to provide dialing parity, number portability, and nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listings; to afford access to poles, ducts, conduits, and rights-of-way; and to establish reciprocal

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compensation arrangements for the transport and termination of telecommunications traffic. In addition to federal regulation of CLECs, the states also impose regulatory obligations upon CLECs. While these obligations vary from state to state, most states require CLECs to file a tariff for their services and charges; require CLECs to charge just and reasonable rates for their services, and not to discriminate among similarly-situated customers; to file periodic reports and pay certain fees; and to comply with certain services standards and consumer protection laws. As a provider of domestic basic telecommunications services, particularly competitive local exchange services, we could become subject to further regulation by the FCC and/or another regulatory agency, including state and local entities.

The Telecommunications Act has caused fundamental changes in the markets for local exchange services. In particular, the Telecommunications Act and the related FCC promulgated rules mandate competition in local markets and require that ILECs interconnect with CLECs. Under the provisions of the Telecommunications Act, the FCC and state public utility commissions share jurisdiction over the implementation of local competition: the FCC was required to promulgate general rules and the state commissions were required to arbitrate and approve individual interconnection agreements. The courts have generally upheld the FCC in its promulgation of rules, including a January 25, 1999 U.S. Supreme Court ruling which determined that the FCC has jurisdiction to promulgate national rules in pricing for interconnection.

In July 2000, the Eighth Circuit Court issued a decision on the earlier remand from the Supreme Court and rejected, as contrary to the 96 Act, the use of hypothetical network costs, including total element long-run incremental costs methodology (TELRIC), which the FCC had used in developing certain of its pricing rules. The Eighth Circuit Court also vacated the FCC's pricing rules related to UNEs, termination and transport, but upheld its prior decision that ILECs' universal service subsidies should not be included in the costs of providing network elements. Finally, the Eighth Circuit Court also vacated the FCC's rules requiring that: (1) ILECs recombine unbundled network elements for competitors in any technically feasible combination; (2) all preexisting interconnection agreements be submitted to the states for review; and (3) the burden of proof for retention of a rural exemption be shifted to the ILEC. The FCC sought review of the Eighth Circuit Court's invalidation of TELRIC and was granted certiorari. On May 13, 2002, the Supreme Court reversed certain of the Eighth Circuit Court's findings and affirmed that the FCC's rules concerning forward looking economic costs, including TELRIC, were proper under the 96 Act. The Supreme Court also restored the FCC's requirement that the ILECs combine UNEs for competitors when they are unable to do so themselves.

In November 1999, the FCC released an order making unbundling requirements applicable to all ILEC network elements uniformly. UNE-P is created when a competing carrier obtains all the network elements needed to provide service from the ILEC. In December 1999, the FCC released an order requiring the provision of unbundled local copper loops enabling CLECs to offer competitive Digital Subscriber Loop Internet access. The FCC reconsidered both orders in its first triennial review of its policies on UNEs completed in early 2003, as further discussed below.

On August 21, 2003, the FCC released the text of its Triennial Review Order. In response to the remand of the United States Court of Appeals for the District of Columbia circuit, the FCC adopted new rules governing the obligations of ILECs to unbundle the elements of their local networks for use by competitors. The FCC made national findings of impairment or non-impairment for loops, transport and, most significantly, switching. The FCC delegated to the states the authority to engage in additional fact finding and make alternative impairment findings based on a more granular impairment analysis including evaluation of applicability of FCC-established triggers. The FCC created mass market and enterprise market customer classifications that generally correspond to the residential and business markets, respectively. The FCC found that CLECs were not impaired without access to local circuit switching when serving enterprise market customers on a national level. CLECs, however, were found to be impaired on a national level without access to local switching when serving mass market customers. State commissions had 90 days to ask the FCC to waive the finding of no impairment without switching for enterprise market customers. The FCC presumption that CLECs are impaired without access to transport, high capacity loops and mass market switching is subject to a more granular nine month review by state commissions pursuant to FCC-established triggers and other

economic and operational criteria.

The FCC also opened a further notice of proposed rulemaking to consider the pick and choose rules under which a competing carrier may select from among the various terms of interconnection offered by an ILEC in its various interconnection agreements. Comments have been filed, but the FCC has not issued a decision.

The Triennial Review Order also provided that:

ILECs are not required to unbundle packet switching as a stand-alone network element.

Two key components of the FCC's TELRIC pricing rules were clarified. First, the FCC clarified that the risk-adjusted cost of capital used in calculating UNE prices should reflect the risks associated with a competitive market. Second, the FCC declined to mandate the use of any particular set of asset lives for depreciation, but clarified that the use of an accelerated depreciation mechanism may present a more accurate method of calculating economic depreciation.

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CLECs continue to be prohibited from avoiding any liability under contractual early termination clauses in the event a CLEC converts a special access circuit to an UNE.

We are monitoring the Oklahoma state commission proceedings and participating where necessary as the commission undertakes the 90 day and nine month analyses to establish rules or make determinations as directed by the Triennial Review Order. In addition, numerous petitions and appeals have been filed in the courts and with the FCC challenging many of the findings in the Triennial Review Order and seeking a stay on certain portions of the order. The appeals have been consolidated in the D.C. Circuit Court of Appeals. Oral arguments were heard on January 28, 2004. On March 2, 2004, a three-judge panel in the D.C. Circuit Court of Appeals overturned the FCC's Triennial Review Order with regard to network unbundling rules. A majority of the FCC Commissioners is seeking a court-ordered stay and plan to appeal the ruling to the Supreme Court. Until all of these proceedings are concluded, the impact of this order, if any, on our CLEC operations cannot be determined.

An important issue for CLECs is the right to receive reciprocal compensation for the transport and termination of Internet traffic. We believe that, under the Telecommunications Act, CLECs are entitled to receive reciprocal compensation from ILECs. However, some ILECs have disputed payment of reciprocal compensation for Internet traffic, arguing that Internet service provider traffic is not local traffic. Most states have required ILECs to pay CLECs reciprocal compensation. However, in October 1998, the FCC determined that dedicated digital subscriber line service is an interstate service and properly tariffed at the interstate level. In February 1999, the FCC concluded that at least a substantial portion of dial-up Internet service provider traffic is jurisdictionally interstate. The FCC also concluded that its jurisdictional decision does not alter the exemption from access charges currently enjoyed by Internet service providers. The FCC established a proceeding to consider an appropriate compensation mechanism for interstate Internet traffic. Pending the adoption of that mechanism, the FCC saw no reason to interfere with existing interconnection agreements and reciprocal compensation arrangements. The FCC order has been appealed. In addition, there is a risk that state public utility commissions that have previously considered this issue and ordered the payment of reciprocal compensation by the ILECs to the CLECs may be asked by the ILECs to revisit their determinations, or may revisit their determinations on their own motion. To date, at least one ILEC has filed suit seeking a refund from a carrier of reciprocal compensation that the ILEC had paid to that carrier. There can be no assurance that any future court, state regulatory or FCC decision on this matter will favor our position. An unfavorable result may have an adverse impact on our potential future revenues as a CLEC. We have billed, collected and are continuing to bill reciprocal compensation. However, continuance of this revenue stream is subject to ongoing regulation. Reciprocal compensation is unlikely to be a significant or a long-term revenue source for us.

As we become a competitor in local exchange markets, we will become subject to state requirements regarding provision of intrastate services. This may include the filing of tariffs containing rates and conditions. As a new entrant, without market power, we expect to face a relatively flexible regulatory environment. Nevertheless, it is possible that some states could require us to obtain the approval of the public utilities commission for the issuance of debt or equity or other transactions which would result in a lien on our property used to provide intrastate services.

Additional Factors to Consider

This Report includes forward looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Although we believe that our plans, intentions and expectations reflected in such forward looking statements are reasonable, we can give no assurance that such plans, intentions or expectations will be achieved. Important factors that could cause actual results to differ materially from our forward looking statements are set forth below and elsewhere in this Annual Report. All forward looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth below.

Limited Operating History. We have a relatively limited operating history upon which an evaluation of our prospects can be made. Consequently, the likelihood of our success must be considered in view of all of the risks, expenses and delays inherent in the establishment and growth of a new business including, but not limited to, expenses, complications and delays which cannot be foreseen when a business is commenced, initiation of marketing activities, the uncertainty of market acceptance of new services, intense competition from larger more established competitors and other factors. Our ability to achieve profitability and growth will depend on successful development and commercialization of our current and proposed services. No assurance can be given that we will be able to introduce our proposed services or market our services on a commercially successful basis.

Necessity of Additional Financing. In order for us to have any opportunity for significant commercial success and profitability, we must successfully obtain additional financing, either through borrowings, additional private placements or an initial public offering, or some combination thereof. Although we are actively pursuing a variety of funding sources, there can be no assurance that we will be successful in such pursuit.

Limited Marketing Experience. We have limited experience in developing and commercializing new services based on innovative technologies, and there is limited information available concerning the potential performance of our hardware or market acceptance of our proposed services. There can be no assurance that unanticipated expenses, problems or technical

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difficulties will not occur which would result in material delays in product commercialization or that our efforts will result in successful product commercialization.

Uncertainty of Products/Services Development. Although considerable time and financial resources were expended in the development of our services and products, there can be absolutely no assurance that problems will not develop which would have a material adverse effect on us. We will be required to commit considerable time, effort and resources to finalize such development and adapt our products/services to satisfy specific requirements of potential customers. Continued system refinement, enhancement and development efforts are subject to all of the risks inherent in the development of new products/services and technologies, including unanticipated delays, expenses, technical problems or difficulties, as well as the possible insufficiency of funds to satisfactorily complete development, which could result in abandonment or substantial change in commercialization. There can be no assurance that development efforts will be successfully completed on a timely basis, or at all, that we will be able to successfully adapt our hardware and/or software to satisfy specific requirements of potential customers, or that unanticipated events will not occur which would result in increased costs or material delays in development or commercialization. In addition, technologies as complex as those planned to be incorporated into our products/services may contain errors which become apparent subsequent to commercial use. Remedying such errors could delay our plans and cause us to incur substantial additional costs.

New Concept; Uncertainty of Market Acceptance and Commercialization Strategy. As is typical in the case of a new business concept, demand and market acceptance for a newly introduced product/service is subject to a high level of uncertainty. Achieving market acceptance for this new concept will require significant efforts and expenditures by us to create awareness and demand by consumers. Our marketing strategy and preliminary and future marketing plans may be unsuccessful and are subject to change as a result of a number of factors, including progress or delays in our marketing efforts, changes in market conditions (including the emergence of potentially significant related market segments for applications of our technology), the nature of possible license and distribution arrangements which may or may not become available to us in the future and economic, regulatory and competitive factors. There can be no assurance that our strategy will result in successful product commercialization or that our efforts will result in initial or continued market acceptance for our proposed products.

Competition; Technological Obsolescence. The markets that we intend to enter are characterized by intense competition and an increasing number of potential new market entrants who have developed or are developing potentially competitive products and/or services. We will face competition from numerous sources, certain of which may have substantially greater financial, technical, marketing, distribution, personnel and other resources than us, permitting such companies to implement extensive marketing campaigns, both generally and in response to efforts by additional competitors to enter into new markets and market new products and services. In addition, the markets for our proposed products/services are characterized by rapidly changing technology and evolving industry standards that could result in product obsolescence or short product life cycles. Accordingly, our ability to compete will be dependent upon our ability to complete the development of our products and to introduce our products and/or services into the marketplace in a timely manner, to continually enhance and improve our software and to successfully develop and market new products. There can be no assurance that we will be able to compete successfully, that competitors will not develop technologies or products that render our products and/or services obsolete or less marketable or that we will be able to successfully enhance our products or develop new products and/or services.

Risks Relating to the Internet. Businesses reliant on the Internet may be at risk due to inadequate development of the necessary infrastructure, such as reliable network backbones, or complementary services, such as high-speed modems and security procedures. The Internet has experienced, and is expected to continue to experience, significant growth in the number of users and amount of traffic. There can be no assurance that the Internet infrastructure will continue to be able to support the demands placed on it by sustained growth. In addition, there may be delays in the development and adoption of new standards and protocols, the inability to handle increased levels of Internet activity

or due to increased government regulation. If the necessary Internet infrastructure or complementary services are not developed to effectively support growth that may occur, our business, results of operations and financial condition would be materially adversely affected.

Potential Government Regulations. We are subject to state commission, Federal Communications Commission and court decisions as they relate to the interpretation and implementation of the Telecommunications Act, the interpretation of Competitive Local Exchange Carrier interconnection agreements in general and our interconnection agreements in particular. In some cases, we may become bound by the results of ongoing proceedings of these bodies or the legal outcomes of other contested interconnection agreements that are similar to agreements to which we are a party. The results of any of these proceedings could have a material adverse effect on our business, prospects, financial condition and results of operations.

Dependence on Key Personnel. Our success depends in large part upon the continued successful performance of our current executive officers and key employees, Messrs. Timothy J. Kilkenny, Roger P. Baresel and Jason C. Ayers, for our continued research, development, marketing and operation. Although we have employed, and will employ in the future, additional qualified employees as well as retaining consultants having significant experience, if Messrs. Kilkenny, Baresel or Ayers fail to perform any of their duties for any reason whatsoever, our ability to market, operate and support our

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products/services will be adversely affected. While we are located in areas where the available pool of people is substantial, there is also significant competition for qualified personnel.

Limited Public Market. During February 2000, our common stock began trading on the OTC Bulletin Board under the symbol FULO. While our common stock continues to trade on the OTC Bulletin Board, there can be no assurance that our stockholders will be able to sell their shares should they so desire. Any market for the common stock that may develop, in all likelihood, will be a limited one, and if such a market does develop, the market price may be volatile.

No Payment of Dividends on Common Stock. We have not paid any dividends on our common stock. For the foreseeable future, we anticipate that all earnings, if any, which may be generated from our operations, will be used to finance our growth and that cash dividends will not be paid to holders of the common stock.

Penny Stock Regulation. Broker-dealer practices in connection with transactions in penny stocks are regulated by certain penny stock rules adopted by the SEC. Penny stocks generally are equity securities with a price of less than \$5.00 (other than securities registered on certain national securities exchanges or quoted on the NASDAQ system). The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document that provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, and, if the broker dealer is the sole market-maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market, and monthly account statements showing the market value of each penny stock held in the customer's account. In addition, broker-dealers who sell such securities to persons other than established customers and accredited investors (generally, those persons with assets in excess of \$1,000,000 or annual income exceeding \$200,000 or \$300,000 together with their spouse), must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. Consequently, these requirements may have the effect of reducing the level of trading activity, if any, in the secondary market for a security that is or becomes subject to the penny stock rules. Our common stock is subject to the penny stock rules at the present time, and consequently our stockholders will find it more difficult to sell their shares.

Customers

In 2004 and 2003, we had one customer that represented 30% and 33%, respectively, of our gross revenues. In June 2000, pursuant to an agreement that ends on December 31, 2005, we began providing co-location services to KMC Telecom V, Inc. (KMC), a facilities-based competitive local exchange carrier. Under the terms of this agreement, we receive \$42,275 per month to provide co-location and support services for KMC's telecommunications equipment at our network operations center in Oklahoma City, Oklahoma. KMC has notified us that they will not renew their contract. Therefore we will experience a loss of this revenue without a corresponding reduction in expense.

Employees

As of December 31, 2004, we had 14 employees employed in engineering, sales, marketing, customer support and related activities and general and administrative functions. None of our employees are represented by a labor union, and we consider our relations with our employees to be good. We also engage consultants from time to time with respect to various aspects of our business.

Item 2. Description of Property

We maintain our executive office in approximately 13,000 square feet at 201 Robert S. Kerr Avenue, suite 210 in Oklahoma City, at an effective annual rental rate of \$10.20 per square foot. These premises are occupied pursuant to a ten-year lease that expires December 31, 2009.

Item 3. Legal Proceedings

As a telecommunications company, we are effected by regulatory proceedings in the ordinary course of our business at the state and federal levels. These include proceedings before both the Federal Communications Commission and the Oklahoma Corporation Commission (OCC). For example, we along with many other telecommunications companies in Oklahoma are currently a party to one or more proceeding before the OCC relating to the terms of our interconnection agreement with SBC Communications and an anticipated successor to this interconnection agreement. These proceedings were initiated due to the unreasonable changes that SBC was proposing be incorporated in the successor interconnection agreement. The regulatory proceeding concerning the terms of our interconnection agreement with SBC Communication, which is based upon their standard interconnection agreement, and the anticipated successor thereto is ongoing and is not expected to conclude until either late this year or early next year. We cannot anticipate the outcome of this regulatory proceeding at this time but a negative outcome with

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any of these regulatory proceedings could have a material adverse effect on our business, financial condition or results of operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this Report.

Table of Contents**PART II****Item 5. Market for Common Equity and Related Stockholder Matters**

Our common stock is traded in the over-the-counter market and is quoted on the OTC Bulletin Board under the symbol FULO. The closing sale prices reflect inter-dealer prices without adjustment for retail markups, markdowns or commissions and may not reflect actual transactions. The following table sets forth the high and low closing sale prices of our common stock during the calendar quarters presented as reported by the OTC Bulletin Board.

| | Common Stock Closing Sale Prices | |
|------------------------------|-------------------------------------|--------|
| | High | Low |
| 2004 Calendar Quarter Ended: | | |
| March 31 | \$.05 | \$.05 |
| June 30 | .04 | .04 |
| September 30 | .05 | .05 |
| December 31 | .07 | .05 |
| 2003 Calendar Quarter Ended: | | |
| March 31 | \$.06 | \$.06 |
| June 30 | .04 | .04 |
| September 30 | .05 | .05 |
| December 31 | .05 | .05 |

Number of stockholders

The number of beneficial holders of record of our common stock as of the close of business on March 25, 2005 was approximately 109.

Dividend Policy

To date, we have declared no cash dividends on our common stock, and do not expect to pay cash dividends in the near term. We intend to retain future earnings, if any, to provide funds for operations and the continued expansion of our business.

Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth as of December 31, 2004, information related to each category of equity compensation plan approved or not approved by our shareholders, including individual compensation arrangements with our non-employee directors. We do not have any equity compensation plans that have been approved by our shareholders. All of our outstanding stock option grants and warrants were pursuant to individual compensation arrangements and exercisable for the purchase of our common stock shares.

| Weighted- | Number of Securities Remaining |
|-----------|---|
|-----------|---|

| Plan Category | Number of Shares Underlying Unexercised Options and Warrants | Average Exercise Price of Outstanding Options and Warrants | Available for Future Issuance under Equity Compensation Plans(1) |
|--|---|---|---|
| <i>Equity compensation plans approved by our shareholders:</i> | | | |
| None | Not Applicable | Not Applicable | Not Applicable |
| <i>Equity compensation plans not approved by our shareholders:</i> | | | |
| Stock option grants to non-employee directors | | \$ | |
| Stock options granted to employees | 3,014,700 | \$.43 | |
| Warrants and certain stock options issued to non-employees | 402,000 | \$.39 | |
| Total | 3,416,700 | \$.43 | |

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Recent Sales of Unregistered Securities

During October 2004, we issued 10,000 shares of common stock as part of a settlement of a note payable. This offering was pursuant to Rule 506 of Regulation D of the Securities Act, and no commissions and fees were paid.

During December 2003, we issued 50,000 shares of common stock as a result of the exercise of an option at a price of \$.04 per share. This offering was pursuant to Rule 506 of Regulation D of the Securities Act, and no commissions and fees were paid.

With respect to each of the foregoing common stock transactions, we relied on Sections 4(2) and 3(b) of the Securities Act of 1933 and applicable registration exemptions of Rules 504 and 506 of Regulation D and applicable state securities laws.

Item 6. Management's Discussion and Analysis or Plan of Operation

The following discussion should be read in conjunction with our Consolidated Financial Statements and notes thereto included in Part II, Item 7 of this Report. The results shown herein are not necessarily indicative of the results to be expected in any future periods. This discussion contains forward-looking statements based on current expectations that involve risks and uncertainties. Actual results and the timing of events could differ materially from the forward-looking statements as a result of a number of factors. For a discussion of the factors that could cause actual results to differ materially from the forward-looking statements, see Item 1. Description of Business Additional Factors to Consider and our other periodic reports and documents filed with the Securities and Exchange Commission.

Overview

We are an integrated communications provider offering integrated communications and Internet connectivity to individuals, businesses, organizations, educational institutions and government agencies. Through our subsidiaries, we provide high quality, reliable and scalable Internet access, web hosting, and equipment co-location.

Our overall goal is to become the dominant integrated communications provider for residents and small to medium-sized businesses in Oklahoma. We believe that the rural areas of Oklahoma are underserved by Internet service providers, and that significant profitable growth can be achieved in serving these markets by providing reliable Internet connectivity and value-added services at a reasonable cost to the residents and businesses located in these areas. We believe we can obtain a significant Internet service provider and business-to-business market share in Oklahoma. Our wholly-owned subsidiary, FullTel, is a licensed competitive local exchange carrier in Oklahoma. FullTel, as a competitive local exchange carrier, is able to provide local telephone numbers for Internet access.

The market for Internet connectivity and related services is extremely competitive. We anticipate that competition will continue to intensify. The tremendous growth and potential market size of the Internet access market has attracted many new start-ups as well as existing businesses from a variety of industries. We believe that a reliable network, knowledgeable salespeople and the quality of technical support currently are the primary competitive factors in our targeted market and that price is usually secondary to these factors.

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Results of Operations

The following table sets forth certain statement of operations data as a percentage of revenues for the years ended December 31, 2004 and 2003:

| | For the Years Ended December 31, | | | |
|--|---|----------------|---------------|----------------|
| | 2004 | | 2003 | |
| | Amount | Percent | Amount | Percent |
| Revenues: | | | | |
| Access service revenues | \$ 898,973 | 40.0% | \$ 990,769 | 46.7% |
| Co-location and other revenues | 1,361,795 | 60.0 | 1,131,113 | 53.3 |
| Total revenues | 2,260,768 | 100.0 | 2,121,882 | 100.0 |
| Cost of access service revenues | 231,274 | 10.2 | 518,049 | 24.4 |
| Cost of co-location and other revenues | 114,517 | 5.1 | 109,914 | 5.2 |
| Selling, general and administrative expenses | 1,279,779 | 56.6 | 1,140,905 | 53.8 |
| Loss (gain) on sale of assets | 4,253 | .2 | (30,218) | (1.4) |
| Depreciation and amortization | 403,209 | 17.8 | 467,483 | 22.0 |
| Total operating costs and expenses | 2,033,032 | 89.9 | 2,206,133 | 104.0 |
| Income (loss) from operations | 227,736 | 10.1 | (84,251) | (4.0) |
| Gain on debt forgiveness | 163,380 | 7.2 | | |
| Interest expense | (165,110) | (7.3) | (594,357) | (28.0) |
| Income (loss) before income taxes | 226,006 | 10.0 | (678,608) | (32.0) |
| Income tax expense (benefit) | | | | |
| Net income (loss) | \$ 226,006 | 10.0% | \$ (678,608) | (32.0)% |

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Revenues

Access service revenues decreased \$91,796 or 9.3% to \$898,973 for the year 2004 from \$990,769 for the year 2003 primarily due to a 28% decline in the number of customers including the sale of approximately 5% of our customers in 2003. The decline was offset by the purchase of approximately 1,300 customers on July 30, 2004.

Co-location and other revenues increased \$230,682 or 20.4% to \$1,361,795 for the year 2004 from \$1,131,113 for the year 2003. This increase was primarily attributable to the addition of new customers. In addition we recorded approximately \$77,000 of reciprocal compensation revenue. In June 2004, we billed SBC approximately \$97,000 for reciprocal compensation (fees for terminating SBC customers' local calls onto our network). This is the first reciprocal compensation billing that we presented to SBC and it covered the period March 1, 2003 through May 31, 2004. Subsequent to June 2004, and without explanation SBC failed to pay approximately \$38,000 of the billing. We are pursuing SBC for the balance due, however there is significant uncertainty as to whether or not it will be successful. Consequently, we have established a reserve of \$38,000 and have not recorded any revenue associated with the reserve. Upon the ultimate resolution of our challenge, we will recognize the associated revenue, if any. On a going forward basis we do not believe that reciprocal compensation revenues will be material. We recorded \$18,000 in revenue for the period of June 1, 2004 through December 31, 2004 and expect to submit this billing to SBC during April 2005.

Operating Costs and Expenses

Cost of access service revenues decreased \$286,775 or 55.4% to \$231,274 for the year 2004 from \$518,049 for the year 2003. This decrease was primarily due to the restructuring of our network in order to operate in a more cost effective manner. During 2003 we received approximately \$76,000 in back billings from SBC. During 2004, we received a credit on these billings of approximately \$13,000. On September 30, 2004 we signed a settlement agreement with SBC and recorded a gain on debt settlement of \$55,099.

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Cost of co-location and other revenues remained relatively stable at \$114,517 for the year 2004 compared to \$109,914 for the year 2003. Cost of co-location and other revenues as a percentage of co-location and other revenues decreased to 8.4% from 9.7% primarily as a result of being able to generate more revenue from our existing co-location facility.

Selling, general and administrative expenses increased \$138,874 or 12.2% to \$1,279,779 for the year 2004 from \$1,140,905 for the year 2003. This increase was prim