TALK AMERICA HOLDINGS INC
Form 10-Q/A
April 27, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A
(Amendment No. 1)

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____to _____

Commission file number 000 - 26728

Talk America Holdings, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**23-2827736**
(State of incorporation)	(I.R.S. Employer Identification No.)

12020 Sunrise Valley Drive, Suite 250, Reston, Virginia	**20191**
(Address of principal executive offices)	(Zip Code)

(703) 391-7500
(Registrant's telephone number, including area code)

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 whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes X No____

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

26,978,275 shares of Common Stock, par value of $0.01 per share, were issued and outstanding as of November 2, 2004.

Explanatory Note

Talk America Holdings, Inc. is filing this Amendment No. 1 on Form 10-Q/A (“Amendment No. 1”) to our Quarterly Report on Form 10-Q originally filed with the Securities and Exchange Commission on November 9, 2004, for the purpose of restating our consolidated financial statements for the quarters ended September 30, 2004 and 2003 to reflect corrections of the following errors:

The quarterly results for the four quarters of 2003 and for the first three quarters of 2004 have been adjusted to reflect the restatement of our previously reported consolidated financial statements for those periods and for the year ended December 31, 2003 as detailed below.

We have revised our consolidated financial statements for these periods to correct for the following errors:

(a) Due to a classification error in our general ledger, we incorrectly recorded certain customer fee revenues as sales, use and excise tax liability to the consolidated balance sheets for the four quarters of 2003, for the year ended December 31, 2003 and for the first three quarters of 2004. These customer fee revenues were $0.4 million for the third quarter of 2004, $0.2 million for the third quarter of 2003, $1.0 million for the nine months ended September 30, 2004, $0.7 million for the nine months ended September 30, 2003, and an aggregate of $1.0 million for the full year 2003. These customer fees have now been appropriately recorded to revenues in the consolidated statement of operations for the year ended December 31, 2003 and in the unaudited quarterly periods for the first three quarters 2004 and 2003;

(b) We determined that in our calculations of earnings per share since the third quarter of 2003 we had not incorporated the tax benefits associated with the assumed exercise of employee stock options. As a result, fully diluted shares outstanding were over-reported and income per fully diluted share was understated in the periods subsequent to third quarter 2003; and

(c) We identified errors in the computation of the deferred tax assets recognized in the third quarter of 2003 as follows: (i) failure to deduct state income tax expense from federal taxable income resulted in the deferred tax benefit as originally reported for the year ended December 31, 2003 and the unaudited third quarter 2003 being understated by $0.9 million and (ii) failure to complete the appropriately detailed analysis of our deferred tax assets relating to state net operating loss carryforwards resulted in the deferred tax benefit as originally reported for the year ended December 31, 2003 and the unaudited third quarter 2003 being understated by $1.7 million. In February 2005, we determined that we improperly corrected for the errors in the deferred tax computations through an adjustment to the effective tax rate for 2004 rather than through the restatement of our prior period financial statements. As a result, we have restated the first three quarters of 2004 and the third and fourth quarter of 2003 and year end December 31, 2003.

(d) In connection with the release of the valuation allowance in the third quarter 2003, $6.5 million of deferred tax assets associated with acquired net operating loss carryforwards were realizable and should have been recorded as a deferred tax asset. Originally, we believed this deferred tax asset was limited due to provisions of the Internal Revenue Code Section 382. This error resulted in deferred tax assets being understated and goodwill being overstated in each of the periods beginning in the third quarter 2003. As a result, we have restated the first three quarters of 2004 and the third and fourth quarter of 2003 and year end December 31, 2003.

The effect of these items are reflected in our consolidated financial statements contained in Item 1 of this Amendment, with corresponding changes reflected in Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations and Item 4, Controls and Procedures. The effect of these items on our consolidated statement of operations for the four quarters of 2003, the year ended December 31, 2003 and for the first three quarters of 2004 is summarized in the following table.

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(in 000s, except per share data) (Unaudited)	2003				2004		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Revenue:							
Reported	$ 87,843	$ 93,748	$ 99,929	$ 101,143	$ 109,321	$ 114,881	$ 120,537
Adjustments	359	158	249	264	298	332	392
As Restated	$ 88,202	$ 93,906	$ 100,178	$ 101,407	$ 109,619	$ 115,213	$ 120,929
Operating Income:							
Reported	$ 15,179	$ 19,027	$ 17,620	$ 13,432	$ 14,103	$ 13,973	$ 13,864
Adjustments	359	158	249	264	298	332	392
As Restated	$ 15,538	$ 19,185	$ 17,869	$ 13,696	$ 14,401	$ 14,305	$ 14,256
Pre-Tax Income:							
Reported	$ 14,961	$ 17,500	$ 16,106	$ 12,197	$ 13,387	$ 13,573	$ 14,486
Adjustments	358	158	249	264	298	332	392
As Restated	$ 15,319	$ 17,658	$ 16,355	$ 12,461	$ 13,685	$ 13,905	$ 14,878
Income Tax Expense:							
Reported	$ 5,835	$ 6,825	($35,460)	$ 5,103	$ 5,031	$ 5,025	$ 5,339
Adjustments	141	62	(2,287)	(243)	366	458	528
As Restated	$ 5,976	$ 6,887	($37,747)	$ 4,860	$ 5,397	$ 5,483	$ 5,867
Net Income:							
Reported	$ 9,126	$ 10,675	$ 51,566	$ 7,094	$ 8,356	$ 8,548	$ 9,147
Adjustments	217	96	2,536	507	(68)	(126)	(136)
As Restated	$ 9,343	$ 10,771	$ 54,102	$ 7,601	$ 8,288	$ 8,422	$ 9,011
Basic EPS:							
Reported	$ 0.35	$ 0.41	$ 1.96	$ 0.27	$ 0.31	$ 0.32	$ 0.34
Adjustments	--	--	0.09	0.02	--	(0.01)	(0.01)
As Restated	$ 0.35	$ 0.41	$ 2.05	$ 0.29	$ 0.31	$ 0.31	$ 0.33
Fully Diluted EPS:							
Reported	$ 0.32	$ 0.37	$ 1.74	$ 0.25	$ 0.29	$ 0.30	$ 0.32
Adjustments	--	--	0.14	0.02	--	--	--
As Restated	$ 0.32	$ 0.37	$ 1.88	$ 0.27	$ 0.29	$ 0.30	$ 0.32
Fully Diluted Shares:							
Reported	29,940	29,563	29,761	28,884	28,862	28,694	28,212
Adjustments	--	--	(884)	(777)	(732)	(655)	(475)
As Restated	29,940	29,563	28,877	28,107	28,130	28,039	27,737

The consolidated balance sheets for the third quarters of 2004 and 2003 as originally reported have been restated as follows (in thousands):

At September 30, 2004	**As Originally Reported**	**As Restated**
Deferred income tax assets		
Current	$ 27,723	$ 27,723
Long-term	24,733	32,598
Goodwill	19,503	13,013
Total assets	235,831	237,206
Sales, use and excise taxes	14,596	12,544
Deferred income taxes	19,507	19,910
Total liabilities	108,636	106,985
Accumulated deficit	(224,289)	(221,263)
Total stockholders' equity	127,195	130,221

At September 30, 2003*	**As Originally Reported**	**As Restated**
Deferred income tax assets		
Current	$ 20,703	$ 24,605
Long-term	44,112	51,725
Goodwill	19,503	13,013
Total assets	237,752	245,525
Sales, use and excise taxes	13,803	13,037
Deferred income taxes	17,238	20,182
Total liabilities	146,476	151,400
Accumulated deficit	(257,434)	(254,585)
Total stockholders' equity	91,276	94,125

* Certain amounts reflected herein for 2003 have been reclassified to reflect the 2004 presentation.

Unless otherwise expressly stated, this Amendment No. 1 does not reflect events occurring after the filing on November 9, 2004 of our Quarterly Report on Form 10-Q for the period ended September 30, 2004, nor does it modify or update in any way disclosures contained in our Form 10-Q other than to reflect the restatement discussed above.

TALK AMERICA HOLDINGS, INC. AND SUBSIDIARIES

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TALK AMERICA HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except for per share data)
(Unaudited)

	Three Months Ended September, 30		Nine Months Ended September 30,	
	2004 (restated)	2003 (restated)	2004 (restated)	2003 (restated)
Revenue	$ 120,929	$ 100,178	$ 345,761	$ 282,286
Costs and expenses:				
Network and line costs, excluding depreciation and amortization (see below)	60,251	46,033	170,057	133,185
General and administrative expenses	15,934	14,236	46,987	39,664
Provision for doubtful accounts	5,728	3,444	14,054	8,561
Sales and marketing expenses	19,318	14,146	55,806	35,146
Depreciation and amortization	5,442	4,450	15,895	13,138
Total costs and expenses	106,673	82,309	302,799	229,694
Operating income	14,256	17,869	42,962	52,592
Other income (expense):				
Interest income	61	42	204	337
Interest expense	561	(1,560)	(698)	(6,066)
Other income, net	--	4	--	2,469
Income before provision for income taxes	14,878	16,355	42,468	49,332
Provision (benefit) for income taxes	5,867	(37,747)	16,747	(24,884)
Net income	$ 9,011	$ 54,102	$ 25,721	$ 74,216
Income per share - Basic:				
Net income per share	$ 0.33	$ 2.05	$ 0.96	$ 2.82
Weighted average common shares outstanding	26,974	26,367	26,799	26,325
Income per share - Diluted:	$ 0.32	$ 1.88	$ 0.92	$ 2.55
Net income per share				
Weighted average common and common equivalent shares outstanding	27,737	28,877	27,854	29,337

See accompanying notes to consolidated financial statements.

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TALK AMERICA HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except for share and per share data)
(Unaudited)

	September 30, 2004 (restated)	December 31, 2003 (restated)	September 30, 2003 (restated)
Assets			
Current assets:			
Cash and cash equivalents	$ 29,354	$ 35,242	$ 35,132
Accounts receivable, trade (net of allowance for uncollectible accounts of $14,304, $9,414, and $9,483 at September 30, 2004, December 31, 2003, and September 30, 2003, respectively)	48,876	40,321	36,777
Deferred income taxes	27,723	24,605	24,605
Prepaid expenses and other current assets	7,967	5,427	5,680
Total current assets	113,920	105,595	102,194
Property and equipment, net	66,643	68,069	65,860
Goodwill	13,013	13,013	13,013
Intangibles, net	2,533	4,666	5,245
Deferred income taxes	32,598	48,288	51,725
Other assets	8,499	7,547	7,488
	$ 237,206	$ 247,178	$ 245,525
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable	$ 43,678	$ 35,296	$ 35,707
Sales, use and excise taxes	12,544	13,521	13,037
Deferred revenue	15,588	10,873	9,797
Current portion of long-term debt	3,188	16,806	42
Accrued compensation	4,658	9,888	7,913
Other current liabilities	5,067	6,851	5,237
Total current liabilities	84,723	93,235	71,733
Long-term debt	2,352	31,791	59,485
Deferred income taxes	19,910	19,009	20,182
Commitments and contingencies			
Stockholders' equity:			
Preferred stock - $.01 par value, 5,000,000 shares authorized; no shares outstanding	--	--	--
Common stock - $.01 par value, 100,000,000 shares authorized; 26,976,075 and 26,662,952, and 26,406,864, issued and outstanding at September 30, 2004, December 31, 2003 and	283	280	277

September 30, 2004, respectively						
Additional paid-in capital		356,201		354,847		353,433
Accumulated deficit		(221,263)		(246,984)		(254,585)
Treasury stock - $.01 par value, 1,315,789 shares at September 30, 2004 and December 31, 2003 and September 30, 2003, respectively		(5,000)		(5,000)		(5,000)
Total stockholders' equity		130,221		103,143		94,125
	$	237,206	$	247,178	$	245,525

See accompanying notes to consolidated financial statements.

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TALK AMERICA HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock Shares	Treasury Stock Amount	Total
Balances, December 31, 2003 (restated)	27,979	$ 280	$ 354,847	$ (246,984)	1,316	$ (5,000)	$ 103,143
Net income (restated)	--	--	--	25,721	--	--	25,721
Income tax benefit related to exercise of common stock options	--	--	784	--	--	--	784
Change in terms of employee stock options	--	--	9	--	--	--	9
Exercise of common stock options	313	3	561	--	--	--	564
Balances, September 30, 2004 (restated)	28,292	$ 283	$ 356,201	$ (221,263)	1,316	$ (5,000)	$ 130,221

See accompanying notes to consolidated financial statements.

TALK AMERICA HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2004 (restated)	**2003 (restated)**
Cash flows from operating activities:		
Net income	$ 25,721	$ 74,216
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	14,054	8,561
Depreciation and amortization	15,895	13,138
Loss on sale and retirement of assets	--	16
Non-cash compensation	9	--
Non-cash interest and amortization of accrued interest liabilities	(956)	(195)
Gain from extinguishment of debt	--	(2,476)
Deferred income taxes	14,257	(26,665)
Changes in assets and liabilities:		
Accounts receivable, trade	(22,609)	(17,495)
Prepaid expenses and other current assets	(1,979)	(1,786)
Other assets	(17)	1,404
Accounts payable	8,382	3,555
Sales, use and excise taxes	(977)	1,598
Deferred revenue	4,715	3,317
Accrued compensation	(5,230)	2,304
Other current liabilities	(1,784)	(3,776)
Net cash provided by operating activities	49,481	55,716
Cash flows from investing activities:		
Capital expenditures	(8,053)	(9,166)
Capitalized software development costs	(2,673)	(2,038)
Net cash used in investing activities	(10,726)	(11,204)
Cash flows from financing activities:		
Payments of borrowings	(44,258)	(38,672)
Payments of capital lease obligations	(949)	(46)
Proceeds from exercise of options	564	750
Purchase of treasury stock	--	(5,000)
Net cash used in financing activities	(44,643)	(42,968)
Net increase (decrease) in cash and cash equivalents	(5,888)	1,544
Cash and cash equivalents, beginning of period	35,242	33,588
Cash and cash equivalents, end of period	$ 29,354	$ 35,132

See accompanying notes to consolidated financial statements.

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TALK AMERICA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. ACCOUNTING POLICIES

(a) Basis of Financial Statements Presentation

The consolidated financial statements include the accounts of Talk America Holdings, Inc. and its wholly-owned subsidiaries (collectively, "Talk America," "we," "our" and "us"). All intercompany balances and transactions have been eliminated.

The consolidated financial statements and related notes thereto as of September 30, 2004 and for the three and nine months ended September 30, 2004 and September 30, 2003 are presented as unaudited, but in the opinion of management include all adjustments necessary to present fairly the information set forth therein. The consolidated balance sheet information for December 31, 2003 was derived from the audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2003, filed March 12, 2004, as amended by our Form 10-K/A filed May 7, 2004, as restated by our Form 10-K/A Amendment No. 2 filed March 28, 20005. These interim financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2003, as amended by our Form 10-K/A, as restated by our Form 10-K/A Amendment No. 2. The interim results are not necessarily indicative of the results for any future periods. Certain prior year amounts have been reclassified for comparative purposes.

(b) Risks and Uncertainties

Future results of operations involve a number of risks and uncertainties. Factors that would likely negatively affect future operating results and cash flows and cause actual results to vary materially from historical results include, but are not limited to:

- Dependence on the availability and functionality of the networks of the incumbent local telephone carriers as they relate to the unbundled network element platform.
- Outcomes unfavorable to us of the FCC’s rule-making process and of pending litigation with regard to the availability and pricing of various network elements and bundles thereof.
- Additional changes in government policy, regulation and enforcement or adverse judicial or administrative interpretations and rulings or legislative action relating to regulations, enforcement and pricing.
- Increased price competition in telecommunication services, including bundled services of local and long distance
- Unanticipated delays, costs and technical difficulties in developing, deploying and operating our own local networking capability, including our potential inability to acquire and successfully utilize certain of those technologies that will permit us to reduce our reliance on the incumbent local telephone companies and profitably provide local telephone services through new methods of delivery.

Further negative developments in these areas would likely have a material adverse effect on our business prospects, financial condition and results of operations.

NOTE 2. DEBT AND CAPITAL LEASE OBLIGATIONS

The following is a summary of our debt and capital lease obligations (in thousands):

	September 30, 2004	December 31, 2003	September 30, 2003
8% Secured Convertible Notes Due 2006	$ --	$ --	$ 12,452
12% Senior Subordinated Notes Due 2007	--	40,730	42,520
8% Convertible Senior Subordinated Notes Due 2007 (1)	--	3,778	3,843
5% Convertible Subordinated Notes Due 2004	670	670	670
Other, primarily vendor-financed computer software	2,401	--	--
Capital lease obligations	2,469	3,419	42
Total long-term debt and capital lease obligations	5,540	48,597	59,527
Less: current maturities	3,188	16,806	42
Total long-term debt and capital lease obligations, excluding current maturities	$ 2,352	$ 31,791	$ 59,485

(1) Includes future accrued interest of $1.0 million as of December 31, 2003.

(a) 12% Senior Subordinated Notes Due 2007 and 8% Convertible Senior Subordinated Notes Due 2007

On August 23, 2004, we redeemed the remaining principal amounts of our 12% Senior Subordinated Notes and our 8% Convertible Senior Subordinated Notes. The redemption of the 8% Convertible Senior Subordinated Notes prior to maturity resulted in recording $0.8 million of future accrued interest benefit as an offset to interest expense.

(b) 5% Convertible Subordinated Notes Due 2004

As of September 30, 2004, we had $0.7 million principal amount outstanding of our 5% Convertible Subordinated Notes that mature on December 15, 2004. The notes are convertible, at the option of the holder, at a conversion price of $76.14 per share. The 5% Convertible Subordinated Notes are redeemable, in whole or in part at our option, at 100.71% of par.

(c) Other

In 2004, we entered into a vendor-financed computer software purchase agreement for upgrades to our database management systems. Approximately $2.4 million was outstanding under this agreement at September 30, 2004. Total assets under this purchase agreement are approximately $2.9 million as of September 30, 2004, consisting of a perpetual software license agreement of approximately $2.5 million and a one-year vendor maintenance agreement of approximately $0.4 million. The agreement is repayable in 12 quarterly installments through March 2007, which includes interest based on an annual percentage rate of approximately 3% and annual maintenance agreement renewals.

(d) Capital Leases

During 2003, we entered into a non-cancelable capital lease agreement for upgrades to our customer data storage equipment. Total debt of approximately $2.5 million and $3.4 million was outstanding under this agreement at September 30, 2004 and December 31, 2003, respectively. Total assets, net of accumulated depreciation, under this lease agreement are approximately $2.8 million and $3.4 million as of September 30, 2004 and December 31, 2003, respectively. The lease is repayable in monthly installments through December 2006, which includes interest based on an annual percentage rate of approximately 2%.

NOTE 3. COMMITMENTS AND CONTINGENCIES

We are party to a number of legal actions and proceedings arising from our provision and marketing of telecommunications services (including matters involving do not call regulations), as well as certain legal actions and regulatory matters arising in the ordinary course of business. During the first quarter of 2003, we were made aware that AOL agreed to settle a class action case for approximately $10 million; the claims in the case allegedly relate to marketing activities conducted pursuant to the former telecommunications marketing agreement, between us and AOL. At the time of the settlement agreement, AOL asserted that we are required to indemnify AOL in this matter under the terms of the marketing agreement and advised that it will seek such indemnification from us. We believe that we do not have an obligation to indemnify AOL in this matter and that any claim by AOL for this indemnification would be without merit. We have received no further information regarding this matter and it is our intention, if AOL initiates a claim for indemnification under the marketing agreement, to defend against the claim vigorously. We believe that the ultimate outcome of the foregoing actions will not result in a liability that would have a material adverse effect on our financial condition or results of operations.

In December 2003, we entered into a new four-year master carrier agreement with AT&T. The agreement provides us with a variety of services, including transmission facilities to connect our network switches as well as services for international calls, local traffic, international calling cards, overflow traffic and operator assisted calls. The agreement also provides that, subject to certain terms and conditions, we will purchase these services exclusively from AT&T during the term of the agreement, provided, however, that we are not obligated to purchase exclusively in certain cases, including if such purchases would result in a breach of any contract with another carrier that was in place when we entered into the AT&T agreement, or if vendor diversity is required. Certain of our network service agreements, including the AT&T agreement, contain certain minimum usage commitments. Our contract with AT&T establishes pricing and provides for annual minimum commitments based upon usage as follows: 2004 - $25 million, 2005 - $32 million, 2006 - $32 million and 2007 - $32 million and obligates us to pay 65 percent of the revenue shortfall, if any. A separate contract with a different vendor establishes pricing and provides for annual minimum payments for 2004 of $3.0 million. While we anticipate that we will not be required to make any shortfall payments under these contracts as a result of the restructuring of these obligations, there can be no assurances that we will be successful in our efforts. To the extent that we are unable to meet these minimum commitments, our costs of purchasing the services under the agreement will correspondingly increase.

NOTE 4. STOCK-BASED COMPENSATION

We account for our stock option awards under the intrinsic value based method of accounting prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, including FASB Interpretation No. 44 "Accounting for Certain Transactions Including Stock Compensation," an interpretation of APB Opinion No. 25. Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at grant date or other measurement date over the amount an employee must pay to acquire the stock. We make pro forma disclosures of net income and earnings per share as if the fair value based method of accounting had been applied as required by SFAS No. 123, "Accounting for Stock-Based Compensation" and SFAS 148, “Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of SFAS 123.” The following disclosure complies with the adoption of this statement and includes pro forma net income as if the fair value based method of accounting had been applied (in thousands except for per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004 (restated)	2003 (restated)	2004 (restated)	2003 (restated)
Net income as reported	$ 9,011	$ 54,102	$ 25,721	$ 74,216
Add: Stock-based employee compensation expense included in reported net income	--	--	5	--
Deduct: Total stock-based employee compensation expense determined under fair value based method for all options	1,424	304	4,299	867
Pro forma net income	$ 7,587	$ 53,798	$ 21,427	$ 73,349

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004 (restated)	2003 (restated)	2004 (restated)	2003 (restated)
Basic earnings per share:				
As reported	$ 0.33	$ 2.05	$ 0.96	$ 2.82
Pro forma	$ 0.28	$ 2.04	$ 0.80	$ 2.79
Diluted earnings				

per share:								
As reported	$	0.32	$	1.88	$	0.92	$	2.56
Pro forma	$	0.28	$	1.90	$	0.78	$	2.63

For purposes of pro forma disclosures under SFAS 123, the estimated fair value of the options is assumed to be amortized to expense over the options' vesting period. The fair value of the options granted has been estimated at the various dates of the grants using the Black-Scholes option-pricing model with the following assumptions:

- Fair market value based on our closing common stock price on the date the option is granted;
- Risk-free interest rate based on the weighted averaged 5 year U.S. treasury note strip rates;
- Volatility based on the historical stock price over the expected term (5 years);
- No expected dividend yield based on future dividend payment plans.

NOTE 5. PER SHARE DATA

Basic earnings per common share for a fiscal period is calculated by dividing net income by the weighted average number of common shares outstanding during the fiscal period. Diluted earnings per common share is calculated by adjusting the weighted average number of common shares outstanding and the net income during the fiscal period for the assumed conversion of all potentially dilutive stock options, warrants and convertible bonds (and assuming that the proceeds hypothetically received from the exercise of dilutive stock options are used to repurchase our common stock at the average share price during the fiscal period). For the diluted earnings calculation, we also adjust the net income by the interest expense on the convertible bonds assumed to be converted. Income per share is computed as follows (in thousands except per share data):

	Three Months Ended September 30,		Nine Months Ended September30,	
	2004 (restated)	2003 (restated)	2004 (restated)	2003 (restated)
Net income used to compute basic earnings per share	$ 9,011	$ 54,102	$ 25,721	$ 74,216
Interest expense on convertible bonds, net of tax affect (See Note 2 (a))	--	152	--	455
Net income used to compute diluted earnings per share	$ 9,011	$ 54,254	$ 25,721	$ 74,671
Average shares of common stock outstanding used to compute basic earnings per share	26,974	26,367	26,799	26,325
Additional common shares to be issued assuming exercise of stock options and warrants (net of shares assumed reacquired) and conversion of convertible bonds *	763	2,510	1,055	3,012
Average shares of common and common equivalent stock outstanding used to compute diluted earnings per share	27,737	28,877	27,854	29,337
Income per share - Basic:				
Net income per share	$ 0.33	$ 2.05	$ 0.96	$ 2.82
Weighted average common shares outstanding	26,974	26,367	26,799	26,325
Income per share - Diluted:				
Net income per share	$ 0.32	$ 1.88	$ 0.92	$ 2.55
Weighted average common and common equivalent shares	27,737	28,877	27,854	29,337

outstanding

* The diluted share basis for both the three and nine months ended September 30, 2004, excludes 9 shares associated with certain convertible bonds due to their antidilutive effect. The diluted share basis for the three months ended September 30, 2004 and 2003 excludes 3,400 and 1,204 shares, respectively, and for the nine months ended September 30, 2004 and 2003 excludes 2,933 and 1,288 shares, respectively, associated with the options and warrants due to their antidilutive effect.

NOTE 6. INCOME TAXES

For the quarter ended September 30, 2003, management evaluated the deferred tax asset valuation allowance and determined that a portion of the allowance should be reversed. The evaluation considered the profitability of our business, the ability to utilize the deferred tax assets in the future and possible restrictions on use due to provisions of the Internal Revenue Code Section 382 "Change in Ownership." After consideration of each of these factors, we concluded certain deferred tax assets would more likely than not be utilized, and, in the quarter ended September 30, 2003, reversed deferred tax asset valuation allowances of $50.6 million, recognized a non-cash deferred income tax benefit of $44.1 million and reduced the amount of goodwill related to the August, 2000 acquisition of Access One Communications, Inc. by $6.5 million.

As of September 30, 2003, we had a deferred tax asset of $76.3 million, representing the future tax benefit from the application of net operating loss carryforwards for federal income tax purposes to our future taxable income, alternative minimum tax credits, and allowance for doubtful accounts. We also had a deferred tax liability of $20.2 million, representing the future tax liability attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. There can be no assurance that we will realize the full benefit of the carryforwards.

NOTE 7. RESTATEMENT

Our consolidated financial statements have been revised to reflect the correction for the following errors:

(a) Due to a classification error in our general ledger, we incorrectly recorded certain customer fee revenues as sales, use and excise tax liability to the consolidated balance sheets for the four quarters of 2003, for the year ended December 31, 2003 and for the first and second quarters of 2004. These customer fee revenues were $0.4 million for the third quarter of 2004, $0.2 million for the third quarter of 2003, $1.0 million for the nine months ended September 30, 2004, $0.7 million for the nine months ended September 30, 2003, and an aggregate of $1.0 million for the full year 2003.These customer fees have now been appropriately recorded to revenues in the consolidated statement of operations for the year ended December 31, 2003 and in the unaudited quarterly periods for the first three quarters 2004 and 2003.

(b) We determined that in our calculations since the third quarter of 2003 we had not incorporated the tax benefits associated with the assumed exercise of employee stock options. As a result, fully diluted shares outstanding were over-reported and income per fully diluted share was understated in those periods.

(c) We identified errors in the computation of the deferred tax assets recognized in the third quarter of 2003 as follows: (i) failure to deduct state income tax expense from federal taxable income resulted in the deferred tax benefit as originally reported for the year ended December 31, 2003 and the unaudited third quarter of 2003 being understated by $0.9 million and (ii) failure to complete the appropriately detailed analysis of our deferred tax assets relating to state net operating loss carryforwards resulted in the deferred tax benefit as originally reported for the year ended December 31, 2003 and the unaudited third quarter of 2003 being understated by $1.7 million. In February 2005, we determined that we improperly corrected for the errors in the deferred tax computations through an adjustment to the effective tax rate for 2004 rather than through the restatement of our prior period financial statements. As a result, we have restated the first three quarters of 2004 and the third and fourth quarter of 2003 and year end December 31, 2003.

(d) In connection with the release of the valuation allowance in the third quarter 2003, $6.5 million of deferred tax assets associated with acquired net operating loss carryforwards were realizable and should have been recorded as a deferred tax asset. Originally, we believed this deferred tax asset was limited due to provisions of the Internal Revenue Code Section 382. This error resulted in deferred tax assets being understated and goodwill being overstated in each of the periods beginning in the third quarter 2003. As a result, we have restated the first three quarters of 2004 and the third and fourth quarter of 2003 and year end December 31, 2003.

As a result of these restatements, certain originally reported amounts in the consolidated statements of operations for the three months and nine months ended September 30, 2004 and 2003 have been restated as follows (in thousands, except per share data):

	As Originally Reported	Adjustments	As Restated
Three Months Ended September 30, 2004			
Revenue	$ 120,537	$ 392	$ 120,929
Operating income	13,864	392	14,256
Provision for income taxes	5,339	528	5,867
Net income	9,147	(136)	9,011
Net income per share - Basic	0.34	(0.01)	0.33
Net income per share - Diluted	0.32	--	0.32
Weighted average common and common equivalent shares outstanding -Diluted	28,212	(475)	27,737
Three Months Ended September 30, 2003			
Revenue	$ 99,929	$ 249	$ 100,178
Operating income	17,620	249	17,869
Provision (benefit) for income taxes	(35,460)	(2,287)	(37,747)
Net income	51,566	2,536	54,102
Net income per share - Basic	1.96	0.09	2.05
Net income per share - Diluted	1.74	0.14	1.88
Weighted average common and common equivalent shares outstanding -Diluted	29,761	(884)	28,877
Nine Months Ended September 30, 2004			
Revenue	$ 344,739	$ 1,022	$ 345,761
Operating income	41,940	1,022	42,962
Provision for income taxes	15,395	1,352	16,747
Net income	26,051	(330)	25,721
Net income per share - Basic	0.97	(0.01)	0.96
Net income per share - Diluted	0.91	0.01	0.92
Weighted average common and common equivalent shares outstanding -Diluted	28,482	(628)	27,854
Nine Months Ended September 30, 2003			
Revenue	$ 281,520	$ 766	$ 282,286
Operating income	51,826	766	52,592
Provision (benefit) for income taxes	(22,801)	(2,083)	(24,884)
Net income	71,367	2,849	