

**EXHIBIT 2 TO THE DISCLOSURE STATEMENT  
SUPPORTING THE SECOND JOINT PLAN OF REORGANIZATION**

Financial Report

**visitalk.com, Inc.**

for the 12 month periods  
ending May 31, 2003 and May 31, 2004

(Unaudited)

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**visitalk.com, Inc.**

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**BALANCE SHEETS**  
(unaudited)

	May 31, 2004
<b>ASSETS</b>	
Current assets:	
Cash and cash equivalents	\$ 265
Accounts receivable, net of reserve for bad debts	67,400
Advances and prepaid expenses	30,000
Notes receivable	637,351
Advances and prepaid expenses	30,000
Total current assets	<u>765,016</u>
Property and equipment, net	<u>-</u>
	<u>\$ 765,016</u>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>	
Current liabilities:	
Liabilities not subject to Chapter 11 proceedings:	
Accounts payable and accrued liabilities	\$ 1,020,474
Notes payable and accrued interest	753,468
Liabilities subject to compromise	8,801,782
Deferred revenue	79,487
Total current liabilities	<u>10,490,243</u>
Commitments and contingencies	<u>-</u>
Stockholders' Deficit:	
Preferred stock; Series A to F; 11,541,667 authorized shares, 10,883,291 shares issued and outstanding, convertible into common stock on a 1:1 basis	39,385,905
Common stock: no par value, 100,000,000 shares authorized, 7,433,211 shares issued and outstanding	1,448,542
Additional paid-in-capital	871,251
Accumulated deficit	<u>(53,125,925)</u>
Total stockholders' deficit	<u>(11,420,227)</u>
	<u>\$ 765,016</u>

The accompanying notes are an integral part of these balance sheets.

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**visitalk.com, Inc.**

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**STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	12 months ending May 31, 2004	12 months ending May 31, 2003
REVENUES	\$ 55,100	\$ 85,337
OPERATING EXPENSES:		
Direct costs of revenues	38,799	99,498
Depreciation and amortization	940	88,475
Legal fees	207,041	111,357
Payroll, benefits and consulting	78,443	202,861
Other general and administrative	47,168	227,703
Total operating expenses	<u>372,391</u>	<u>729,894</u>
LOSS FROM OPERATIONS	<u>(317,291)</u>	<u>(644,557)</u>
OTHER INCOME (EXPENSE):		
Gain or loss on NavEdge sale	-	(483,101)
Interest income (expense)	<u>(63,952)</u>	<u>(18,994)</u>
Net interest income (expense)	<u>(63,952)</u>	<u>(502,095)</u>
NET LOSS	<u>\$ (381,243)</u>	<u>\$ (1,146,652)</u>

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

**NOTES TO THE FINANCIAL REPORT  
(Unaudited)**

12 months ending May 31, 2004 and May 31, 2003

**NOTE 1 – ORGANIZATION AND OPERATIONS**

visitalk.com, Inc. (the “*Company*”) was incorporated in the State of Arizona on September 3, 1998. The Company is a software development company formed to develop a comprehensive Internet communications portal and directory for voice, video and data communications. The Company commenced operating its Beta version website (visitalk.com) in June 1999 and formally launched the website in October 1999.

***Chapter 11 Bankruptcy***

On November 29, 2000, the Company filed a petition for relief under Chapter 11 of the United States Bankruptcy Code (the “*Petition*”) and has been operating since that time as a Debtor-in-Possession (see Note 3). Although the Chapter 11 bankruptcy filing raises substantial doubt about the Company’s ability to continue as a going concern, the accompanying financial statements have been prepared on a going concern basis. This basis contemplates the continuity of operations, realization of assets, and discharge of liabilities in the ordinary course of business. The statements also present the assets of the Company as historical cost and the current intention that they will be realized as a going concern and in the normal course of business. A plan of reorganization could materially change the amounts currently disclosed in the financial statements.

The accompanying financial statements do not present the amount that may ultimately be paid to settle liabilities and contingencies that may be allowed in bankruptcy cases. Under Chapter 11 bankruptcy, the ultimate payment by the company to pre-Petition creditors may be substantially altered. This could result in claims being paid at less (and possibly substantially less) than 100 percent of their face value. At this time, because of material uncertainties, per-Petition claims are carried at face value in the accompanying financial statements. In addition the interests of existing preferred and common shareholders could, among other things, be substantially diluted or even eliminated.

Prior to its Petition, the Company reported on a 52/53 week accounting fiscal year. In conjunction with the Chapter 11 bankruptcy filing, the Company changed its accounting fiscal year end and no longer reports on a 52/53 week basis. The unaudited financial statements presented herein are as of May 31, 2004 and for the twelve months then ended.

***Bankruptcy accounting and going concern***

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern in accordance with Statement of Position (“*SOP*”) 90-7, “*Financial*

*Reporting by Entities in Reorganization under the Bankruptcy Code*". Entering a reorganization, although a significant event, does not ordinarily affect or change the application of generally accepted accounting principles ("GAAP") followed by a company. However, it does require that the financial statements for periods including and subsequent to filing the Chapter 11 Petition distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business.

The Company faces many operating and industry challenges. There is no meaningful operating history to evaluate the Company's prospects for successful operations. The Company is doing business in a highly competitive industry and has incurred huge operating losses and negative cash flow since incorporation. Future losses for the Company are anticipated and the proposed plan of operations, even if successful, may not result in cash flow sufficient to finance and develop its business.

The Company incurred net losses from inception to November 30, 2000 of more than \$50,000,000 and had negative working capital as of May 31, 2004. The Company will require substantial additional financing to fully implement its plan of operations and emerge from bankruptcy. These factors raise substantial doubt about the Company's ability to continue as a going concern. In addition to bankruptcy accounting in accordance the SOP 90-7, the accompanying financial statements have been prepared using accounting principals applicable to a going concern.

The ability of the Company to continue as a going concern is dependent on many factors including the confirmation of a Second Joint Plan of Reorganization and successful execution of some of management's plans for funding (see below). The unaudited financial statements do not include adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

### ***Chapter 11 Plans of Reorganization***

On May 25, 2001, the Company filed a Disclosure Statement ("D/S") and an accompanying Plan of Reorganization (the "*First Plan*") with the United States Bankruptcy Court, District of Arizona (the "*Bankruptcy Court*"). Sufficient creditors approved this Plan to allow confirmation but the Court withdrew the First Plan in 2002 due to insufficient funding to fully execute the First Plan. In June 2004, the Company filed a Second Disclosure Statement ("D/S") and an accompanying Second Joint Plan of Reorganization (the "*Second Plan*") with the Bankruptcy Court. The Second Plan contemplates implementation of a comprehensive restructuring transaction (see Note 3). The Bankruptcy Court has not yet approved the D/S or the proposed Second Plan. There is no assurance that the D/S will be approved by the Bankruptcy Court or that the D/S and the proposed Plan will not be amended by the Bankruptcy Court or in response to objections by interested parties. If the D/S and the proposed Plan are approved by the Bankruptcy Court, there is no assurance that the Plan will obtain sufficient affirmative votes from the various parties to be confirmed by the Bankruptcy Court.

To fund the plan of operations under the proposed Plan and emerge from bankruptcy, the Company has and is attempting to sell up to \$3,000,000 of notes pursuant to two Private Placement Memorandums (the "*Offerings*"). The "*Accredited Lender*" Offering is for up to

\$1,000,000 and the “*New Value*” Offering is for up to \$2,000,000. The Notes to be issued under both of these Offerings are payable in securities other than debt at the option of holders as provided under the Second Plan. The Notes will be newly issued and are being sold by the Company under an exemption from registration allowed under Section 334(f) of the Bankruptcy Code. To date \$338,500 in notes have been sold with an additional \$100,000 to \$200,000 expected to be sold in the near future.

## **NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES**

### ***Basis of presentation***

The financial statements presented herein have been prepared by the Company, without audit. Accordingly, certain information and footnote disclosures normally included in audited financial statements prepared in accordance with GAAP may have been omitted. In the opinion of management, the unaudited financial statements presented as of May 31, 2004 and for the 12 months then ended, reflect all adjustments (consisting of normal recurring accruals only) which are necessary to present fairly the financial position and results of operations of the Company. These financial statements should be read in conjunction with the Disclosure Statement filed in support of the Second Plan as discussed further in Note 3. Terms defined in the Second Plan are used in this financial statement.

### ***Liabilities subject to compromise***

Liabilities subject to compromise are liabilities that are subject to the Chapter 11 proceedings, including claims that became known after the Petition date. Such liabilities are reported at their expected allowed claim amount in accordance with Statement of Financial Accounting Standards (“*SFAS*”) No. 5, “*Accounting for Contingencies*.” To the extent that the amounts of claims change as a result of actions in the bankruptcy case or other factors, the recorded amount of liabilities subject to compromise will be adjusted. The results of these adjustments are recorded as Reorganization Items on the accompanying statements of operations.

### ***Reorganization items***

Reorganization items are income and expenses that are realized or incurred by the Company because it is in reorganization. Any valid claims that that were not recorded at the Petition date but which become known after the Petition date, are recorded in the period recognized as liabilities subject to compromise, with a corresponding charge to Reorganization Items on the accompanying statements of operations

### ***Development stage reporting***

Since filing bankruptcy the Company has more than \$300,000 in revenues and is currently selling subscriptions for its services. Accordingly, the Company no longer reports as a development stage company and has not presented its financial statements cumulatively since inception as would be required under development stage company reporting.

### ***Property and equipment***

Property and equipment, including purchased software, is stated at estimated realizable value, due to the Company's bankruptcy. Depreciation is provided using the straight-line method over the estimated useful lives of two to seven years based on the revised realizable value. Maintenance, repairs and renewals, which do not materially add to the value of an asset or appreciably prolong its life, are charged to expense (see Note 5).

### ***Revenue recognition***

All revenue is recognized as received. A majority of revenues are from sales related to annual subscriptions.

### ***Management estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has made significant estimates in the preparation of these financial statements.

### ***Stock based compensation***

The Company applies the provisions of Accounting Principles Board Opinion ("APB") No. 25, *Accounting for Stock Issued to Employees*, and provides the pro forma net earnings and pro forma earnings per share disclosures for employee stock option grants made in 1998 and subsequent years as if the fair-value-based method defined in SFAS No. 123, *Accounting for Stock-Based Compensation*, had been applied. In accordance with APB No. 25, compensation expense is recorded on the date an option is granted only if the current market price of the underlying stock exceeds the exercise price.

### ***Loss per share***

Net loss per share is not presented since the Company's bankruptcy makes such calculation not meaningful. Under the proposed Plan, all classes of the Company's common and preferred equity are cancelled and retired.

### ***Federal income taxes***

The Company accounts for income taxes under the provisions of SFAS No. 109, *Accounting for Income Taxes*. SFAS No. 109 requires the use of an asset and liability approach in accounting for income taxes. Deferred tax assets and liabilities are recorded based on the differences between the financial statement and tax bases of assets and liabilities and the tax rates in effect when these differences are expected to reverse. SFAS No. 109 requires the reduction of deferred tax assets by a valuation allowance, if, based on the weight of available evidence, it is more likely than not that such portion of the deferred tax asset will not be realized. Due to cost constraints no tax filings have been done and all information is estimated.

### ***Impairment of long-lived assets and long-lived assets to be disposed of***

The Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future, undiscounted, net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. In applying these principals, the Company recorded an impairment of \$6,277,508 as of November 30, 2000 related to property and equipment (See Note 5).

### ***Recently issued accounting standards***

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which is effective for fiscal years beginning after June 15, 2000 (as amended). This statement establishes accounting and reporting standards requiring that derivative instruments be recorded on the balance sheet as either an asset or liability measured at its fair value. The statement also requires that changes in the derivative's fair value be recognized in earnings unless specific hedge accounting criteria are met. The adoption of SFAS No. 133 will have no impact on the Company.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 101, *Revenue Recognition in Financial Statements*. SAB No. 101 summarizes the staff's views in applying GAAP to revenue recognition in financial statements. The adoption of SAB No. 101 did not have a material effect on the Company's revenues or revenue recognition policy.

### **NOTE 3 – CHAPTER 11 BANKRUPTCY**

On November 29, 2000, the Company filed a voluntary Petition for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court, District of Arizona. The filing was made necessary by a lack of sufficient liquidity, which made it impossible for the Company to service its debt and fund ongoing operations. The Company is in possession of its properties and assets and continues to manage its businesses as debtor-in-possession subject to the supervision of the Bankruptcy Court. As a debtor-in-possession, the Company is authorized to operate its business but may not engage in transactions outside the ordinary course of business without approval of the Bankruptcy Court. Pursuant to the provisions of the Bankruptcy Code, all actions to collect upon any of the Company's liabilities as of the Petition date or to enforce pre-Petition contractual obligations were automatically stayed by the Petition. The Bankruptcy Court has approved the retention of legal professionals.

As debtor-in-possession, the Company has the right to assume or reject any pre-Petition contracts and unexpired leases. The Company has rejected all leases and most contracts. Parties affected by rejections may file claims with the Bankruptcy Court. All pre-Petition unsecured liabilities, including amounts due to vendors, damages due to the Company's landlord for early lease



termination, and unsecured debentures are presented as “*Liabilities subject to compromise*” on the accompanying balance sheets (see Note 7). Such amounts include significant estimates.

The Company has filed a D/S and the Second Plan with the Bankruptcy Court. The objective of the proposed Second Plan is to restructure the Company’s balance sheet to strengthen its financial position, fund its required capital expenditures and working capital needs and fulfill its obligations necessary to allow it to emerge from Chapter 11. The proposed Second Plan contemplates implementation of a comprehensive restructuring transaction, involving the creation of operating subsidiaries. Under the proposed Second Plan, most classes of pre-Petition creditors will receive a distribution of securities, including common stock and warrants, of the Reorganized Debtor and of the Reorganized Debtor’s operating subsidiaries. No holders of the Company’s common or preferred equity classes are entitled to any distributions under the proposed Second Plan.

The Bankruptcy Court is expected to schedule a hearing on the adequacy of the D/S and the confirmation of the Second Plan in July 2004. The Bankruptcy Court has not yet approved the D/S or the proposed Second Plan. The acceptance of the Second Plan by the all the Company’s creditors is an integral part of the Company’s continued existence. While management believes the Company has made adequate provision for the liabilities to be incurred in connection with Chapter 11 claims, there can be no assurance as to the amount of the ultimate liabilities.

#### **NOTE 4 – ADVANCES AND PREPAID EXPENSES**

Advances and prepaid expenses at May 31, 2004 total \$30,000 and consist of deposits held by the Company’s bankruptcy counsel and the counsel for the unsecured creditors’ committee.

#### **NOTE 5 – NOTES RECEIVABLE**

Notes receivable are comprised of the following:

	May 31, 2004
Note due from NavEdge for technology purchase	\$ 250,000
Notes from the NavEdge held as collateral	336,000
Notes secured on the proceeds of the Causes of Action	52,500
Accrued interest	164,968
	<u>\$ 753,468</u>

The technology purchase notes are due in 2005 and convertible into 30% of NavEdge’s common equity.

## NOTE 6 – PROPERTY AND EQUIPMENT

Property and equipment is comprised of the following:

	May 31, 2004
Computer equipment	\$ 369,902
Capitalized software	200,000
Leasehold improvements	-
Furniture & fixtures	1,950
	<u>571,852</u>
Less: Accumulated depreciation	<u>(571,852)</u>
	<u>\$ -</u>

As of the bankruptcy date the value of the equipment was reduced for impairment. This amount was determined by an independent appraisal of the property and equipment. That amount has been depreciated over three years. Since the Company terminated its building lease effective May 31, 2001 in accordance with its rights under Chapter 11 bankruptcy, all leasehold improvements have been written off as of May 31, 2001 and charged to Reorganization Items on the statement of operations.

## NOTE 7 – LIABILITIES NOT SUBJECT TO CHAPTER 11 PROCEEDINGS.

### *Post-petition unsecured liabilities*

As of May 31, 2004, the Company has incurred obligations that did not exist as of the Chapter 11 Petition date (“*post-Petition liabilities*”). Under the Bankruptcy Code, post-Petition liabilities are to be paid at the “*Effective Date*” of a reorganization plan, unless the post-Petition claimants agree otherwise. Post-Petition claimants holding approximately \$600,000 of claims have agreed to convert their post-Petition liabilities into securities of the Reorganized Debtor and a small percentage ownership of each operating subsidiary. Certain other holders have agreed to accept some cash payment and contingent payments depending on the outcome of the causes of action. The Second Plan pays any other non electing post petition creditors with a note in accordance with the Second Plan for their full liability unless they elect other treatment.

### *Notes payable*

Notes payable are comprised of the following:

	May 31, 2004
Note due to the LLC	\$ 250,000
Notes due to the New Value Lender Group	88,500
Notes due to the Primary Lender Group	250,000
Accrued interest	164,968
	<u>\$ 753,468</u>

The LLC notes are secured by a lien on all the Company's equipment and proceeds therefore. The other notes are all secured on some of the notes receivable from NavEdge as well as up to \$52,500 of the proceeds of the Causes of Action.

The proposed Second Plan provides the members of the LLC the option to directly convert their LLC investment into either debt or they may accept payment in securities issued under the Second Plan, including common stock and warrants of the Reorganized Debtor and a small percentage ownership of each of the Reorganized Debtor's operating subsidiaries.

## NOTE 8 – LIABILITIES SUBJECT TO COMPROMISE

Liabilities subject to compromise consists of:

	May 31, 2004
	<u>                    </u>
Secured claim of Axient – lease on various pieces of computer equipment.	\$ 295,843
Unsecured Priority claims – wages to former and current employees.	52,137
Unsecured claims:	
Liabilities owed to vendors and damages due to the Company's landlord for early lease termination.	5,070,697
Liabilities owed to note holders under a Convertible Note offering.	2,509,000
Wages to former and current employees, not listed as Priority claims.	531,105
Liabilities owed to investors under a note offering. Secured but not perfected.	343,000
	<u>\$ 8,801,782</u>

The Axient secured claim and the priority wage claim are treated as separate classes from the unsecured creditors. The Company believes that the grant of security interest to Axient is a "preference" under the Bankruptcy Code. Under the proposed Second Plan, the holder of the Axient claim will receive a distribution of securities, including common stock and warrants, of the Reorganized Debtor and a small percentage ownership of each of the Reorganized Debtor's operating subsidiaries for its post petition claim.

The Priority wage claims of former and current employees are to be paid upon the Effective Date of the Second Plan with notes issued under the Second Plan, unless the parties agree otherwise.

The proposed Second Plan provides that the holders of unsecured claims receive a distribution of securities, including common stock and warrants, estimated to represent approximately 10% ownership of the Reorganized Debtor and a small percentage ownership of each of the Reorganized Debtor's operating subsidiaries. In addition, the unsecured creditors will receive all claims and causes of actions, including but not limited to preference actions, fraudulent transfer

claims, claims against former officers and directors, avoidance actions, and causes of action arising from the breach of fiduciary duty, fraud, negligence, misappropriation, etc. Under the proposed Second Plan, these causes of action and claims will be placed in a trust for the unsecured creditors and may be pursued by the unsecured creditors as a group with no further recourse to the Reorganized Debtor.

## **NOTE 9 – STOCKHOLDERS’ DEFICIT**

### ***Common Stock***

The Company is authorized to issue 100,000,000 shares of common stock, no par value per share, of which 7,433,211 shares are issued and outstanding. The holders of common stock are entitled to dividends when, as and if declared by the Board of Directors from funds legally available therefor. No holder of any shares of common stock has a preemptive right to purchase any securities nor are any common shares subject to redemption or convertible into other securities. Upon liquidation, dissolution or winding up, and after payment of creditors and preferred shareholders, if any, assets will be divided pro-rata on a share-for-share basis among the holders of common stock. All shares of common stock issued and outstanding are fully paid, validly issued and non-assessable.

Each holder of common stock is entitled to one vote per share. Holders also have cumulative voting rights in the election of directors, as provided under Arizona law. This means that shareholders may multiply the total number of shares they are entitled to vote by the total number of directors for whom they are entitled to vote, and may apply that product to vote for a single director or distribute that product among two or more candidates. Arizona’s cumulative voting rights may allow shareholders holding a minority of our shares greater opportunity to elect a director even though management or larger shareholders control a substantial percentage of our shares.

In September 1998, the Company was incorporated and issued 6,100,000 shares of the Company’s common stock to the founders of the Company for no cash consideration. Subsequently, shares have been issued for warrant and option exercises and as fees related to the issuance of preferred stock.

### ***Preferred Stock***

The Company is presently authorized to issue up to 20,000,000 shares of Preferred Stock. Under the Articles of Incorporation, the Board of Directors has the power, without further action by the shareholders, to issue the preferred stock in such series as designated by the Board of Directors. The Board of Directors has designated the following series of preferred stock: Series A 7% Non-Cumulative Convertible Preferred Stock, Series B Convertible Preferred Stock, Series C Convertible Preferred Stock, Series D Convertible Preferred Stock; and Series E Convertible Preferred Stock. The following table shows the Company’s Preferred stock issued and outstanding:

	Nov. 30, 2000	May 31, 2001
Series A; \$.50 liquidation value, 2,800,000 authorized shares, 2,400,000 shares issued and outstanding	466,800	466,800
Series B; \$1.00 liquidation value, 2,200,000 authorized shares, 2,050,000 shares issued and outstanding	1,905,600	1,905,600
Series C; \$5.00 liquidation value, 4,400,000 authorized shares, 4,291,624 shares issued and outstanding	20,013,505	20,013,505
Series D; \$7.50 liquidation value, 266,667 authorized shares, 266,667 shares issued and outstanding	2,000,000	2,000,000
Series E; \$8.00 liquidation value, 1,875,000 authorized shares, 1,875,000 shares issued and outstanding	15,000,000	15,000,000
	<u>\$ 39,385,905</u>	<u>\$ 39,385,905</u>

For each series of preferred stock, the Board of Directors has established the following rights, preferences and limitations (any material differences between the Series A, Series B, Series C, Series D and Series E are noted below):

- *Dividend Preference:* Each series of preferred stock ranks pari passu with the other and each series is senior to all other capital stock in right of priority to receive dividends or other distributions.
- *Liquidation Preference:* Each series of preferred stock ranks pari passu with the other and each series is senior to all other capital stock in right of priority to distributions paid upon our liquidation. Upon liquidation or winding up, each preferred shareholders will be entitled to receive, in preference to common shareholders, an amount equal to the greater of (a) \$0.50 for Series A holders, \$1.00 for Series B holders, \$5.00 for Series C holders, \$7.50 for Series D holders and \$8.00 for Series E holders, plus declared but unpaid dividends, if any, on the preferred stock and (b) the pro rata distributable amount per share available to holders of each outstanding share of capital stock (on an as converted basis).
- *Conversion Rights:* Each series of preferred stock is convertible into common stock on a 1:1 basis at any time at the option of the holder and automatically in the event of a qualifying underwritten public offering of the Company's common stock. Each series of preferred stock may also be automatically converted into common stock upon the consent of not less than a majority of the then outstanding shares in a given series.
- *Voting Rights:* The shares of common and preferred stock vote as a single class on all matters submitted to the vote of shareholders. Generally, the consent of the holders of a majority of the shares of preferred stock is required for: (a) the creation of any new class or series of shares senior to any existing preferred stock as to dividend or liquidation preferences, (b) any increase or decrease in the authorized number of shares of preferred stock, or (c) any distribution, as a dividend, in liquidation or otherwise, in preference to any existing preferred stock. Each holder of preferred stock is entitled to vote the number of shares equal to the number of shares of common stock into which such preferred stock is

convertible. In addition, the Series A Preferred Stock has the right to elect one director to the Board of Directors.

- *Rights of Participation:* Holders of Preferred Stock do not have any right of participation or other preemptive rights.

No holders of the Company's common or preferred equity classes are entitled to distributions under the proposed Second Plan. All classes of the Company's common and preferred equity are cancelled and retired.

#### **NOTE 10 – STOCK OPTIONS**

In September 1998, the Company granted options to purchase 7,650,000 shares of the Company's common stock to the two original founders. These options are exercisable immediately at an exercise price of \$0.1375 per share and expired on November 30, 2001.

Subsequently, during 1998 the Company adopted a stock option plan (the "1998 Plan") that provides for the granting of options to employees, consultants, officers and directors generally at not less than fair value, as determined by the Board of Directors, at the date of the grant. Options granted under the 1998 Plan may be incentive stock options or nonstatutory stock options. A total of 5,400,000 shares of common stock are reserved for issuance under the 1998 Plan. Unless otherwise determined by the Board of Directors, all options expire ten years from date of grant. All employees covered by the 1998 Plan have resigned or been otherwise terminated and there are no options outstanding under the 1998 Plan or are any likely to be issued.

#### **NOTE 11 – INCOME TAXES**

The Company has incurred losses since inception for both financial statement and income tax purposes. With no assurance of likely profitability, the Company's income tax benefit has been fully offset by a valuation allowance. As a result, the Company has fully reserved deferred tax assets of approximately \$20 million (assuming a 40% tax rate) at May 31, 2004. This arises from a net operating loss carry-forward ("*NOL*") of approximately \$50 million. This *NOL* must be reduced by the amount the creditors do not receive under the Second Plan. The estimate is that this adjustment will be approximately \$10,000,000. No provision or benefit for income taxes has been reported in the accompanying statements of operations as any current income tax benefit would be offset by increasing the valuation allowance.

#### **NOTE 12 – CAUSES OF ACTION PROCEEDS**

The Company and its various counsels' approved by the Bankruptcy Court are pursuing multiple Causes of Action including preference claims, claims against officers and directors and claims against other parties. Some of these Causes of Action have been settled but not yet approved by the Bankruptcy Court. Such settlement may increase the unsecured claims. Since these amounts have not yet been formal approved, they are no listed as a Company asset.

### **NOTE 13 – SALE OF THE COMPANY ASSETS**

In February 2004, the Official Unsecured Creditors Committee of the Company appointed under the Chapter 11 process the Company's Chapter 11 case (the "Committee") petitioned the Bankruptcy Court to convert the case to a Chapter 7 liquidation. On May 11, 2004, the Bankruptcy Court, in lieu of this conversion motion, approved a proposal by VT Acquisition Corp. to acquire substantially all the assets of the Company under a complex structure designed to preserve the NOLs. The consideration to be paid was proposed as cash, securities of the purchaser to be used to pay certain secured lenders plus the assumption of a limited amount of specific post petition liabilities totaling about \$200,000. The Committee supported this proposal but the buyer, the Company and the Committee agreed to circulate the Second Plan and because the proposed Second Plan would yield a greater return to the unsecured creditors only sell the assets under this approval if the Second Plan was not approved by a date to be mutually agreed to among those parties.

### **NOTE 14 – COMMITMENTS AND CONTINGENCIES**

The Company may be subject to additional claims and assessments relating to unpaid vendors of the Company and other damage claims. While management believes the Company has made adequate provision for the liabilities to be incurred in connection with Chapter 11 claims, there can be no assurance as to the amount of the ultimate liabilities until all creditor claims are received. The Bankruptcy Court will set a "*bar date*" as part of the Plan confirmation process, whereby all creditors must make a formal claim or be barred from making further claims thereafter.