ELEC COMMUNICATIONS CORP
Form 10-Q
July 23, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended May 31, 2007.

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the transition period from ______________________ to ______________________.

Commission file number 0-4465

eLEC Communications Corp.
(Exact Name of Registrant as Specified in Its Charter)

New York (State or Other Jurisdiction of Incorporation or Organization)	13-2511270 (I.R.S. Employer Identification No.)
75 South Broadway, Suite 302, White Plains, New York (Address of Principal Executive Offices)	10601 (Zip Code)
Registrant s Telephone Number, Including Area Code	914-682-0214

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer___ Accelerated Filer___ Non-Accelerated Filer_ X_.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes___ No_ X_

The number of outstanding shares of the Registrant s Common Stock as of June 30, 2007 was 23,489,506

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

eLEC Communications Corp. and Subsidiaries
Condensed Consolidated Balance Sheet

	May 31, 2007 (Unaudited)	Nov. 30, 2006 (See Note 1)
Assets		
Current assets:		
Cash and cash equivalents	$ 49,183	$1,337,525
Accounts receivable, net	72,653	630,197
Prepaid expenses and other current assets	72,016	154,749
Assets held for sale	775,811	-
Deferred finance costs, net	1,010,766	1,012,941
Total current assets	1,980,429	3,135,412
Property, plant and equipment, net	835,414	903,281
Other assets	110,212	149,525
Total assets	$2,926,055	$4,188,218
Liabilities and stockholders equity deficiency		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	$2,538,059	$3,347,707
Warrant liability	2,073,892	1,251,182
Accounts payable and accrued expenses	2,438,623	2,897,495
Taxes payable	7,964	559,617
Liabilities assumed in sale	2,390,151	-
Deferred Revenue	-	166,100
Total current liabilities	9,448,689	8,222,101
Long-term debt and capital lease obligations, less current maturities	189,448	214,907
Total liabilities	9,638,137	8,437,008
Stockholders equity deficiency:		
Preferred stock $.10 par value, 1,000,000 shares authorized, none issued and outstanding	-	-
Common stock $.10 par value, 50,000,000 shares authorized, 22,459,282 and 22,434,282 shares issued and outstanding in 2007 and 2006	2,245,928	2,243,428

Capital in excess of par value	27,337,537	27,071,584
Deficit	(36,284,625)	(33,554,700)
Accumulated other comprehensive loss, unrealized loss on securities	(10,922)	(9,102)
Total stockholders equity deficiency	(6,712,082)	(4,248,790)
Total liabilities and stockholders equity deficiency	$2,926,055	$4,188,218

See notes to the condensed consolidated financial statements.

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eLEC Communications Corp. and Subsidiaries

Condensed Consolidated Statements of Operations and Comprehensive Loss

(Unaudited)

	For the Six Months Ended		For the Three Months Ended	
	May 31, 2007	May 31, 2006	May 31, 2007	May 31, 2006
Revenues	$408,506	$ 83,106	$ 213,389	$ 58,245
Costs and expenses:				
Costs of services	535,535	241,139	230,968	134,086
Selling, general and administrative	1,340,739	1,158,979	675,498	606,549
Depreciation and amortization	235,352	113,568	137,853	58,338
Total costs and expenses	2,111,626	1,513,686	1,044,319	798,973
Loss from operations	(1,703,120)	(1,430,580)	(830,930)	(740,728)
Other income (expense):				
Interest expense	(355,903)	(267,046)	(212,183)	(143,384)
Interest and other income	21,363	25,738	10,593	428
Change in warrant valuation	(510,148)	224,611	450,074	246,868
Total other income (expense)	(844,688)	(16,697)	248,484	103,912
Loss from continuing operations before discontinued operations	(2,547,808)	(1,447,277)	(582,446)	(636,816)
Earnings (loss) from discontinued operations	(182,117)	135,857	(147,020)	(11,125)
Net loss	(2,729,925)	(1,311,420)	(729,466)	(647,941)
Other comprehensive income (loss) unrealized income (loss) on marketable securities	(1,820)	(160)	(364)	755
Comprehensive loss	($2,731,745)	($1,311,580)	($729,830)	($647,186)
Basic loss per share:				
Loss from continuing operations before Discontinued operations	($0.11)	($0.09)	($0.02)	($0.04)
Earnings (loss) from discontinued operations	(.01)	.01	(.01)	.00
	($0.12)	($0.08)	($0.03)	($0.04)
Weighted average number of common shares				

outstanding				
Basic	22,447,744	16,844,337	22,459,282	16,849,282

See notes to the condensed consolidated financial statements.

eLEC Communications Corp. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	For the Six Months Ended	
	May 31, 2007	May 31, 2006
Net cash used in operating activities:	($1,457,096)	($ 882,493)
Cash flows used in investing activities, purchase of property and equipment	(84,171)	(177,899)
Cash flows from financing activities:		
Repayment of short-term debt	-	(328,324)
Repayment of long-term debt	(22,075)	(114,490)
Proceeds from notes	275,000	1,753,500
Net cash provided by financing activities	252,925	1,310,686
Increase (decrease) in cash and cash equivalents	(1,288,342)	250,294
Cash and cash equivalents at beginning of period	1,337,525	205,998
Cash and cash equivalents at the end of period	$ 49,183	$ 456,292

See notes to the condensed consolidated financial statements.

eLEC COMMUNICATIONS CORP.

Notes To Condensed Consolidated Financial Statements (Unaudited)

Note 1-Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month or six-month periods ended May 31, 2007 are not necessarily indicative of the results that may be expected for the year ended November 30, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended November 30, 2006.

Note 2-Going Concern Matters and Realization of Assets

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. However, we have sustained substantial losses from continuing operations in recent years and we have negative working capital and a stockholders equity deficiency. In addition, similar to many start-up ventures, we are experiencing difficulty in generating sufficient cash flow to meet our obligations and sustain our operations. We are currently in default of our financing agreement with our principal lender (Note 10).

We expect our operating losses and cash deficits from operations to continue through fiscal 2007. As a result, we will need to raise additional cash through some combination of borrowings, sale of equity or debt securities or sale of assets to enable us to meet our cash requirements.

We may not be able to raise sufficient additional debt, equity or other cash on acceptable terms, if at all. Failure to generate sufficient revenues, achieve certain other business plan objectives or raise additional funds could have a material adverse effect on the Company s results of operations, cash flows and financial position, including our ability to continue as a going concern, and may require us to significantly reduce, reorganize, discontinue or shut down our operations.

In view of the matters described above, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon continued operations of the company which, in turn, is dependent upon our ability to meet our financing requirements on a continuing basis, and to succeed in our future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should we be unable to continue operating.

Management s plans include (1) seeking additional financing to continue operations as a broadband voice carrier and increasing our sales channels and sales staff so our broadband voice facilities are more fully utilized, (2) seeking additional financing to purchase target businesses that are generating positive cash flow, and (3) evaluating strategic partnerships with companies that may want to purchase a portion of our business.

There can be no assurance that we will be able to achieve our business plan objectives or that we will achieve or maintain cash flow positive operating results. If we are unable to generate adequate funds from operations or raise additional funds, we may not be able to repay its existing debt, continue to operate our network, respond to competitive pressures or fund our operations. As a result, we may be required to significantly reduce, reorganize, discontinue or shut down our operations. Our financial statements do not include any adjustments that might result from this uncertainty.

Note 3-Major Customers

During the six-month and three-month periods ended May 31, 2007, one customer accounted for 42% and 50%, respectively, of revenue from continuing operations. During the six-month and three-month periods ended May 31, 2006, one customer accounted for 48% and 36%, respectively, of revenue from continuing operations, and a second customer accounted for 19% and 20%, respectively, of revenue from continuing operations.

Note 4-Loss Per Common Share

Basic loss per common share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period.

Approximately 13,093,000 and 10,950,000 shares of common stock issuable upon the exercise of our outstanding stock options and warrants and in the six-month and three-month periods ending May 31, 2006, the conversion of our outstanding convertible debt, were excluded from the calculation of loss per share for the six-month and three-month periods ended May 31, 2007 and 2006, respectively, because the effect would be anti-dilutive.

Note 5-Risks and Uncertainties

We have created our own proprietary Internet Protocol (IP) telephony network and have transitioned from a reseller of traditional wireline telephone services into a facilities-based broadband service provider to take advantage of the network cost savings that are inherent in an IP network. Although we continue to build our IP telephony business, we face strong competition and we continue to grow our IP telephony business without adequate financial resources. At this point in time, the survival of our business is dependent upon the success of our IP operations. Future results of operations involve a number of risks and uncertainties. Factors that could affect future operating results and cash flows and cause actual results to vary materially from historical results include, but are not limited to:

- The availability of additional funds to successfully pursue our business plan;
- The acceptance of IP telephony by mainstream consumers;
- Our ability to market our services to current and new customers and to generate customer demand for our products and services in the geographical areas in which we operate;
- Our ability to comply with provisions of our financing agreements;
- The impact of changes the Federal Communications Commission or State Public Service Commissions may make to existing telecommunication laws and regulations, including laws dealing with Internet telephony;
- The highly competitive nature of our industry;
- Our ability to retain key personnel;
- Our ability to maintain adequate customer care and manage our churn rate;
- The cooperation of industry service partners that have signed agreements with us;
- Our ability to maintain, attract and integrate internal management, technical information and management information systems;
- The availability and maintenance of suitable vendor relationships in a timely manner and at reasonable cost;
- Our ability to manage rapid growth while maintaining adequate controls and procedures;

- Failure or interruption in our network and information systems;
- Our inability to adapt to technological change;
- The perceived infringement of our technology on another entity s patents;
- Our inability to manage customer attrition and bad debt expense;
- Failure or bankruptcy of other telecommunications companies upon which we rely for services and revenues;
- Our lack of capital or borrowing capacity, and inability to generate cash flow;
- The decrease in telecommunications prices to consumers; and
- General economic conditions.

Note 6-Stock-Based Compensation Plans

We issue stock options to our employees and outside directors pursuant to stockholder-approved and non-approved stock option programs. In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R, Share-Based Payment . SFAS 123R is a revision of SFAS 123, and supersedes APB 25. Among other items, SFAS 123R eliminates the use of APB 25 and the intrinsic value method of accounting, and requires companies to recognize in their financial statements the cost of employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards. SFAS 123R permits companies to adopt its requirements using either a modified prospective method, or a modified retrospective method. Under the modified prospective method, compensation cost is recognized in the financial statements beginning with the effective date, based on the requirements of SFAS 123R for all share-based payments granted after that date, and based on the requirements of SFAS 123 for all unvested awards granted prior to the effective date of SFAS 123R. Under the modified retrospective method, the requirements are the same as under the modified prospective method, but this method also permits entities to restate financial statements of previous periods based on proforma disclosures made in accordance with SFAS 123. Beginning in fiscal 2006, we account for stock-based compensation in accordance with the provisions of SFAS 123R and have elected the modified prospective method and have not restated prior financial statements. For the six-month periods ended May 31, 2007 and 2006, we recorded approximately $91,000 and $100,000, respectively, in employee stock-based compensation expense, which is included in our selling, general and administrative expenses. For the three-month periods ended May 31, 2007 and 2006, we recorded approximately $44,000 and $47,000, respectively, in employee stock-based compensation expense. As of May 31, 2007, there was approximately $142,000 of unrecognized stock-compensation expense for previously-granted unvested options that will be recognized over a three-year period.

Note 7-Impairment of Long-Lived Assets

We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value 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 forecasted net undiscounted 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 values. We founded our IP telephony business in 2004, and since its inception it has incurred significant operating and cash flow losses. It can be considered a late-stage start-up business, and we have evaluated the assets of this business and future operations to determine if we need to recognize an impairment expense. We recently received a written offer for this business payable in stock of a public company, assumption of debt and cash. Even if the portion payable in stock is discounted, the offer is significantly higher than the book value of the assets of our IP telephony business. Accordingly, we have determined that such assets are not impaired. In addition, subsequent to the balance sheet date of May 31, 2007, we sold our wireline telephony business for a gain (see Note 12), and consequently, we determined that such assets were not impaired.

Note 8-Accrued Expenses

At May 31, 2007, we were disputing payments on invoices from Verizon amounting to approximately $537,000 because we believe Verizon overcharged us for certain calls made by our former wireline telephone customers. Although we are not currently required to pay the disputed amount, Verizon initially rejected our claims. We have escalated many of our claims and hired a firm that specializes in telecom disputes to analyze past call records and to resubmit and pursue the claims. Although we intend to vigorously pursue all claims and would consider a settlement for a partial amount, the minimum amount of claims that our outside claim consultant believes will be honored is $65,000. Consequently, we have recorded $477,000 of the disputed charges as a liability and have not recorded the $65,000 amount.

Note 9-Defined Benefit Plan

We sponsor a defined benefit plan covering one active employee and a number of former employees. Our funding policy with respect to the defined benefit plan is to contribute annually not less than the minimum required by applicable law and regulation to cover the normal cost and to fund supplemental costs, if any, from the date each supplemental cost was incurred.

Contributions are intended to provide not only for benefits attributable to service to date, but also for those expected in the future.

For the six-month and three-month periods ended May 31, 2007 and 2006, we recorded pension expense of $48,000 and $24,000, respectively. In the six-month period ended May 31, 2007, we contributed $10,000 to our defined benefit plan. There were no contributions in the three-months ended May 31, 2007. In the six- and three-month periods ended May 31, 2006, we contributed $52,500 and $0, respectively, to the pension plan. We expect to contribute approximately $68,000 to our defined benefit plan in fiscal 2007. The current investment strategy for the defined benefit plan is to invest in conservative debt and equity securities. The expected long-term rate of return on plan assets is 8%.

We also sponsor a 401(k) profit sharing plan for the benefit of all eligible employees, as defined. The plan provides for the employees to make voluntary contributions not to exceed the statutory limitation provided by the Internal Revenue Code. We may make discretionary contributions. There were no discretionary contributions made for the six-month and three-month periods ended May 31, 2007 or 2006.

Note 10-Principal Financing Arrangements

We have completed three financings with our principal lender, one in February 2005, one in November 2005 and one in May 2006. Each financing requires a certain amount of monthly principal payments. We did not make any principal payments on our loans during fiscal 2007, and on April 16, 2007 we received a waiver and a modification to our lending agreement from our principal lender that deferred principal payments on our February 2005 financing and our November 2005 financing, so that monthly principal payments on such loans were not required until June 1, 2007, and August 1, 2007, respectively. In consideration for the principal deferral, we issued to our lender a seven-year warrant to purchase 1,200,000 shares of our common stock at a price of $0.25 per share. We valued the warrant at $313,162 using the Black-Scholes method with an interest rate of 5.25%, volatility of 103%, zero dividends and an expected term of seven years. The underlying contracts provide for a potential cash settlement and accordingly, the warrants are classified as debt. Deferred financing cost of $313,162 was also recorded as of April 16, 2007 and is being amortized to interest expense over the life of the notes payable.

In conjunction with the sale of two of our subsidiaries in June 2007 (see Note 11), the remaining principal balance from our financing in February 2005, which had a book value of $1,006,799 as of May 31, 2007, has been paid in full. We are in default with our lender for not making all of our June and July 2007 principal and interest payments, and we are working with our lender to adjust our payment schedule. Because of the default on such debt, the debt can be called immediately, and we have classified such debt as a current liability on our balance sheet and have shown the related debt finance costs as a current asset.

Note 11-Income Taxes

At November 30, 2006, we had net operating loss carryforwards for Federal income tax purposes of approximately $25,400,000 expiring in the years 2008 through 2026. As a result of the sale of two wholly owned subsidiaries in June 2007 (see Note 11), the amount of our net operating loss that we can carry forward to future years will be reduced by the amount of the net operating losses that are attributable to the divested subsidiaries. We have not yet determined the

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reduction in the amount of net operating loss carryforwards available to us. We will continue to have an annual limitation of approximately $187,000 on the utilization of approximately $2,400,000 of our remaining net operating loss carryforwards under the provisions of Internal Revenue Code Section 382. We did not provide for a tax benefit, as it is more likely than not that any such benefit will not be realized.

Note 12-Sale of Subsidiaries

On December 14, 2006, we entered into two separate definitive purchase agreements (Agreements) to sell to Cyber Digital, Inc. (Purchaser), a publicly-traded shell company, our two wholly-owned subsidiaries that operate as competitive local exchange carriers (CLECs). The CLECs were sold in June 2007. The operations of the CLECs are presented in our income statement as discontinued operations for the six-month and three-month periods ended May 31, 2007 and 2006. The gain on the sale of the CLECs will be recorded in the third fiscal quarter of fiscal 2007. The May 31, 2007 balance sheet includes assets held for sale of approximately $776,000 and liabilities assumed in sale of approximately $2,390,000 to reflect the May 31, 2007 balances of the assets and liabilities that were transferred to the Purchaser in June 2007. Further, in the third quarter of fiscal 2007, we will write off the remaining deferred financing costs of approximately $319,000 from the February 2005 loan that was paid in full as part of the sale of the CLECs. We anticipate recording a gain on the sale of discontinued operations of approximately $1,200,000.

CLEC revenues amounted to approximately $3,013,000 and $1,456,000 for the six-month and three-month periods ended May 31, 2007 and approximately $4,591,000 and $2,112,000 for the six-month and three-month periods ended May 31, 2006. Pretax income (loss) attributable to the operations of the CLECs amounted to approximately ($182,000) and ($147,000) for the six-month and three-month periods ended May 31, 2007 and approximately $135,000 and ($11,000) for the six-month and three-month periods ended May 31, 2006.

Item 2. Management s Analysis and Discussion of Financial Condition and Results of Operations

The statements contained in this Report that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our financial condition, results of operations and business, which can be identified by the use of forward-looking terminology, such as estimates, projects, plans,