IDT CORP
Form 10-K/A
September 03, 2003
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO

SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE FISCAL YEAR ENDED JULY 31, 2002,

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

Commission File Number: 0-27898

IDT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**22-3415036**
(State of other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

520 Broad Street

Newark, New Jersey 07102

(Address of principal executive offices, including area code)

(973) 438-1000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $.01 per share

Class B Common Stock, par value $.01 per share

(Title of class)

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

None

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing price on October 25, 2002 of the Common Stock of $17.66 and of the Class B Common Stock of $16.30, as reported on the New York Stock Exchange, was approximately $821 million. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock (assuming conversion of the Registrant s Class A Common Stock) or Class B Common Stock have been excluded from this computation, in that such persons may be deemed to be affiliates of the Registrant. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

As of October 25, 2002, the Registrant had outstanding 19,601,009 shares of Common Stock, $.01 par value, 9,816,988 shares of Class A Common Stock, $.01 par value, and 50,072,692 shares of Class B Common Stock, $.01 par value. Excluded from these numbers are 5,419,963 shares of Common Stock and 4,019,163 shares of Class B Common Stock held by IDT Corporation.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information in the Registrant s definitive Proxy Statement for its 2002 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after July 31, 2002, is incorporated by reference in Part II (Item 5) and Part III (Items 10, 11, 12 and 13) of this Form 10-K.

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EXPLANATORY NOTE

We are filing this Amendment No. 1 on Form 10-K/A to our annual report for the fiscal year ended July 31, 2002 (Fiscal 2002) primarily for the purpose of restating our financial statements and other financial information included in this report to consolidate the results of Net2Phone, Inc. for the period beginning on October 23, 2001 through July 31, 2002. In our original annual report for Fiscal 2002 on Form 10-K, we accounted for our investment in Net2Phone during this period using the equity method. Note 2 to our consolidated financial statements included in this report summarizes the basis for this restatement. In addition, we have made certain other changes throughout this report to include additional information regarding Net2Phone, and our investment therein, and to clarify and supplement previously disclosed information regarding topics other than Net2Phone.

We have amended and restated our Annual Report on Form 10-K for Fiscal 2002 in its entirety because the changes referenced above have been made throughout the report. This Amendment No. 1 does not contain updates to reflect any events occurring after the original October 29, 2002 filing of our Annual Report on Form 10-K for Fiscal 2002. All information contained in this Amendment No. 1 is subject to updating and supplementing as provided in our reports filed with the Securities and Exchange Commission, as may be amended, for periods subsequent to the date of the original filing of the Annual Report on Form 10-K. We have not amended, and will not be amending, our quarterly reports on Form 10-Q for the first three quarters of Fiscal 2002, and the financial statements and related financial information contained in such reports should no longer be relied upon and should be viewed in the context of this report. We are, however, amending our quarterly reports on Form 10-Q for the first three quarters of the fiscal year ended July 31, 2003 for the purpose of restating the financial statements and other financial information included therein to consolidate the results of Net2Phone for the period beginning on October 23, 2001 through July 31, 2002.

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IDT CORPORATION

ANNUAL REPORT ON FORM 10-K/A (Amendment No. 1)

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PART I

As used in this Annual Report, unless the context otherwise requires, the terms the Company, IDT, we, us, and our refer to IDT Corporation, a Delaware corporation, its predecessor, International Discount Telecommunications, Corp., a New York corporation, and their subsidiaries, collectively. All information in this Annual Report gives effect to the 1995 reincorporation of IDT in Delaware. Our fiscal year ends on July 31 of each calendar year. Each reference to a Fiscal Year in this Annual Report refers to the Fiscal Year ending in the calendar year indicated (e.g., Fiscal 2002 refers to the Fiscal Year ended July 31, 2002).

Item 1. *BUSINESS.*

INTRODUCTION

IDT Corporation is a multinational communications company that provides services and products to retail and wholesale customers worldwide. Our primary offerings are prepaid debit and rechargeable calling cards, wholesale carrier services and consumer long distance services. We also operate several media and entertainment-related businesses, most of which are currently in the early stages of development.

We have grown throughout our history, and our growth continued in Fiscal 2002. Our revenues grew to $1.6 billion in Fiscal 2002, from $1.2 billion in Fiscal 2001 and $1.1 billion in Fiscal 2000. We derive the majority or our revenues from our calling card and wholesale carrier services, which generated revenues of $1.4 billion in Fiscal 2002, $1.2 billion in Fiscal 2001 and $1.0 billion in Fiscal 2000. In Fiscal 2002, minutes of use from our calling card and wholesale carrier services grew to 11.3 billion minutes in Fiscal 2002, an increase from 7.0 billion minutes in Fiscal 2001 and 4.2 billion minutes in Fiscal 2000.

In providing calling card and wholesale carrier services, we utilize our network of more than 180 switches in the United States, Europe and South America, as well as our owned and leased capacity on 14 undersea fiber-optic cables that connect our U.S. facilities with our international facilities and with third-party facilities in Europe, Latin America and Asia. We utilize another carriers networks in providing consumer long distance services.

Our growth, however, has not deteriorated the strength of our balance sheet. As of October 1, 2002, we had more than $1 billion in cash, cash equivalents and marketable securities and virtually no long-term debt. Management believes that our strong balance sheet creates numerous business opportunities for us, including (i) selling our services to significant customers who take comfort in our solid financial position, (ii) enabling us to make strategic investments and acquisitions at attractive prices and (iii) expanding our network and the range of services and products that we provide at attractive prices.

In December 2001, we acquired substantially all of the core domestic telecommunications assets of Winstar Communications, Inc., which we refer to as Old Winstar, a broadband and telephony service provider to commercial and governmental customers, in a transaction pursuant to Section 363 of the United States Bankruptcy Code. Additionally, in September 2002, we more than doubled the size of our domestic telecommunications backbone by acquiring indefeasible rights of use, commonly known as IRUs (rights to transmission lines, which are more akin to ownership than leases of capacity), and equipment from the bankrupt estate of Star Telecommunications, Inc.

While we have experienced significant growth, we have continued to incur operating losses. For Fiscal 2002, our operating loss was $440.3 million compared to $432.7 million in Fiscal 2001 and $216.6 million in Fiscal 2000. In addition, we incurred a net loss in Fiscal 2002 of $303.3 million compared with net income of $532.4 million in Fiscal 2001 and net income of $230.9 million in Fiscal 2000.

HISTORY

We were founded in August 1990 and were originally incorporated in New York as International Discount Telecommunications Corp. We were renamed IDT Corporation and reincorporated in Delaware in December 1995. Our main offices are located at 520 Broad Street, Newark, New Jersey 07102. Our headquarters telephone number is (973) 438-1000 and our Internet address is www.idt.net.

We entered the telecommunications business in 1990 by introducing our international call reorigination service to capitalize on the opportunity created by the large spread between U.S.-originated and foreign-originated international long distance telephone rates. At the time, long distance calling costs for calls originated in certain highly regulated international markets were often prohibitive. Our call reorigination service enables customers to access a U.S. dial tone from overseas and place international calls that are reoriginated in the United States. The customer benefits from more favorable U.S. outbound long distance rates and superior transmission quality. We used the calling volume and expertise derived from our call reorigination business to enter the consumer long distance business in late 1993 by reselling long distance services of other carriers to our customers. As a value-added service for our long distance customers, we began offering Internet access in early 1994, eventually offering dial-up and dedicated Internet access to individuals and businesses as stand-alone services. In 1995, we began reselling access to the

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favorable telephone rates and special tariffs we receive as a result of the calling volume generated by our call reorigination and other customers to other long distance carriers. We entered the Internet telephony market in August 1996 with our introduction of PC2Phone, the first commercial telephone service to connect calls between personal computers and telephones over the Internet. We began marketing and selling prepaid calling cards in January 1997.

The initial public offering of our Common Stock occurred on March 15, 1996. Our Common Stock was quoted on the Nasdaq National Market until February 26, 2001, when it was listed on the New York Stock Exchange under the symbol IDT. On May 31, 2001, we distributed a stock dividend of one share of our Class B Common Stock for each outstanding share of our Common Stock, Class A Common Stock and Class B Common Stock. On June 1, 2001, our Class B Common Stock was listed on the New York Stock Exchange under the symbol IDT.B.

On August 3, 1999, Net2Phone, Inc., then our subsidiary, completed an initial public offering of 6.2 million shares of its common stock, yielding $85.3 million in net proceeds. In December 1999, Net2Phone completed another offering of 3.4 million shares of its common stock. In connection with that offering, we also sold 2.2 million shares of Net2Phone common stock, generating $115.0 million in cash proceeds. In August 2000, we completed the sale of 14.9 million shares of Net2Phone common stock to AT&T, receiving approximately $1.1 billion in cash proceeds.

On October 23, 2001, we entered into an agreement to create a consortium, which now holds approximately 46% of Net2Phone s outstanding capital stock. The consortium consists of us, Liberty Media Corporation and AT&T. As part of the agreement, IDT and AT&T contributed shares of Net2Phone Class A common stock (approximately 10.0 million and 18.9 million shares, respectively) to a newly formed limited liability company, NTOP Holdings, LLC. Liberty Media then acquired a substantial portion of NTOP Holdings units from AT&T. NTOP Holdings holds an aggregate of 28.9 million shares of Net2Phone s Class A common stock. We have the ability to control NTOP Holdings because we have the right to appoint the majority of the members of its board of managers. Because NTOP Holdings holds Net2Phone Class A common stock with two votes per share, NTOP Holdings has approximately 63% of the voting power in Net2Phone.

On December 19, 2001, we, through our subsidiary, Winstar Holdings, LLC, acquired substantially all of the core domestic telecommunications assets of Old Winstar in exchange for (i) $30 million in cash, (ii) $12.5 million of our Class B Common Stock and (iii) 5% of Winstar Holdings in a transaction pursuant to Section 363 of the United States Bankruptcy Code. On April 16, 2002, we purchased from the estate of Old Winstar the 5% of Winstar Holdings that we did not already own for $13.3 million of our Class B Common Stock.

CORPORATE ORGANIZATION

We conduct our business primarily through the following four operating subsidiaries:

> *IDT Telecom, Inc.* IDT Telecom operates our principal telecommunications operations. We own 95.2% of IDT Telecom s common stock, with Liberty Media holding the remaining 4.8% for which it paid $30 million in cash in March 2002. IDT Telecom provides both retail and wholesale telecommunications services. Retail services include prepaid debit and rechargeable calling cards, private label calling cards and consumer long distance services. Wholesale services consist of our carrier services for other telecommunications companies, or carrier s carrier services. In Fiscal 2002, IDT Telecom generated $1.4 billion of revenues, which equaled 89.1% of our consolidated revenues and recorded operating income of $30.8 million. Retail services comprised 79.5% of IDT Telecom s revenues, with the remaining 20.5% attributable to wholesale services.

Winstar Holdings, LLC. Winstar Holdings, our wholly owned subsidiary, which was created to hold the assets of Old Winstar that we acquired, is a broadband and telephony service provider to commercial and governmental customers that offers a cost-effective last mile (the connection between a telecommunications switch and the end user) telecommunications solution through its fixed-wireless and fiber infrastructure, including local and long distance phone services, high speed Internet and data communications, wide-area-network, or WAN, solutions, co-location, mobile network infrastructure and web hosting. From our December 19, 2001 acquisition of Old Winstar s assets through the end of Fiscal 2002, Winstar generated $79.6 million of revenues, which equaled 5.0% of our consolidated revenues and recorded an operating loss of $96.6 million.

Net2Phone, Inc. Effective October 23, 2001, we reconsolidated Net2Phone, which is a provider of voice over Internet protocol, or VoIP, telephony products and services. As of July 31, 2002, IDT s effective equity investment in Net2Phone (through NTOP Holdings) was 19.2%. In Fiscal 2002, our Internet Telephony segment, consisting of Net2Phone, generated $71.9 million of revenues, which equaled 4.5% of our consolidated revenues and recorded an operating loss of $216.0 million.

IDT Media, Inc. IDT Media, our wholly owned subsidiary, is a holding company for our media-related holdings, including the Talk America Radio Network, our WMET radio station, Digital Production Solutions and CTM Brochure Display. In Fiscal 2002, IDT Media generated $21.3 million of revenues, which equaled 1.3% of our consolidated revenues and recorded an operating loss of $132.0 million, which included the impairment charge of $111.1 million resulting from the writedown of assets received from TyCom Ltd. described below.

In each of our business units, we seek to leverage our strong balance sheet (more than $1 billion in cash, cash equivalents and marketable securities and virtually no long-term debt as of October 1, 2002), our established telecommunications network and our dynamic, entrepreneurial corporate culture to capitalize on new market opportunities.

IDT TELECOM

Our subsidiary, IDT Telecom, provides its customers with competitively priced retail and wholesale telecommunications services and products, including prepaid debit and rechargeable calling cards, private label calling cards, consumer long distance services and wholesale carrier services. Our telecom division leverages our financial strength, network and expertise to capitalize on opportunities presented by an evolving worldwide telecommunications industry to profitably grow our business.

Our telecom division generated revenues of $1.4 billion during Fiscal 2002, an 18.8% increase over the $1.2 billion of revenues generated during Fiscal 2001. Our telecom division s revenues represented 89.1% of our total consolidated revenues in Fiscal 2002, as compared to 97.9% in Fiscal 2001. During Fiscal 2002, our retail telecommunications services and products (prepaid debit and rechargeable calling cards, private label calling cards and consumer long distance services) comprised 79.5% of our telecom division s revenues, with the remaining 20.5% attributable to wholesale carrier services. Our telecom division s operating income increased to $30.8 million in Fiscal 2002, from an operating loss in Fiscal 2001 of $103.6 million.

We are one of the largest providers of prepaid calling cards in the United States. In Fiscal 2002, we recorded revenues of $1.01 billion from sales of calling cards worldwide, which were primarily distributed through Union Telecard Alliance, LLC, a joint venture of which we own 51% of the outstanding membership interests, and provided 9.2 billion minutes of phone service to our calling card customers. We also provide consumer long distance services to more than 550,000 individual and business customers in the United States. In addition, as of October 1, 2002, we had approximately 173 wholesale carrier customers (i.e., other telecommunications companies that purchase our telecommunications services to terminate their traffic) located in the United States and Europe.

We deliver our telecommunications services over a network consisting of more than 180 switches in the United States, Europe and South America, including seven international gateway switches. Four of these switches are located in the United States (in Piscataway and Newark, New Jersey), two are located in London, England and the remaining switch is in Lima, Peru. During Fiscal 2003, we plan to install at least two additional gateway switches, one in New Jersey and one in Argentina. We also own and lease capacity on 14 undersea fiber-optic cables that connect our U.S. facilities with our international facilities and with third-party facilities in Europe, Latin America and Asia. We utilize other carriers networks in providing consumer long distance services.

The International Long Distance Market

In the United States, an international long distance telephone call typically originates on the caller s local exchange carrier s (most often a Regional Bell Operating Company, commonly referred to as a RBOC) network and is switched to the caller s long distance provider (such as AT&T, MCI or Sprint). The long distance provider then carries the call to its own or to another carrier s (a carrier s carrier such as IDT Telecom) international gateway switch. From there, it is carried directly or indirectly to a corresponding gateway switch operated in the destination country by the dominant carrier of that country (typically a state-owned or state-sanctioned foreign post, telephone or telegraph company, commonly referred to as a PTT), and then that country s domestic telephone network routes the call to the party being called. All of this routing and switching of calls is automatically performed in milliseconds based upon a predetermined set of routing criteria.

International long distance providers can generally be categorized by the extent of their ownership and use of switches and transmission facilities. The largest U.S. carriers, AT&T, MCI and Sprint, own the U.S. transmission facilities that they primarily use and tend to utilize other international long distance providers only to reach niche markets where they do not own a network, to take advantage of lower prices or to carry their overflow traffic. A significant group of alternative long distance providers emerged that own and operate their own switches but either rely solely on resale agreements with carrier s carriers to terminate traffic or use a combination of resale agreements and leased or owned facilities in order to terminate their traffic.

The international telecommunications industry is undergoing a period of rapid technological and regulatory change that, we believe, continues to offer market opportunities for telecommunications services providers such as us. Recent years have witnessed rapid growth in the usage of international telecommunications services (international long distance telephone minutes increased from approximately 93 billion in 1998 to approximately 146 billion in 2001) and a shift towards deregulation in many of the world s major telecommunications markets (including Eastern Europe, Latin America and Asia).

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We believe that growth in international long distance telecommunications traffic will continue to be driven by:

- the globalization of the world s economies and the worldwide trend toward deregulation of telecommunications;
- declining prices arising from increased competition generated by privatization and deregulation;
- increased worldwide telephone density in both traditional landline and wireless telephones;
- a wider selection of products and services; and
- the growth in the transmission of data traffic.

We believe that growth of voice and data traffic originated outside of the United States will exceed the growth in voice and data traffic originated within the United States due to recent deregulation in many foreign markets and increasing access to telecommunications facilities in emerging foreign markets.

However, many participants in the worldwide telecommunications industry have not been able to benefit from the growth in worldwide telecommunications traffic. Rather, the telecommunications industry currently finds itself in a worldwide downturn, which has resulted in a number of companies recently filing for protection under Chapter 7 or Chapter 11 of the U.S. Bankruptcy Code (including WorldCom, Global Crossing and Williams Communications), and a 61.3% decline in the industry s aggregate public market value in the last two years, according to Deutsche Bank. This has resulted in a dramatic change to the competitive landscape in the international long distance market during the past two to three years.

Commencing in the mid-1990s, spurred primarily by the deregulation of telecommunications services in the United States and abroad, new entrants in the international long distance market cut prices to try to gain market share. With relatively easy access to the public debt and equity markets in the late 1990s, many of these emerging companies were able to survive without generating profits. This access to funding enabled many emerging companies to begin constructing large telecommunications networks in an attempt to compete directly with the industry s largest facilities-based carriers. At the time, these investments were justified by projections of growth in both voice and data traffic which would, in turn, increase demand for bandwidth. According to this belief, the strong price elasticity of demand for voice and data services would ensure that industry revenues would climb, even as prices rapidly fell, due to surging volumes of telecommunications traffic. It was believed that data demand would be the key driver of demand growth, as the increase in Internet use experienced during the mid and late-1990s was expected to continue unabated. Many believed that a fortuitous cycle for bandwidth demand had been set in motion, where increased demand for bandwidth would lead to an increased supply, which would enable bandwidth-hungry applications such as video-on-demand to become mainstream, which in turn would lead to even more need for bandwidth.

By mid-2000, however, it was becoming apparent that the estimates for future demand for bandwidth were overly optimistic. Demand for data transmission, in particular, was not nearly as robust as had been anticipated by many. The bandwidth-hungry applications that were supposed to drive much of the growth in data demand had not yet materialized. In addition, the oversupply of bandwidth was further exacerbated with the introduction of enhanced compression technologies. With supply significantly outpacing demand, prices for bandwidth plummeted, while pricing for termination of international calls also fell significantly. As a result of these falling prices and lower-than-expected demand, many telecommunications companies fell short of their revenue projections. In addition, many emerging telecommunications companies were subject to large principal and interest payments on their substantial indebtedness. At the same time, raising funds in the public debt and equity markets became more difficult. As a result, many of these new entrants either filed for bankruptcy or otherwise exited the international long distance marketplace.

Beginning in 2001, a second wave of financial difficulties swept the international telecommunications market. Significantly larger and established telecommunications companies encountered cash flow and fundraising difficulties. Companies that built or purchased large fiber networks with massive capacities, such as WorldCom, Global Crossing and Williams Communications, suffered when both prices and demand for bandwidth decreased.

Because we did not increase our leverage and did not participate in the network overbuild which plagued the industry, we were not affected financially as greatly as other telecommunications companies who over-leveraged themselves and overbuilt their networks. Nevertheless, our revenues (and revenues per minute) were negatively affected as industry pricing dropped significantly, due primarily to the industry oversupply of capacity. We were also affected by the financial difficulties or bankruptcies of some of our customers, primarily in terms of managing our relationships with them and our adapting credit risk management policies and in lost opportunities for sales to entities where we determined that such additional sales would leave us overexposed.

The industry s malaise has not been limited to emerging international long distance providers and bandwidth companies. In the local calling markets in the United States, which have traditionally been dominated by the RBOCs, competitors known as competitive local exchange carriers, or CLECs, have entered the market since the Telecommunications Act of 1996 effectively

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opened local markets for competition. To this point, however, the CLECs experience has not generally been successful. Whether due to the RBOCs inherent advantages in their local markets, or because of the overbuilding of networks and large debt burdens of some of the CLECs, most competitors in the local markets have failed, with a significant number of the CLECs (including XO Communications, ICG Communications, CTC Communications Group and McLeod USA) filing for bankruptcy protection.

In addition, since 1996, the FCC has allowed the RBOCs to provide long distance telephone service as well as local telephone service if a RBOC can successfully establish that it has opened its local footprint to local telephone competition. For example, Verizon now offers long distance telephone service in all Northeastern U.S. states from Maine to Delaware. The FCC has approved applications for RBOCs to provide long distance service in 22 states, having determined that the RBOCs have properly opened their local markets for competition in those states. The FCC is considering applications in other states. Although we will compete with the RBOCs for long distance customers, we believe that we can benefit from the RBOCs entrance into the long distance market because the RBOCs, which lack the international network possessed by most existing long distance providers, rely more heavily on carrier s carriers, such as us, to arrange for termination of their international telephone traffic. During Fiscal 2003, we intend to include the RBOCs as a major focus of our wholesale carrier strategy.

Despite the recent downturn in the telecommunications industry, we continue to believe in the international long distance industry s solid underlying fundamentals. Volumes of both voice and data traffic continue to grow, presenting opportunities for companies like us. We do not believe that the current weakness in the global telecommunications industry represents a refutation of the positive long-term factors that have driven the industry s growth. Even during the recent downturn in the telecommunications industry, the volume of worldwide voice and data traffic continued to increase, and we expect that such traffic will continue to increase for the foreseeable future. In fact, while we were also affected by the industry downturn, it has also provided us with opportunities to buy potentially valuable assets and businesses at a fraction of their original cost.

The IDT Approach

Our approach to the constantly changing, deregulating worldwide telecommunications industry has allowed us to survive and grow even as many companies in the telecommunications industry such as Global Crossing, WorldCom and Williams Communications have endured financial difficulties. Our approach can be encapsulated into two overarching concepts:

- our niche strategy; and
- our smart-build approach.

Throughout our history, we have sought to exploit profitable niches within the telecommunications industry. This included establishing ourselves as a low cost provider of services by setting our price points below those offered by the larger, brand-name companies (e.g., our rechargeable calling cards and consumer long distance), by providing services to under-served segments of the retail markets (e.g., our prepaid calling cards) and by providing wholesale telecommunications services to other telecommunications companies (e.g., our wholesale carrier services).

Our smart-build approach refers to the incremental approach we take to expand our network we add new facilities only when we determine that such investments are justified by existing or imminent traffic volumes. Under this approach, we usually enter a new market by leasing fiber capacity. As traffic grows, we may install a switch to increase our overall capacity. As traffic increases further, we analyze whether purchasing bandwidth, instead of leasing, would reduce our costs by routing calls over an owned network. If our volume continues to grow, we may deploy additional switching and/or fiber capacity. This approach enables us to focus on our network costs on a per minute basis; only when we believe that we have the traffic volumes to justify the fixed cost involved with a switch or owned bandwidth will we consider such an investment.

Although our smart-build approach is often difficult to implement, as it depends on reasonably accurate projections of our future traffic volumes and the ability to execute capital projects quickly, we believe that it serves to effectively insulate us from the overbuilding that has plagued the telecommunications industry in recent years. Our generally cautious approach to purchasing capacity is balanced with the need to obtain sufficient capacity to a destination. Insufficient capacity to a termination point could result in higher costs to carry traffic to that destination, resulting in lower margins.

The following represent key elements of our strategy for Fiscal 2003:

Leverage Existing Infrastructure. We intend to utilize our established network, expertise and market presence to target new markets for our prepaid and private label calling cards and our consumer long distance services, and to expand our marketing efforts in existing markets for these products. As we have done in the past, we will seek to identify niche markets and products in which we can utilize our existing network to generate incremental revenues and increase our margins. For example, our private label calling cards utilize our existing calling card platform to produce calling card products for corporate and promotional users. These cards tend to have higher rates and margins than our other calling cards, and are marketed to users outside of our traditional customer base, allowing us to expand our market for these products.

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Focus on International Opportunities. We believe that the international long distance market provides attractive growth opportunities. We will seek to continue to identify international markets with high volumes of traffic, relatively high per-minute rates and favorable prospects for deregulation, and seek to (i) expand our product offerings to retail customers calling into these markets, (ii) offer to arrange for termination for the RBOCs and other carriers that do not currently possess access to these markets and (iii) where appropriate, introduce our services and products to customers in the target markets.

Pursue International Agreements. We intend to capitalize on our existing relationships with U.S. and foreign companies in order to expand our customer base. We have traditionally been able to capitalize on our volume of traffic and technological expertise to negotiate favorable termination agreements with international carriers. We will continue to seek new termination relationships with established and emerging carriers to reduce our termination costs for traditional international voice telephony, and we will continue to use our relationship with Net2Phone for additional low cost termination. To date, we have entered into over 60 agreements with carriers that provide for the favorably priced termination of our calls worldwide.

Make Strategic Investments and Acquisitions. Consistent with our Winstar acquisition and other acquisitions consummated in Fiscal 2002, we will continue to seek out opportunities in the distressed marketplace to acquire complementary assets, technologies and lines of business at attractive prices.

Expand Switching and Transmission Facilities. We will continue to expand and enhance our network facilities by investing in switching and transmission facilities where traffic volumes justify such investments. During Fiscal 2003, in order to reduce the cost of our services and enable us to continue to grow rapidly while maintaining our high service quality, we intend to continue to invest in:

- the expansion of our debit card platform;
- long haul and local loop fiber capacity within the United States and Europe;
- gateway switches and facilities in the United States, the United Kingdom and other European countries;
- switches, bandwidth and facilities in Latin America; and
- additional network compression equipment.

IDT Telecom s Telecommunications Services

Our telecom division currently provides our customers with a variety of services, including:

- prepaid debit and rechargeable calling cards;
- private label calling cards;
- consumer long distance services; and
- wholesale carrier services.

Retail Telecommunications Services

Prepaid Debit and Rechargeable Calling Cards

We sell prepaid debit and rechargeable calling cards providing telephone access to more than 230 countries and territories. Our strategy is to offer rates on our calling cards that we believe are generally well below the rates for international calls that are offered by most of the major brand-name, facilities-based carriers such as AT&T, MCI and Sprint. We sell more than 150 different prepaid calling cards in the United States, and more than 40 different cards abroad**,** with specific cards featuring favorable rates to specific areas of the world. The cards are sold in several different dollar denominations, most commonly $5, $10 and $20. When a calling card is used to complete a telephone call, its balance is reduced by the then applicable per minute rate to the destination called multiplied by the number of minutes of the call, plus any fees we charge. The calling rates to each location, which we periodically adjust to reflect changes in costs and other market conditions, and other fees on the card (e.g., payphone fees, toll-free access surcharges and monthly fees) vary on a card-to-card basis. We offer calling cards that provide access to our network by dialing a toll-free number or, in certain metropolitan markets, local area calling cards that only require a local call, thereby avoiding the payphone fee and toll-free access surcharges.

Our prepaid calling cards are marketed primarily to the ethnic, immigrant communities in the United States, Europe and Latin America who tend to generate high levels of international traffic. We believe that recent immigrants and members of the ethnic communities tend to be heavy users of international long distance telephone service because of their desire to keep in touch with family members and friends located in their country of origin. Specifically, a large portion of our calling card customers are from the Hispanic community. Therefore, a significant proportion (55% in Fiscal 2002) of our international debit card minutes are

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terminated in Latin America as U.S.-resident Latinos call their native countries. We believe that many customers typically use our calling cards as their primary means of making long distance telephone calls due to attractive rates, reliable service, the ease of monitoring and budgeting their long distance spending and the appealing variety of calling cards that we offer to different market segments.

Our prepaid calling card business is particularly strong in the Northeastern United States because of our extensive distribution network and attractive rates to countries that immigrants in the Northeastern United States prefer to call, such as Colombia, Mexico and the Dominican Republic. Approximately 65% of our U.S. debit card sales in Fiscal 2002 were in the Northeastern United States. We have also been expanding our operations in Arizona, California, Florida, Georgia, Texas and other parts of the United States.

The following table lists some of the major prepaid calling cards that we sell in the United States:

Union Phone Card	Union Georgia	Florida 800	Texas Exclusive	California 800
New York Alliance	PT Phone	Megatel Debit	Florida Payless	USA Card
Union New York	Megatel Africa	New York PT 1 Card	California Exclusive	Ta Buena New York
New York Exclusive	New Jersey Easytalk	Texas 800	Washington Alliance	Union Florida
UTA Card	LA Easytalk	LA Aggressive	New York Payless	New Jersey Alliance
Union California	New Jersey Exclusive	Boston LAC	Megatel USA	Centro America Card

Outside of the United States, we market our calling cards in the United Kingdom, the Netherlands, Spain, Germany, Belgium and parts of Scandinavia, seeking to capitalize on the opportunity presented by the recent surge in immigration from underdeveloped countries around the globe to Europe s developed nations. We plan to begin selling calling cards in France and Italy during Fiscal 2003. We sell approximately 40 different calling cards in Europe, with some of the major cards listed below:

UK Unity	UK Supercard	Nice One (U.K.)	Belgium Unity
Platicard (Spain)	Germany Unity	Asia (Netherlands)	Favourite (U.K.)
Africall (U.K.)	Spain Unity	Afrika (Netherlands)	Dragon (U.K.)
UK Easy	Number One (U.K.)	Cheers Africa (U.K.)	Hot Shot (U.K.)
UK Eastern Europe	Afrika (Germany)	Asiacall (U.K.)	Asia Connect (Spain)

We believe that there is a significant untapped market for prepaid calling cards in Latin America, where certain countries serve as regional nexuses, attracting immigrants due to stronger job markets and opportunities, just as the United States does. Immigrants from satellite countries share the needs of their U.S. counterparts for low-cost, prepaid calling solutions to maintain contact with their countries of origin. In Fiscal 2002, we began distributing prepaid calling cards in Latin America by selling calling cards in Argentina. We anticipate revenues in this region to continue to increase in Fiscal 2003.

We sold more than 198 million prepaid calling cards during Fiscal 2002, a 57% increase from the 127 million calling cards sold in Fiscal 2001. The sale of these calling cards in Fiscal 2002 generated $982.4 million in revenue, as compared with $719.3 million in Fiscal 2001, and resulted in the completion of 8.1 billion minutes of phone calls, as compared with 4.7 billion in Fiscal 2001. During Fiscal 2002, sales of prepaid calling cards accounted for 70.5% of our telecom division s total consolidated revenues. During Fiscal 2002, we sold 85.5% of our calling cards in the United States, with the remaining 14.5% sold abroad.

Our rechargeable cards, with a marketing focus on business travelers, are distributed primarily through in-flight magazines and permit users to place calls from over 25 countries through international toll-free services. Accounts are automatically recharged with a credit card that the customer provides at the time of initial card activation. In Fiscal 2002, revenues attributable to rechargeable calling cards were $25.3 million, or 1.8% of our telecom division s calling card revenues.

We believe that we possess the following competitive advantages in the prepaid calling card industry:

- our status as a carrier s carrier, which allows us to offer calling time over more routes at attractive prices to the countries that are in demand in the prepaid calling card marketplace without relying on a single operator for termination or other services while using our significant network and least-cost-routing system to procure the most cost-effective termination to the required destinations at the quality levels that we require;

- our network of switches and transmission facilities, which allows us to keep our costs low as compared to our competitors whose operations consist solely of selling calling cards;

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our debit platform, which is a database that keeps track of the remaining balance on each calling card. When a user makes calls using the card, the user calls an access number and is connected to the platform, which notifies the user of the remaining balance on the card. As the caller uses the card, the platform deducts the appropriate amount of value from the card. Debit platforms can be scaled to handle a larger number of cards. In addition, functionality can be added to the platform, such as the ability to handle multiple currencies and the ability to communicate in various languages. Our debit platform enables us to process a large number of cards simultaneously and to provide multilingual and multi-currency cards;

our extensive distribution channel, which covers a wide variety of over 350,000 retail outlets worldwide;

the quality and dependability of the telephone service provided by our cards;

our understanding of, and commitment to, the ethnic prepaid calling card market; and

our superior customer service.

Private Label Calling Cards

We also market private label calling cards, which are usually a prepaid calling card printed with a customer s logo and design. Private label calling cards are often used as promotional items or utilized by corporate customers to help generate brand name awareness. In Fiscal 2003, we plan on increasing our efforts to market private label cards, with a focus on retail chain stores.

We currently market the following types of private label calling cards:

Retail Calling Cards. These prepaid calling cards, often printed with a customer s logo and design, are targeted at the mass-market opportunity presented by being located in high-traffic stores. In October of 2002, we became the exclusive prepaid calling card provider to Walgreens, the nation s largest retail pharmacy chain. We will supply Walgreens branded prepaid calling cards to the retail pharmacy chain s nearly 4,000 stores.

Promotional Cards. These prepaid calling cards are usually given away by customers as promotional items. Current customers include Goya, Jet Blue, Coca-Cola and Colgate.

Corporate Cards. Many companies are using the benefits of prepaid/postpaid and rechargeable calling cards to control and track their employees long distance telephone charges by giving each employee a card and mandating its use for long distance telephone service whenever possible.

Private label calling cards generated $9.1 million in revenues, or 0.6% of our telecom division s revenues, during Fiscal 2002.

Other incremental revenues opportunities that we are currently developing for our prepaid calling cards include virtual cards (e-mailing a PIN number for an account, thereby removing the need for a physical calling card) and placing third-party advertising on calling card packaging.

Consumer Long Distance Services

We market long distance services directly to consumers and businesses in all 50 U.S. states, as well as in the District of Columbia. The greatest concentrations of customers are in large urban areas, with the greatest number of customers located in California, Florida, New Jersey and New York. We feature a flat rate calling plan of five cents per minute for state-to-state telephone calls within the continental United States (available in most areas), 24 hours a day, seven days a week, with a monthly service fee of $3.95. We bill in six second increments, instead of one minute rounding, which is the practice of some industry participants. As part of our calling plan, customers are offered our calling cards, with no monthly fees or per-call surcharges, featuring a domestic rate of ten cents per minute. Our rates for international calls are also competitive with those charged by the major facilities-based carriers. During Fiscal 2002, we continued to aggressively market our long distance services by expanding our existing advertising campaign to additional markets and by leveraging our scale to reduce our customer acquisition costs. We utilized many marketing channels to broaden our reach, including national cable television, print, direct mail, on-line advertising and co-marketing agreements. *The Wall Street Journal* s survey of cellular and long distance telephone companies (October 3, 2002), which included AT&T, MCI and Sprint, gave our calling plan Thumbs-Up , the highest ranking given. *The Wall Street Journal* reported, In an age of impossible-to-decipher bills, IDT stands out as an exception.

As of October 1, 2002, we had approximately 550,000 active consumer long distance customers. Consumer long distance services accounted for 7.0% of our telecom division s total consolidated revenues in Fiscal 2002. We grew long distance revenues by 97% in Fiscal 2002 through aggressive customer acquisition campaigns and by adding new services such as IntraLATA (or local toll) service. As we continue to make significant expenditures to market this service, resulting in customer growth, we anticipate that consumer long distance services will account for an increasing proportion of our total revenues in future periods.

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In Fiscal 2002, we began to migrate our customers from Global Crossing, which was the primary provider of long distance service to our customers, and entered into an agreement with AT&T to resell AT&T s services. Our resale agreement with AT&T provides that AT&T will originate calls from our long distance customers and that the types of calls specified (international, specific states, etc.) will be routed to their destination on our network. The agreement with AT&T gives us the flexibility to select those calls which will best leverage our lower cost basis to terminate calls on our own network. Management believes that this flexibility can increase our gross margins and provide the opportunity to market new, even more aggressive plans, particularly international plans, which will generate additional revenues.

Wholesale Carrier Services

Long distance telephone calls are generally originated by the local carrier of the customer placing the call. The local carrier switches the call to the customer s long distance carrier. The call is then routed over the lines of the long distance carrier and/or one or more other carriers until it reaches its destination, where it is switched to the local carrier for termination at the telephone number called. Carriers, such as us, that transmit all or a portion of another carrier s traffic are said to be acting as a carrier s carrier.

By utilizing our flexible and least-cost traffic routing system, we are able to provide major carriers and niche carriers alike with rates that we believe are often lower than those traditionally available through the more established carriers. We are able to offer competitive rates to our carrier customers as a result of our ability to generate a high volume of long distance telephone traffic (aided by the volumes generated by our calling card business) and our attractive rates negotiated with foreign state-owned or state sanctioned post, telephone or telegraph companies and other carriers. As of October 1, 2002, we had approximately 173 wholesale customers located in the United States and Europe, with wholesale carrier sales accounting for $289 million of our telecom division s revenues in Fiscal 2002, which represented 20.5% of our total consolidated revenues. In Fiscal 2002, we carried 2.04 billion minutes, an increase of 9.7% over Fiscal 2001 when we carried 1.86 billion minutes.

In Fiscal 2002, we increased the number of our direct relationships with foreign state-owned or state sanctioned post, telephone or telegraph companies from approximately 40 to more than 60. We believe that a direct connection from one of our switches to a foreign state-owned or state sanctioned post, telephone or telegraph company both increases the quality of a call and lowers cost, which enables us to generate more traffic with higher margins to that foreign locale. During Fiscal 2003, we intend to continue to vigorously expand our existing direct relationships with foreign state-owned or state sanctioned post, telephone or telegraph companies.

The declining price of bandwidth combined with the overall reduction of available investment capital in the market have combined to drive many wholesale carriers such as Viatel and Carrier One out of the market. We anticipate that we and other financially sound carriers will gain market share as weaker companies continue to leave the wholesale carrier market. Additionally, as the RBOCs increase their market share in the long distance market, we expect to gain revenues as a result of the RBOCs current dependence on the global infrastructure of carrier s carriers for the termination of their international voice traffic. This increase in our wholesale carrier revenues from the RBOCs may be offset, in part or in whole, by lost revenues due to increased competition with the RBOCs for our consumer long distance customers. We believe that the trend toward deregulation of the foreign telecommunications sector creates opportunities as lower pricing often brings significant increases in usage. While profit margins may be negatively impacted for some carriers, there are often increases in gross profit for efficient providers, that can continue to operate profitably at lower prices.

Our most significant wholesale carrier customers consist of long distance carriers. While they may vary from quarter to quarter, our five largest wholesale carrier customers accounted for 14.7% of our total consolidated revenues in Fiscal 2002. This concentration of revenues increases our risk associated with nonpayment by customers. This risk has, in general, become more acute for us in recent quarters as several of our customers have declared bankruptcy or are facing financial difficulties, and now pose increased credit risks. We perform ongoing credit evaluations of all of our wholesale carrier customers, but historically we have not required collateral to support accounts receivable from our customers. In light of the deteriorating credit quality of some of our wholesale carrier customers, we have begun to impose stricter credit restrictions on some of our wholesale carrier customers. In some cases, this has resulted in our sharply curtailing or ceasing completely sales to certain of our wholesale carrier customers.

Capitalizing on Our Strengths in the Wholesale Carrier Market

In Fiscal 2003, we intend to capitalize on some of our strengths in order to tailor an increasingly strong, global company including:

our strong commercial relationships with foreign carriers which will, we believe, continue to allow us to negotiate advantageous rates which we can pass on to our prepaid calling card customers and wholesale carrier customers;

our calling card business, which generates a high volume of original long distance call traffic which, we believe will

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continue to prove attractive to foreign state-owned or state sanctioned post, telephone or telegraph companies as we form direct connections with them and create new streams of traffic and direct it to them , as opposed to simply transferring minutes from another carrier with which the foreign state-owned or state sanctioned post, telephone or telegraph company is already allied;

our superior switching, routing and customer service technology supporting our telecommunications backbone which will continue to provide us with superior cost analysis, customer service and strict quality controls;

our ability to distinguish ourselves from purely wholesale carrier competitors by offering value-added carrier services, such as giving carriers remote access to our debit card platform; and

our highly specialized analysis team composed of well-trained telecommunications professionals continually monitoring traffic data which will allow us to maintain maximum network efficiency.

These factors will advance our long-term goal of becoming a multi-faceted provider offering a portfolio of services and products to the most financially stable market participants through long-term contractual relationships. In order to reach this goal, we intend in Fiscal 2003 to:

broaden our portfolio of services and products offered to our wholesale carrier customers;

cultivate our relationships with additional foreign state-owned or state sanctioned post, telephone or telegraph companies and top-tier global carriers;

continue our evaluation of the financial stability of weaker wholesale carrier customers and cautiously manage our financial exposure to such customers in order to safeguard against nonpayment of outstanding receivables;

continue to utilize our strong balance sheet to seek out opportunities in the distressed marketplace to acquire complimentary assets, technologies and lines of business at attractive prices; and

generate significan