FULLNET COMMUNICATIONS INC
Form 10KSB
April 15, 2005

Table of Contents

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

FORM 10-KSB

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

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

For the transition period from ___________________ to ___________________

Commission File Number: 000-27031

FULLNET COMMUNICATIONS, INC.

(Name of small business issuer in its Charter)

OKLAHOMA	**73-1473361**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

201 Robert S. Kerr Avenue, Suite 210

Oklahoma City, Oklahoma 73102

(Address of principal executive offices)

(405) 236-8200

(Issuer s telephone number)

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

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

Title of class

Common Stock, $0.00001 Par Value

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. o

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

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

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

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

TABLE OF CONTENTS

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

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

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

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

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

We may fail to compete with existing and new competitors;

We may not be able to sustain our current growth;

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

We may experience a major system failure;

We may not be able to find needed financing.

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

Table of Contents

PART I

Item 1. Description Of Business

General

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

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

Company History

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

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

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

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

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

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

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

Table of Contents

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

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

Mergers and Acquisitions

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

Our Business Strategy

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

Target Strategic Acquisitions

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

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

- o Favorable consolidation savings.

Generate Internal Sales Growth

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

Grow Subscriber Base

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

Table of Contents

Increase Rural Area Market Share

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

Enhance Subscribers Online Experience

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

o Ease of Use During the first quarter of 2001, we implemented a common, easy to use CD ROM based software package that automatically configures all of the individual Internet access programs after a one time entry by the user of a few required fields of information such as, name, user name and password.

o New Products and Services Offer subscribers new products and services. We recently began offering call waiting modem on hold, Postini e-mail spam and virus protection and a dial-up accelerator.

Internet Access Services

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

o Private label retail and business direct dial-up connectivity to the Internet and

o Secure private networks through our backbone network

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

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

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

o Dial-Up Connections

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

o Leased Line Connections

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

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

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

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

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

CLEC Operations

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

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

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

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

Sales and Marketing

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

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

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

Table of Contents

Competition

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

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

Internet Service Providers

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

Telecommunications Carriers

The major long distance companies, also known as inter-exchange carriers, including AT&T, MCI WorldCom, and Sprint, offer Internet access services and compete with us. Reforms in the federal regulation of the telecommunications industry have created greater opportunities for ILECs, including the Regional Bell Operating Companies or RBOCs, and other competitive local exchange carriers, to enter the Internet connectivity market. In order to address the Internet connectivity requirements of the business customers of long distance and local carriers, we believe that there is a move toward horizontal integration by ILECs and CLECs through acquisitions or joint ventures with, and the wholesale purchase of, connectivity from Internet service providers. The MCI/WorldCom merger (and the prior WorldCom/MFS/UUNet consolidation), GTE s acquisition of BBN, the acquisition by ICG Communications, Inc. of Netcom, Global Crossing s acquisition of Frontier Corp. (and Frontier s prior acquisition of Global Center) and AT&T s purchase of IBM s global communications network are indicative of this trend. Accordingly, we expect that we will experience increased competition from the traditional telecommunications carriers. These telecommunication carriers, in addition to their greater network coverage, market presence, financial, technical and personnel resources also have large existing commercial customer bases.

Cable Companies, Direct Broadcast Satellite and Wireless Communications Companies

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

The companies that own these broadband networks could prevent us from delivering Internet access through the wire and cable connections that they own. Our ability to compete with telephone and cable television companies that are able to support broadband transmissions, and to provide better Internet services and products, may depend on future regulation to guarantee open access to the broadband networks. However, in January 1999, the Federal Communications Commission declined to take any action to mandate or otherwise regulate access by Internet service providers to broadband cable facilities at this time. It is unclear whether and to what extent local and state regulatory agencies will take any initiatives to implement this type of regulation, and whether they will be successful in establishing their authority to do so. Similarly, the Federal Communications Commission is considering proposals that could limit the right of Internet service providers to connect with their customers over broadband local telephone lines. In addition to competing directly in the Internet service provider market, both cable and television facilities operators are also aligning themselves with certain Internet service providers who would receive preferential or exclusive use of broadband local connections to end users. If high-speed, broadband facilities increasingly become the preferred mode by which customers access the Internet and we are unable to gain access to these facilities on reasonable terms, our business, financial condition and results of operations could be materially adversely affected.

Online Service Providers

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

Table of Contents

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

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

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

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

Government Regulations

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

The Triennial Review Order also provided that:

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

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

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

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

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

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

Additional Factors to Consider

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

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

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

Limited Marketing Experience. We have limited experience in developing and commercializing new services based on innovative technologies, and there is limited information available concerning the potential performance of our hardware or market acceptance of our proposed services. There can be no assurance that unanticipated expenses, problems or technical difficulties will not occur which would result in material delays in product commercialization or that our efforts will result in successful product commercialization.

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

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

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

Risks Relating to the Internet. Businesses reliant on the Internet may be at risk due to inadequate development of the necessary infrastructure, such as reliable network backbones, or complementary services, such as high-speed modems and security procedures. The Internet has experienced, and is expected to continue to experience, significant growth in the number of users and amount of traffic. There can be no assurance that the Internet infrastructure will continue to be able to support the demands placed on it by sustained growth. In addition, there may be delays in the development and adoption of new standards and protocols, the inability to handle increased levels of Internet activity or due to increased government regulation. If the necessary Internet infrastructure or complementary services are not developed to effectively support growth that may occur, our business, results of operations and financial condition would be materially adversely affected.

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

Dependence on Key Personnel. Our success depends in large part upon the continued successful performance of our current executive officers and key employees, Messrs. Timothy J. Kilkenny, Roger P. Baresel and Jason C. Ayers, for our continued research, development, marketing and operation. Although we have employed, and will employ in the future, additional qualified employees as well as retaining consultants having significant experience, if Messrs. Kilkenny, Baresel or Ayers fail to perform any of their duties for any reason whatsoever, our ability to market, operate and support our products/services will be adversely affected. While we are located in areas where the available pool of people is substantial, there is also significant competition for qualified personnel.

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

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

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

Customers

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

Employees

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

Item 2. Description of Property

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

Item 3. Legal Proceedings

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

Table of Contents

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

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

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

Table of Contents

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

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

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

Number of stockholders

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

Dividend Policy

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

Securities Authorized for Issuance under Equity Compensation Plans

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

	Weighted-	Number of Securities Remaining

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

Table of Contents

Recent Sales of Unregistered Securities

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

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

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

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

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

Overview

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

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

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

Table of Contents

Results of Operations

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

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

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

Revenues

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

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

Operating Costs and Expenses

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

Table of Contents

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

Selling, general and administrative expenses increased $138,874 or 12.2% to $1,279,779 for the year 2004 from $1,140,905 for the year 2003. This increase was primarily due to an increase in employee costs. Employee costs increased $102,204 for the year 2004 from 2003. This increase was primarily due to increases in health insurance costs and annual wage increases $26,937 and $44,285, respectively. During 2004, the Board of Directors approved a modification of the vacation policy to provide for the accumulation of unused vacation hours earned by the executive officers. The amount of unused vacation recorded during 2004 was $20,977. Selling, general and administrative expenses as a percentage of total revenues increased to 56.6% during 2004 from 53.8% during 2003.

During 2004, we recorded a loss on sale of assets of $4,253 that was primarily attributable to the trade-in of equipment. During 2003 we recorded a gain on sale of assets of $30,218 primarily attributable to the sale of a block of our access service revenue business located in a part of Oklahoma that was outside our primary geographic area of focus.

Depreciation and amortization expense decreased $64,274 or 13.7% to $403,209 for the year 2004 from $467,483 for the year 2003. In January 2002, upon initially applying SFAS 142 we reassessed useful lives and we began amortizing our intangible assets over their estimated useful lives and in direct relation to any decreases in the acquired customer bases to which they relate. Amortization expense for the years ended December 31, 2004 and 2003 relating to intangible assets was $150,914 and $236,791, respectively.

Gain on Debt Forgiveness

During the year 2004, we negotiated and settled the following liabilities for less than their carrying values.

	Carrying Value	Settlement Amount	Gain
Notes payable including accrued interest	$ 96,208	$ 36,536	$ 59,672
Accounts payable	115,519	17,474	98,045
Accrued liabilities	5,663		5,663
Total	$ 217,390	$ 54,010	$ 163,380

Interest Expense

Interest expense decreased $429,247 or 72.2% to $165,110 for the year ended December 31, 2004 from $594,357 for the year 2003. This decrease was primarily attributable to the decrease in amortization of the discount on our convertible promissory notes payable. Pursuant to the provisions of the convertible promissory notes, the conversion price decreased from $.63 at December 31, 2002 to $.49 at December 31, 2003 and 2004. Reductions in conversion price were recognized as an interest expense at the date of reduction by an increase to additional paid-in capital and an increase in the discount on the convertible promissory notes. The majority of these convertible promissory notes matured in 2003 and the remaining note matured in March 2004. Therefore no additional interest from these conversion prices will be recognized.

Liquidity and Capital Resources

As of December 31, 2004, we had $12,226 in cash and $2,211,348 in current liabilities, including $187,194 of deferred revenues that will not require settlement in cash.

At December 31, 2004, we had a deficit working capital of $2,058,101, while at December 31, 2003 we had a deficit working capital of $2,300,220. We do not have a line of credit or credit facility to serve as an additional source of liquidity. Historically we have relied on shareholder loans as an additional source of funds.

As of December 31, 2004, $310,029 of the $317,378 we owed to our trade creditors was past due. We have no formal agreements regarding payment of these amounts. At December 31, 2004, we had outstanding principal and interest owed on matured notes totaling $1,131,244. We have not made payment or negotiated an extension of the notes and the lenders have not made any demands. We are currently developing a plan to satisfy these notes on terms acceptable to the note holders.

In addition, during the years ended December 31, 2004 and 2003, we had one customer that comprised approximately 30% and 33%, respectively, of total revenues. The contract pursuant to which we provide services to this customer expires on

Table of Contents

December 31, 2005. This customer has notified us that they will not renew their contract. Therefore, we will experience a loss of this revenue without a corresponding reduction in expense.

	For the Years Ended December 31,	
	2004	2003
Net cash flows provided by operations	$ 608,208	$ 209,413
Net cash flows (used in) provided by investing activities	(252,362)	12,103
Net cash flows used in financing activities	(355,100)	(236,991)

Cash used for the purchases of equipment was $205,112 and $45,159, respectively, for the years ended December 31, 2004 and 2003. Cash provided by the sales of surplus equipment and furniture was $8,670 for 2004. Cash provided during 2003 of $57,262 was primarily related to the sale of a block of our access service revenue business that was located in a part of Oklahoma that was outside our primarily geographic area of focus. Cash used for the CWIS asset purchase was $55,920 during 2004.

Cash used for principal payments on notes payable and capital lease obligations was $355,100 and $236,991, respectively, for the years ended December 31, 2004 and 2003.

The planned expansion of our business will require significant capital to fund capital expenditures, working capital needs, and debt service. Our principal capital expenditure requirements will include:

- mergers and acquisitions and

- further development of operations support systems and other automated back office systems

Because our cost of developing new networks and services, funding other strategic initiatives, and operating our business depend on a variety of factors (including, among other things, the number of subscribers and the service for which they subscribe, the nature and penetration of services that may be offered by us, regulatory changes, and actions taken by competitors in response to our strategic initiatives), it is almost certain that actual costs and revenues will materially vary from expected amounts and these variations are likely to increase our future capital requirements. Our current cash balances will not be sufficient to fund our current business plan beyond a few months. As a consequence, we are currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. We continue to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund our liquidity needs. There is no assurance that we will be able to obtain additional capital on satisfactory terms or at all or on terms that will not dilute our shareholders interests.

In the event that we are unable to obtain additional capital or to obtain it on acceptable terms or in sufficient amounts, we will be required to delay the further development of our network or take other actions. This could have a material adverse effect on our business, operating results and financial condition and our ability to achieve sufficient cash flows to service debt requirements.

Our ability to fund the capital expenditures and other costs contemplated by our business plan and to make scheduled payments with respect to bank borrowings will depend upon, among other things, our ability to seek and obtain additional financing in the near term. Capital will be needed in order to implement our business plan, deploy our network, expand our operations and obtain and retain a significant number of customers in our target markets. Each of these factors is, to a large extent, subject to economic, financial, competitive, political, regulatory, and other factors, many of which are beyond our control.

There is no assurance that we will be successful in developing and maintaining a level of cash flows from operations sufficient to permit payment of our outstanding indebtedness. If we are unable to generate sufficient cash flows from operations to service our indebtedness, we will be required to modify our growth plans, limit our capital expenditures, restructure or refinance our indebtedness or seek additional capital or liquidate our assets. There is no assurance that (i) any of these strategies could be effectuated on satisfactory terms, if at all, or on a timely basis or (ii) any of these strategies will yield sufficient proceeds to service our debt or otherwise adequately fund operations.

Critical Accounting Policies and Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect certain reported amounts and disclosures. In applying our accounting principles, we must often make individual estimates and assumptions regarding expected outcomes or uncertainties. As you might expect, the actual results or outcomes are generally different than the estimated or assumed amounts. These differences are usually minor and are included in our consolidated financial statements as soon as they are known. Our estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

We periodically review the carrying value of our intangible assets when events and circumstances warrant such a review. One of the methods used for this review is performed using estimates of future cash flows. If the carrying value of our intangible assets is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the intangible assets exceeds its fair value. We believe that the estimates of future cash flows and fair value are reasonable. Changes in estimates of such cash flows and fair value, however, could affect the calculation and result in additional impairment charges in future periods.

Certain Accounting Matters

In December 2004, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standard (SFAS) No. 123R *Share-Based Payment.* The standard amends SFAS No. 123 *Accounting for Stock Based Compensation* and supersedes APB No. 25 *Accounting for Stock Issued to Employees.* SFAS No. 123R requires entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. FAS No. 123R eliminates the alternative to use APB Opinion No. 25 s intrinsic value method of accounting that was provided in Statement 123 as originally issued. FAS No. 123R will be effective for us for the first interim or annual reporting period beginning after December 31, 2005. As permitted by SFAS No. 123, we currently account for share-based payments to employees using the APB No. 25 intrinsic value method and recognize no compensation cost for employee stock options. Accordingly, the provisions of FAS No. 123R will reduce earnings upon adoption. We will adopt FAS No. 123R within the prescribed time and are currently reviewing the provisions to determine its impact on the financial statements.

Item 7. Financial Statements

Our financial statements, prepared in accordance with Regulation S-B, are set forth in this Report beginning on page F-1.

Item 8. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

On January 30, 2004, we engaged EVANS, GAITHER & ASSOCIATES, PLLC as our new independent accountants, commencing with the audit for the fiscal year ended December 31, 2003, and thereby dismissed Buxton & Cloud PC. The decision to change independent accountants was approved by our Board of Directors.

Item 8A. Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer are responsible primarily for establishing and maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the U.S. Securities and Exchange Commission. These controls and procedures are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Furthermore, our Chief Executive Officer and Chief Financial Officer are responsible for the design and supervision of our internal controls over financial reporting that are then effected by and through our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. These policies and procedures (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Our Chief Executive Officer and Chief Financial Officer, based upon their evaluation of the effectiveness of our disclosure controls and procedures and the internal controls over financial reporting as of the last day of the period covered by this report, concluded that our disclosure controls and procedures and internal controls over financial reporting were fully effective during and as of the last day of the period covered by this report and reported to our auditors and the audit committee of our board of directors that no change in our disclosure controls and procedures and internal control over financial reporting occurred during the period covered by this report that would materially affected or is reasonably likely to materially affect our disclosure controls and

Table of Contents

procedures or internal control over financial reporting. In conducting their evaluation of our disclosure controls and procedures and internal controls over financial reporting, these executive officers did not discover any fraud that involved management or other employees who have a significant role in our disclosure controls and procedures and internal controls over financial reporting. Furthermore, there were no significant changes in our disclosure controls and procedures, internal controls over financial reporting, or other factors that could significantly affect our disclosure controls and procedures or internal controls over financial reporting subsequent to the date of their evaluation. Because no significant deficiencies or material weaknesses were discovered, no corrective actions were necessary or taken to correct significant deficiencies and material weaknesses in our internal controls and disclosure controls and procedures.

Item 8B. Other Information

As of the date of this report, we do not have any information required to be reported on Form 8-K during the three months ended December 31, 2004.

Table of Contents

PART III.

Item 9. Directors, Executive Officers, Promoters and Control Persons, Compliance with Section 16(a) of the Exchange Act

The following information is furnished as of March 25, 2005 for each person who serves on our Board of Directors or serves as one of our executive officers. Our Board of Directors currently consists of two members, although we intend to increase the size of the Board in the future. The directors serve one-year terms until their successors are elected. Our executive officers are elected annually by our Board. The executive officers serve terms of one year or until their death, resignation or removal by our Board. There are no family relationships between our directors and executive officers. In addition, there was no arrangement or understanding between any executive officer and any other person pursuant to which any person was selected as an executive officer.

Name	Age	Position
Timothy J. Kilkenny	46	Chairman of the Board of Directors and CEO
Roger P. Baresel	49	Director, President, Chief Financial Officer and Secretary
Jason C. Ayers	30	Vice President of Operations
Patricia R. Shurley	48	Vice President of Finance
Michael D. Tomas	32	Vice President of Technology

Timothy J. Kilkenny has served as our Chief Executive Officer and Chairman of the Board of Directors since our inception in May 1995. Prior to that time, he spent 14 years in the financial planning business as a manager for both MetLife and Prudential. Mr. Kilkenny is a graduate of Central Bible College in Springfield, Missouri.

Roger P. Baresel became one of our directors and our Chief Financial Officer on November 9, 2000, and our President on October 13, 2003. Mr. Baresel is an accomplished senior executive and consultant who has served at a variety of companies. While serving as President and CFO of Advantage Marketing Systems, Inc., a publicly-held company engaged in the multi-level marketing of healthcare and dietary supplements, from June 1995 to May 2000, annual sales increased from $2.5 million to in excess of $22.4 million and annual earnings increased from $80,000 to more than $l.2 million. Also, during this period Advantage successfully completed two public offerings, four major acquisitions and its stock moved from the over the counter bulletin board to the American Stock Exchange. Mr. Baresel has the following degrees from Central State University in Edmond, Oklahoma: BA Psychology, BS Accounting and MBA Finance, in which he graduated Summa Cum Laude. Mr. Baresel is also a certified public accountant.

Jason C. Ayers has been our Vice President of Operations since December 8, 2000 and prior to that served as President of Animus, a privately-held web hosting company which we acquired on April 1, 1998. Mr. Ayers received a BS degree from Southern Nazarene University in Bethany, Oklahoma in May 1996 with a triple major in Computer Science, Math and Physics. Upon graduating, he was a co-founder of Animus.

Patricia R. Shurley has been our Vice President of Finance since May 2001. Prior to that she served for three years as the Controller for Advantage Marketing Systems, Inc., a publicly-held company engaged in the multi-level marketing of healthcare and dietary supplements. Prior to that she was self-employed and owned an accounting practice. She graduated from the University of Central Oklahoma in Edmond, Oklahoma with a BS degree in Accounting and is a certified public accountant.

Michael D. Tomas has been our Vice President of Technology since September 2003. Prior to that he was our Information Systems Manager since June 1999 and our employee since July 1996. Mr. Tomas has formal training with

Cisco, Win 3.1, Win95/98, and Windows NT 4.0 as well as LAN/WAN setup, including experience with wireless networking and is Lucent certified.

Audit Committee Financial Expert

Because our board of directors only consists of two directors, each of whom does not qualify as an independent director; our board performs the functions of an audit committee. Our board of directors has determined that Roger P. Baresel, our President and Chief Financial Officer qualifies as a financial expert. This determination was based upon Mr. Baresel s

o understanding of generally accepted accounting principles and financial statements;

o ability to assess the general application of generally accepted accounting principles in connection with the accounting for estimates, accruals and reserves;

Table of Contents

o experience preparing, auditing, analyzing or evaluating financial statements that present the breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by our financial statements, or experience actively supervising one or more persons engaged in such activities;

o understanding of internal controls and procedures for financial reporting; and

o understanding of audit committee functions.

Mr. Baresel s experience and qualification as a financial expert were acquired through the active supervision of a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions and overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements.

Mr. Baresel is not an independent director. We have been unable to attract a person to serve as one of our directors and that would qualify both as an independent director and as a financial expert because of inability to compensate our directors and provide liability insurance protection.

Compliance with Section 16(a) of the Exchange Act, Beneficial Ownership Reporting Requirements

Section 16(a) of the Securities and Exchange Act of 1934, as amended, requires our directors and executive officers and any persons who own more than 10% of a registered class of our equity securities to file with the Securities and Exchange Commission (SEC) and each exchange on which our securities are listed, reports of ownership and subsequent changes in ownership of our common stock and our other securities. Officers, directors and greater than 10% stockholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file. Based solely on review of the copies of such reports furnished to us or written representations that no other reports were required, we believe that during 2004 all filing requirements applicable to our officers, directors and greater than 10% beneficial owners were met, except for the late filing of one Form 4 by Jason C. Ayers.

Code of Ethics

On March 25, 2003, our board of directors adopted our code of ethics that applies to all of our employees and directors, including our principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions. A copy of the portion of this code of ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions may be obtained by written request addressed to Mr. Roger P. Baresel, Corporate Secretary, Fullnet Communications, Inc., 201 Robert S. Kerr, Suite 210, Oklahoma City, Oklahoma 73102.

Item 10. Executive Compensation

The following table sets forth, for the last three fiscal years, the cash compensation paid by us to our Chairman and Chief Executive Officer (the Named Executive Officer). None of our executive officers earned annual compensation in excess of $100,000 during fiscal 2004.

	Annual Compensation	Long-Term Compensation Securities Underlying

Name and Principal Position	Fiscal Year	Salary	Other Compensation	Options and Warrants (#) (1)
Timothy J. Kilkenny	2004	$ 81,413(2)	$ 17,130(4)	
Chairman and CEO	2003	80,717(3)	14,986(5)	452,000
	2002	75,000(3)	12,614(6)	80,000

(1) Options are granted with an exercise price equal to the fair market value of our common stock on the date of the grant.

(2) Includes $20,833 of deferred compensation.

(3) Includes $25,000 of deferred compensation.

(4) Represents $8,400 of expense reimbursement for business use of Mr. Kilkenny s automobile, $1,995 of expense reimbursement for Mr. Kilkenny s Internet connection and cell phone, and $6,735 of insurance premiums paid by us for the benefit of Mr. Kilkenny.

Table of Contents

(5) Represents $8,400 of expense reimbursement for business use of Mr. Kilkenny s automobile, $1,030 of expense reimbursement for Mr. Kilkenny s Internet connection and cell phone, and $5,556 of insurance premiums paid by us for the benefit of Mr. Kilkenny.

(6) Represents $6,331 of expense reimbursement for business use of Mr. Kilkenny s automobile and $6,283 of insurance premiums paid by us for the benefit of Mr. Kilkenny. We also provided use of an automobile to Mr. Kilkenny for a portion of the year, the value of which is not greater than $5,000 annually.

Stock Options Granted

We do not have a written stock option plan. However, the Board of Directors granted to our employees stock options exercisable for the purchase of 118,000 shares of our common stock during 2004. No stock options were granted to Mr. Kilkenny during 2004.

All options granted during 2004 are nonqualified stock options. During 2004, an aggregate of 118,000 options were granted outside of a formal plan to employees. Options granted generally become exercisable in part after one year from the date of grant and generally have a term of ten years following the date of grant, unless sooner terminated in accordance with the terms of the stock option agreement.

2004 Year End Option Values

The following table sets forth information related to the exercise of stock options during 2004 and the number and value of options held by the following Named Executive Officer at December 31, 2004. During 2004, the Named Executive Officer did not exercise any options, nor did we reprice any outstanding options. For the purposes of this table, the value of an option is the difference between the estimated fair market value at December 31, 2004 of the shares of common stock subject to the option and the aggregate exercise price of such option.

	Number of Unexercised Options at December 31, 2004		Value of Unexercised In-the-Money Options at December 31, 2004 (1)	
Name	Exercisable	Unexercisable	Exercisable	Unexercisable
Timothy J. Kilkenny Chairman and CEO	614,000	100,000	$ 12,160	$ 3,000

(1) Based on the December 31, 2004 estimated fair value of our common stock of $.07 per share.

Director Compensation

During the fiscal year ended December 31, 2004, our directors did not receive any compensation for serving in such capacities.

Employment Agreements and Lack of Keyman Insurance

On July 31, 2002, we entered into employment agreements with Timothy J. Kilkenny and Roger P. Baresel. Each agreement is effective January 1, 2002, and has a term of two years; however, the term is automatically extended for additional one-year terms, unless we or the employee gives six-month advance notice of termination. These agreements provide, among other things, (i) an annual base salary of at least $75,000 for Mr. Kilkenny (of which he has voluntarily agreed to defer $25,000) and $65,000 for Mr. Baresel (of which he has voluntarily agreed to defer $15,000), (ii) bonuses at the discretion of the Board of Directors, (iii) entitlement to fringe benefits including medical and insurance benefits as may be provided to our other senior officers; and (iv) eligibility to participate in our incentive, bonus, benefit or similar plans. These agreements require the employee to devote the required time and attention to our business and affairs necessary to carry out his responsibilities and duties. These agreements may be terminated under certain circumstances and upon termination provide for (i) the employee to be released from personal liability for our debts and obligations, and (ii) the payment of any amounts we owe the employee.

We do not maintain any keyman insurance covering the death or disability of our executive officers. However, Mr. Kilkenny s life insurance carries a death benefit which would pay the three bank notes payable totaling $291,390 at December 31, 2004, each of which he personally guaranteed.

Table of Contents

Item 11. Security Ownership of Certain Beneficial Owners and Management

Security Ownership

The following table sets forth information as of March 25, 2005, concerning the beneficial ownership of our Common Stock by each person (other than our directors and executive officers) who is known by us to own more than 5% of the outstanding shares of our Common Stock. The information is based on Schedules 13D or 13G filed by the applicable beneficial owner with the Securities and Exchange Commission or other information provided to us by the beneficial owner or our stock transfer agent.

	Common Stock	
Beneficial Owner (1)	Number of Shares	Percent of Class (1)
Generation Capital Associates (2)	707,608	9.9%
Rupinder Sidu (3)	628,685	9.0%
Peter Rettman (4)	522,389	7.4%
Karen Gustafson & Greg Kusnick(5)	503,981	7.2%
Greg Lowney & Maryanne Snyder (6)	503,981	7.2%
Laura L. Kilkenny (7)	465,000	6.9%
Rene Miville (8)	441,518	6.6%

(1) Percent of class for any stockholder listed is calculated without regard to shares of common stock issuable to others upon exercise of outstanding stock options. Any shares a stockholder is deemed to own by having the right to acquire by exercise of an option or warrant are considered to be outstanding solely for the purpose of calculating that stockholder s ownership percentage. We computed the percentage ownership amounts in accordance with the provisions of Rule 13d-3(d), which includes as beneficially owned all shares of common stock which the person or group has the right to acquire within the next 60 days, based upon 6,723,135 outstanding shares of common stock as of March 25, 2005.

(2) Generation Capital Associates address is 1085 Riverside Trace, Atlanta, GA 30328. Generation Capital Associates holds 267,608 shares of our common stock. The number of shares includes 440,000 shares of our common stock that are subject to currently exercisable common stock purchase warrants. Amounts shown do not include 150,000 shares of our common stock that are subject to common stock purchase warrants that are not currently exercisable because they contain a provision prohibiting their exercise to the extent that they would increase Generation Capital Associates percentage ownership beyond 9.9% of our outstanding shares of common stock.

(3) Rupinder Sidu s address is 10229 Tavistock Road, Orlando, FL 32827. Mr. Sidu holds 344,018 shares of our common stock. The number of shares includes 284,667 shares of our common stock that are subject to currently exercisable common stock purchase warrants.

(4) Peter Rettman s address is 3700 W. Lawton Street, Seattle, WA 98199. Mr. Rettman holds 163,078 shares of our common stock. The number of shares includes 206,250 shares of our common stock that are subject to currently exercisable common stock purchase warrants and 153,061 shares of our common stock that are subject to a currently convertible promissory note.

(5)

Karen Gustafson & Greg Kusnick s address is P.O. Box 22443, Seattle, WA 98112. Ms. Gustafson & Mr. Kusnick hold 155,129 shares of our common stock. The number of shares includes 93,750 shares of our common stock that are subject to currently exercisable common stock purchase warrants and 255,102 shares of our common stock that are subject to a currently convertible promissory note.

(6) Greg Lowney & Maryanne Snyder s address is 15207 N.E. 68th Street, Redmond, WA 98052. Mr. Lowney & Ms. Snyder hold 155,129 shares of our common stock. The number of shares includes 93,750 shares of our common stock that are subject to currently exercisable common stock purchase warrants and 255,102 shares of our common stock that are subject to a currently convertible promissory note.

(7) Laura L. Kilkenny s address is 3160 Long Dr., Newcastle, OK 73065. Ms. Kilkenny is the ex-wife of Timothy J. Kilkenny, our Chairman of the Board and Chief Executive Officer. Ms. Kilkenny holds 415,000 shares of our common stock. The number of shares includes 50,000 shares of our common stock that are subject to currently exercisable common stock purchase options.

(8) Rene Miville s address is 17081 Captive Drive, P.O. Box 9, Captiva Island, FL 33924. Ms. Miville holds 441,518 shares of our common stock.

The following table sets forth information as of March 25, 2005, concerning the beneficial ownership of our Common Stock by each of our directors, each executive officer named in the table under the heading Item 9. Directors and Executive Officers, Promoters and Control Persons and all of our directors and executive officers as a group. There are no family relationships amongst our executive officers and directors. Unless otherwise indicated, the beneficial owner has sole voting and investment power with respect to such stock.

	Common Stock Beneficially Owned	
Beneficial Owner (1)	Number of Shares	Percent of Class (1)
Timothy J. Kilkenny* (2)(3)	1,629,000	22.3%
Roger P. Baresel* (2)(4)	537,862	7.6%
Jason C. Ayers (2)(5)	252,795	3.7%
Patricia R. Shurley (2)(6)	242,000	3.5%
Michael D. Tomas (2)(7)	210,000	3.1%
All executive officers and directors as a group (5 persons)	2,871,657	40.2%

* Director

(1) Percent of class for any stockholder listed is calculated without regard to shares of common stock issuable to others upon exercise of outstanding stock options. Any shares a stockholder is deemed to own by having the right to acquire by exercise of an option or warrant are considered to be outstanding solely for the purpose of calculating that stockholder s ownership percentage. We computed the percentage ownership amounts in accordance with the provisions of Rule 13d-3(d), which includes as beneficially owned all shares of common stock which the person or group has the right to acquire within the next 60 days, based upon 6,723,135 shares being outstanding at March 25, 2005.

(2) Address is c/o 201 Robert S. Kerr Avenue, Suite 210, Oklahoma City, Oklahoma 73102.

(3) Timothy J. Kilkenny holds 1,015,000 shares of our common stock. The number of shares includes 614,000 shares of our common stock that are subject to currently exercisable stock options held by Mr. Kilkenny. Amounts shown do not include options, held by Mr. Kilkenny, to purchase 100,000 shares of our common stock exercisable at $.04 per share beginning October 9, 2005.

(4) Roger P. Baresel and Judith A. Baresel, husband and wife, hold 34,408 and 92,659 shares of our common stock, respectively. They hold 31,250 shares of our common stock as joint tenants. The number of shares includes 148,745 shares of our common stock subject to currently exercisable stock options held by Mr. Baresel, 218,300 shares of our common stock subject to currently exercisable stock options held by Mrs. Baresel, and 12,500 currently exercisable common stock purchase warrants held jointly. Amounts shown do not include options, held by Mr. Baresel, to purchase 50,000 shares of our common stock exercisable at $.04 per share beginning October 9, 2005.

(5) Jason C. Ayers holds 25,865 shares of our common stock. The number of shares includes 226,930 shares of our common stock that are subject to currently exercisable common stock options held by Mr. Ayers. Amounts shown do not include options, held by Mr. Ayers, to purchase 3,000 shares exercisable at $.08 per share beginning June 4, 2005, 50,000 shares of our common stock exercisable at $.04 per share beginning June 27, 2005 and 100,000 shares of our common stock exercisable at $.05 per share beginning December 21, 2005.

(6) The number of shares includes 242,000 shares of our common stock that are subject to currently exercisable common stock purchase options held by Ms. Shurley. Amounts shown do not include options to purchase

50,000 shares of our common stock exercisable at $.04 per share beginning May 16, 2006.

(7) The number of shares includes 210,000 shares of our common stock that are subject to currently exercisable common stock purchase options held by Mr. Tomas. Amounts shown do not include options to purchase 50,000 shares of our common stock exercisable at $.04 per share beginning October 9, 2005.

Item 12. Certain Relationships and Related Transactions

We are in default on an operating lease for certain equipment which is leased from one of our significant shareholders who also holds a $320,000 interim loan which is also in default (see Note E Notes Payable). The original lease was dated November 21, 2001 and the terms were $6,088 per month for 12 months with a fair market purchase option at the end of the lease. Upon default on the lease, we were allowed to continue leasing the equipment on a month-to-month basis at the same monthly rate as the original lease. We have been unable to make the month-to-month payments and at December 31, 2004 had recorded $145,921 in unpaid lease payments. The lessor has not made any demands.

In connection with his employment, during October 2003, we issued stock options exercisable for the purchase of 452,000 shares of our common stock to Timothy J. Kilkenny, our Chairman of the Board and Chief Executive Officer, of which 120,000 were 100% vested and exercisable immediately, 182,000 which vest and become exercisable on November 16, 2004 and 150,000 which one-third vest and become exercisable on each of the first three anniversary dates of the issuance. These options had an exercise price of $.04 per share and expire during October 2013.

In connection with his employment, during October 2003, we issued stock options exercisable for the purchase of 370,848 shares of common stock to Roger P. Baresel, our President and Chief Financial Officer, of which 34,651 were 100% vested and exercisable immediately, 261,197 which vest and become exercisable on November 16, 2004 and 75,000 which one-third vest and become exercisable on each of the first three anniversary dates of the issuance. These options had an exercise price of $.04 per share and expire during October 2013.

In connection with his employment, during December 2003, we issued stock options exercisable for the purchase of 50,000 shares of common stock to Roger P. Baresel, our President and Chief Financial Officer that were 100% vested and exercisable immediately. These options had an exercise price of $.04 per share and expire during March 2012. Subsequently, Mr. Baresel exercised these options for $2,000.

In connection with his employment, during March 2002, we issued stock options exercisable for the purchase of 80,000 shares of our common stock to Timothy J. Kilkenny, our Chairman of the Board and Chief Executive Officer, which were one-third vested and exercisable immediately and will vest and become exercisable one-third on each annual anniversary of the issue. The options have an exercise price of $.05 per share and expire during March 2012.

In connection with his employment, during March 2002, we issued stock options exercisable for the purchase of 60,000 shares of our common stock to Roger P. Baresel, our Chief Financial Officer that were one-third vested and exercisable immediately and will vest and become exercisable one-third on each annual anniversary of the issue. These options have an exercise price of $.05 per share and expire during March 2012.

On August 2, 2000, we obtained a short-term loan of $100,000 from Timothy J. Kilkenny, our Chairman of the Board and Chief Executive Officer, through the issuance of a 14% promissory note. The terms of the financing additionally provided for the issuance of five-year warrants to purchase 50,000 shares of our common stock at $.01 per share, and provided for certain registration rights. The promissory note required monthly interest payments, matured on the earlier of (i) the date which is within five days of receipt of funds by us of any offering raising gross proceeds to us of at least $1,000,000 or (ii) in three months, and was extendible for two 90-day periods upon issuance of additional warrants exercisable for the purchase of 50,000 shares of our common stock for $.01 per share for each extension. In the fourth quarter of 2000, our founder and CEO agreed to reduce the interest rate on the promissory note to 9% and waive the warrant provisions relating to extensions of the loan. We repaid $50,000 on this note and the note was due in May 2001. In May 2001 Mr. Kilkenny agreed to a replacement note with an interest rate of 8.5% with monthly principal and interest payments and the note will mature in May 2006.

Item 13. Exhibits

(a) The following exhibits are filed as part of this Report:

Exhibit Number	*Exhibit*	
3.1	Certificate of Incorporation, as amended (filed as Exhibit 2.1 to Registrant s Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
3.2	Bylaws (filed as Exhibit 2.2 to Registrant s Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference)	#
4.1	Specimen Certificate of Registrant s Common Stock (filed as Exhibit 4.1 to the Company s Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
4.2	Certificate of Correction to the Amended Certificate of Incorporation and the Ninth Section of the Certificate of Incorporation (filed as Exhibit 2.1 to Registrant s Registration Statement	#

	on form 10-SB, file number 000-27031 and incorporated by reference).	
4.3	Certificate of Correction to Articles II and V of Registrant s Bylaws (filed as Exhibit 2.1 to Registrant s Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
4.4	Form of Warrant Agreement for Interim Financing in the amount of $505,000 (filed as Exhibit 4.1 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.5	Form of Warrant Certificate for Florida Investors for Interim Financing in the amount of $505,000 (filed as Exhibit 4.2 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#

27

Exhibit Number	*Exhibit*	
4.6	Form of Promissory Note for Florida Investors for Interim Financing in the amount of $505,000 (filed as Exhibit 4.3 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.7	Form of Warrant Certificate for Georgia Investors for Interim Financing in the amount of $505,000 (filed as Exhibit 4.4 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.8	Form of Promissory Note for Georgia Investors for Interim Financing in the amount of $505,000 (filed as Exhibit 4.5 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.9	Form of Warrant Certificate for Illinois Investors for Interim Financing in the amount of $505,000 (filed as Exhibit 4.6 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.10	Form of Promissory Note for Illinois Investors for Interim Financing in the amount of $505,000 (filed as Exhibit 4.7 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.11	Form of Warrant Agreement for Interim Financing in the amount of $500,000 (filed as Exhibit 4.8 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.12	Form of Warrant Certificate for Interim Financing in the amount of $500,000 (filed as Exhibit 4.9 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.13	Form of Promissory Note for Interim Financing in the amount of $500,000 (filed as Exhibit 4.10 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.14	Form of Convertible Promissory Note for September 29, 2000, private placement (filed as Exhibit 4.13 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000 and incorporated herein by reference).	#
4.15	Form of Warrant Agreement for September 29, 2000, private placement (filed as Exhibit 4.13 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000 and incorporated herein by reference).	#
4.16	Form of 2001 Exchange Warrant Agreement (filed as Exhibit 4.16 to Registrant s Form 10-QSB for the quarter ended June 30, 2001 and incorporated herein by reference)	#
4.17	Form of 2001 Exchange Warrant Certificate (filed as Exhibit 4.17 to Registrant s Form 10-QSB for the quarter ended June 30, 2001 and incorporated herein by reference)	#

10.1	Financial Advisory Services Agreement between the Company and National Securities Corporation, dated September 17, 1999 (filed as Exhibit 10.1 to Registrant s Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
10.2	Lease Agreement between the Company and BOK Plaza Associates, LLC, dated December 2, 1999 (filed as Exhibit 10.2 to Registrant s Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
10.3	Interconnection agreement between Registrant and Southwestern Bell dated March 19, 1999 (filed as Exhibit 6.1 to Registrant s Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
10.4	Stock Purchase Agreement between the Company and Animus Communications, Inc. (filed as Exhibit 6.2 to Registrant s Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#

Table of Contents

Exhibit Number	*Exhibit*	
10.5	Registrar Accreditation Agreement effective February 8, 2000, by and between Internet Corporation for Assigned Names and Numbers and FullWeb, Inc. d/b/a FullNic f/k/a Animus Communications, Inc. (filed as Exhibit 10.1 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
10.6	Master License Agreement For KMC Telecom V, Inc., dated June 20, 2000, by and between FullNet Communications, Inc. and KMC Telecom V, Inc. (filed as Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference).	#
10.7	Domain Registrar Project Completion Agreement, dated May 10, 2000, by and between FullNet Communications, Inc., FullWeb, Inc. d/b/a FullNic and Think Capital (filed as Exhibit 10.2 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference).	#
10.8	Amendment to Financial Advisory Services Agreement between Registrant and National Securities Corporation, dated April 21, 2000 (filed as Exhibit 10.3 to Registrant s Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference).	#
10.9	Asset Purchase Agreement dated June 2, 2000, by and between FullNet of Nowata and FullNet Communications, Inc. (filed as Exhibit 99.1 to Registrant s Form 8-K filed on June 20, 2000 and incorporated herein by reference).	#
10.10	Asset Purchase Agreement dated February 4, 2000, by and between FullNet of Bartlesville and FullNet Communications, Inc. (filed as Exhibit 2.1 to Registrant s Form 8-K filed on February 18, 2000 and incorporated herein by reference).	#
10.11	Agreement and Plan of Merger Among FullNet Communications, Inc., FullNet, Inc. and Harvest Communications, Inc. dated February 29, 2000 (filed as Exhibit 2.1 to Registrant s Form 8-K filed on March 10, 2000 and incorporated herein by reference).	#
10.12	Asset Purchase Agreement dated January 25, 2000, by and between FullNet of Tahlequah, and FullNet Communications, Inc. (filed as Exhibit 2.1 to Registrant s Form 8-K filed on February 9, 2000 and incorporated herein by reference).	#
10.13	Promissory Note dated August 2, 2000, issued to Timothy J. Kilkenny (filed as Exhibit 10.13 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.14	Warrant Agreement dated August 2, 2000, issued to Timothy J. Kilkenny (filed as Exhibit 10.14 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.15	Warrant Certificate dated August 2, 2000 issued to Timothy J. Kilkenny (filed as Exhibit 10.15 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.16		#

	Stock Option Agreement dated December 8, 2000, issued to Timothy J. Kilkenny (filed as Exhibit 10.16 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	
10.17	Warrant Agreement dated November 9, 2000, issued to Roger P. Baresel (filed as Exhibit 10.17 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.18	Warrant Agreement dated December 29, 2000, issued to Roger P. Baresel (filed as Exhibit 10.18 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.19	Stock Option Agreement dated February 29, 2000, issued to Wallace L Walcher (filed as Exhibit 10.19 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.20	Stock Option Agreement dated February 17, 1999, issued to Timothy J. Kilkenny (filed as Exhibit 3.1 to Registrant s Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
10.21	Stock Option Agreement dated October 19, 1999, issued to Wesdon C. Peacock (filed as Exhibit 10.21 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#

Table of Contents

Exhibit Number	*Exhibit*	
10.22	Stock Option Agreement dated April 14, 2000, issued to Jason C. Ayers (filed as Exhibit 10.22 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.23	Stock Option Agreement dated May 1, 2000, issued to B. Don Turner (filed as Exhibit 10.23 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.24	Form of Stock Option Agreement dated December 8, 2000, issued to Jason C. Ayers, Wesdon C. Peacock, B. Don Turner and Wallace L. Walcher (filed as Exhibit 10.24 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.25	Warrant Certificate Dated November 9, 2000, issued to Roger P. Baresel (filed as Exhibit 10.25 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.26	Warrant Certificate Dated November 9, 2000, issued to Roger P. Baresel (filed as Exhibit 10.26 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.27	Warrant Certificate Dated December 29, 2000, issued to Roger P. Baresel (filed as Exhibit 10.27 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.28	Stock Option Agreement dated October 13, 2000, issued to Roger P. Baresel (filed as Exhibit 10.28 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.29	Stock Option Agreement dated October 12, 1999, issued to Travis Lane (filed as Exhibit 10.29 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.30	Promissory Note dated January 5, 2001, issued to Generation Capital Associates (filed as Exhibit 10.30 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.31	Placement Agency Agreement dated November 8, 2000 between FullNet Communications, Inc. and National Securities Corporation (filed as Exhibit 10.31 to Registrant s Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.32	Promissory Note dated January 25, 2000, issued to Fullnet of Tahlequah, Inc.	#
10.33	Promissory Note dated February 7, 2000, issued to David Looper	#
10.34	Promissory Note dated February 29, 2000, issued to Wallace L. Walcher	#
10.35	Promissory Note dated June 2, 2000, issued to Lary Smith	#
10.36	Promissory Note dated June 15, 2001, issued to higganbotham.com L.L.C.	#
10.37	Promissory Note dated November 19, 2001, issued to Northeast Rural Services	#
10.38	Promissory Note dated November 19, 2001, issued to Northeast Rural Services	#

10.39	Form of Convertible Promissory Note dated September 6, 2002	#
10.40	Employment Agreement with Timothy J. Kilkenny dated July 31, 2002	#
10.41	Employment Agreement with Roger P. Baresel dated July 31, 2002	#
10.42	Letter from Grant Thornton LLP to the Securities and Exchange Commission dated January 30, 2003	#
10.43	Form 8-K dated January 30, 2003 reporting the change in certifying accountant	#
10.44	Form 8-K dated January 30, 2004 reporting the change in certifying accountant	#
22.1	Subsidiaries of the Registrant	#
31.1	Certification pursuant to Rules 13a-14(a) and 15d-14(a) of Timothy J. Kilkenny	*

Table of Contents

Exhibit Number	*Exhibit*	
31.2	Certification pursuant to Rules 13a-14(a) and 15d-14(a) of Roger P. Baresel	*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Timothy J. Kilkenny	*
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Roger P. Baresel	*

Incorporated by reference.

* Filed herewith.

(b) Reports on Form 8-K

None.

Item 14. Principal Accountant Fees and Services

On January 30, 2004, we engaged EVANS, GAITHER & ASSOCIATES, PLLC as our new independent accountants, commencing with the audit for the fiscal year ended December 31, 2003, and thereby dismissed Buxton & Cloud PC. The decision to change independent accountants was approved by our Board of Directors. The following table sets forth the aggregate fees, including expenses, billed to us for the years ended December 31, 2004 and 2003 by our principal accountant.

		2004	2003
Audit Fees	Evans, Gaither & Associates, PLLC	$ 33,160	$ 23,625
Audit Fees	Buxton & Cloud PC		6,071
Audit Related Fees			
Tax Fees			
All Other Fees			

The audit fees include services rendered by our principal accountant for the audit of our financial statements, review of financial statements included in our quarterly reports and other fees that are normally provided by the accountant in connection with statutory and regulatory filings or engagements. Because our Board of Directors only consists of two directors, each of whom does not qualify as an independent director, our Board of Directors performs the functions of an audit committee. It is our policy that the Board of Directors pre-approve all audit, tax and related services. All of the services described above in this Item 14 were approved in advance by our Board of Directors. No items were approved by the Board of Directors pursuant to paragraph (c)(7)(ii)(C) of Rule 2-01 of Regulation S-X.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Exchange Act, the Registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

REGISTRANT:
FULLNET COMMUNICATIONS, INC.

Date: April 15, 2005	By: /s/ TIMOTHY J. KILKENNY
	Timothy J. Kilkenny Chief Executive Officer
Date: April 15, 2005	By: /s/ ROGER P. BARESEL
	Roger P. Baresel President and Chief Financial and Accounting Officer

Pursuant to the requirements of the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Date: April 15, 2005	By: /s/ TIMOTHY J. KILKENNY
	Timothy J. Kilkenny, Chairman of the Board and Director
Date: April 15, 2005	By: /s/ ROGER P. BARESEL
	Roger P. Baresel, Director

Table of Contents

Report of Independent Certified Public Accountants

Board of Directors
FullNet Communications, Inc.

We have audited the accompanying consolidated balance sheets of FullNet Communications, Inc. (an Oklahoma corporation) and Subsidiaries, as of December 31, 2004 and 2003 and the related consolidated statements of operations, stockholders deficit, and cash flows for the years then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FullNet Communications, Inc. and Subsidiaries, as of December 31, 2004 and 2003 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As shown in the financial statements, the Company s current liabilities exceeded its current assets by $2,058,101 and its total liabilities exceeded its total assets by $1,294,497. These factors, among others, as discussed in Note A to the financial statements, raise substantial doubt about the Company s ability to continue as a going concern. Management s plans in regard to these matters are also described in Note A. The 2004 financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Evans, Gaither & Associates, PLLC

Oklahoma City, Oklahoma
March 31, 2005

Table of Contents

FullNet Communications, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

December 31,

	2004	2003
ASSETS		
CURRENT ASSETS		
Cash	**$ 12,226**	$ 11,480
Accounts receivable, net	**59,212**	29,510
Prepaid expenses and other current assets	**81,809**	60,163
Total current assets	**153,247**	101,153
PROPERTY AND EQUIPMENT, net	**990,863**	995,730
INTANGIBLE ASSETS, net	**160,010**	269,482
OTHER ASSETS	**5,250**	6,771
TOTAL	**$ 1,309,370**	$ 1,373,136
LIABILITIES AND STOCKHOLDERS DEFICIT		
CURRENT LIABILITIES		
Accounts payable trade	**$ 317,378**	$ 464,903
Accrued and other current liabilities	**725,190**	548,027
Notes payable, current portion	**968,825**	1,184,845
Capital lease obligations, current portion	**12,761**	31,722
Deferred revenue	**187,194**	171,876
Total current liabilities	**2,211,348**	2,401,373
NOTES PAYABLE, less current portion	**205,070**	330,322
CAPITAL LEASE OBLIGATIONS, less current portion	**18,825**	17,325
OTHER	**168,624**	145,329
STOCKHOLDERS DEFICIT		
Common stock $.00001 par value; authorized, 10,000,000 shares; issued and outstanding, 6,652,878 shares in 2004 and 6,642,878 shares in 2003	**66**	66

Common stock issuable, 70,257 shares in 2004 and 2003	**57,596**	57,596
Additional paid-in capital	**8,328,004**	8,327,294
Accumulated deficit	**(9,680,163)**	(9,906,169)
Total stockholders deficit	**(1,294,497)**	(1,521,213)
TOTAL	**$ 1,309,370**	$ 1,373,136

See accompanying notes to financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS

Years ended December 31,

	2004	2003
REVENUES		
Access service revenues	**$ 898,973**	$ 990,769
Co-location and other revenues	**1,361,795**	1,131,113
Total revenues	**2,260,768**	2,121,882
OPERATING COSTS AND EXPENSES		
Cost of access service revenues	**231,274**	518,049
Cost of co-location and other revenues	**114,517**	109,914
Selling, general and administrative expenses	**1,279,779**	1,140,905
Loss (gain) on sale of assets	**4,253**	(30,218)
Depreciation and amortization	**403,209**	467,483
Total operating costs and expenses	**2,033,032**	2,206,133
INCOME (LOSS) FROM OPERATIONS	**227,736**	(84,251)
GAIN ON DEBT FORGIVENESS	**163,380**	
INTEREST EXPENSE	**(165,110)**	(594,357)
INCOME (LOSS) before income taxes	**226,006**	(678,608)
Income tax expense (benefit)		
NET INCOME (LOSS)	**$ 226,006**	$ (678,608)
Net income (loss) per common share		
Basic	**$ .03**	$ (.10)
Assuming dilution	**$ .03**	$ (.10)
Weighted average number of common shares outstanding		
Basic	**6,715,718**	6,665,218

Assuming dilution	**7,799,796**	6,665,218

See accompanying notes to financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIT

Years ended December 31, 2004 and 2003

	Common stock		Common stock	Additional paid-in	Accumulated	
	Shares	Amount	issuable	capital	deficit	Total
Balance at January 1, 2003	6,592,878	$ 66	$ 57,596	$ 8,127,293	$ (9,227,561)	$ (1,042,606)
Intrinsic value of beneficial conversion feature on debt				195,385		195,385
Warrants issued related to financing				2,403		2,403
Options issued in exchange for compensation				213		213
Options exercise	50,000			2,000		2,000
Net loss					(678,608)	(678,608)
Balance at December 31, 2003	6,642,878	$ 66	$ 57,596	$ 8,327,294	$ (9,906,169)	$ (1,521,213)
Intrinsic value of beneficial conversion feature on debt				210		210
Stock issued on debt settlement	10,000			500		500
Net income					226,006	226,006
Balance at December 31, 2004	6,652,878	$ 66	$ 57,596	$ 8,328,004	$ (9,680,163)	$ (1,294,497)

See accompanying notes to financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31,

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ 226,006	$ (678,608)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	403,209	467,483
Warrants issued related to financing		2,403
Options and warrants issued for compensation and services		213
Amortization of discount and costs relating to financing	1,757	404,960
Accrued interest converted to equity		
Gain on debt forgiveness	(163,380)	
Loss (gain) on sale of assets	4,253	(30,218)
Provision for uncollectible accounts receivable	60,592	15,822
Net (increase) decrease in		
Accounts receivable	(51,669)	(10,593)
Prepaid expenses and other current assets	(21,646)	(25,547)
Other assets	1,521	8,742
Net increase (decrease) in		
Accounts payable trade	(49,480)	26,731
Accrued and other liabilities	209,240	169,871
Deferred revenue	(12,195)	(141,846)
Net cash provided by operating activities	608,208	209,413
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(205,112)	(45,159)
Proceeds from sale of assets, net of closing costs	8,670	57,262
Acquisition of CWIS assets	(55,920)	
Net cash (used in) provided by investing activities	(252,362)	12,103
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on borrowings under notes payable	(272,118)	(173,046)
Principal payments on note payable to related party	(10,529)	(9,674)
Principal payments on capital lease obligations	(72,453)	(54,271)
Net cash used in financing activities	(355,100)	(236,991)
NET INCREASE (DECREASE) IN CASH	746	(15,475)

Cash at beginning of year	**11,480**	26,955
Cash at end of year	**$ 12,226**	$ 11,480
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for interest	**$ 76,735**	$ 91,826
NONCASH INVESTING AND FINANCING ACTIVITIES		
Assets acquired through issuance of capital lease	**54,992**	2,723
Assets acquired through issuance of note payable		202,200

See accompanying notes to financial statements.

F-5

Table of Contents

FullNet Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2004 and 2003

NOTE A ORGANIZATION AND NATURE OF OPERATIONS

FullNet Communications, Inc. and Subsidiaries (the Company) is an integrated communications provider (ICP) offering integrated communications, Internet connectivity and data storage to individuals, businesses, organizations, educational institutions and governmental agencies. Through its subsidiaries, FullNet, Inc., FullTel, Inc. and FullWeb, Inc., the Company provides high quality, reliable and scalable Internet solutions designed to meet customer needs. Services offered include:

Dial-up and direct high-speed connectivity to the Internet through the FullNet brand name;

Backbone services to private label Internet services providers (ISPs) and businesses;

Carrier-neutral telecommunications premise co-location; and

Web page hosting and server co-location.

The Company operates and grants credit, on an uncollateralized basis. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the Company s customer base and their dispersion across different industries. However, the Company has one primary customer for its carrier-neutral telecommunications premise co-location services.

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles, which contemplate continuation of the Company as a going concern. However, the Company has sustained substantial net losses prior to 2004. In addition, at December 31, 2004 current liabilities exceeded current assets by $2,058,101 and total liabilities exceeded total assets by $1,294,497.

In view of the matters described in the preceding paragraph, the ability of the Company to continue as a going concern is dependent upon continued operations of the Company that in turn is dependent upon the Company s ability to meet its financing requirements on a continuing basis, to maintain present financing, to achieve the objectives of its business plan and to succeed in its 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 the Company be unable to continue in existence.

The Company s business plan includes, among other things, expansion of its Internet access services through mergers and acquisitions and the development of its web hosting and co-location services. Execution of the Company s business plan will require significant capital to fund capital expenditures, working capital needs and debt service. Current cash balances will not be sufficient to fund the Company s current business plan beyond the next few months. As a consequence, the Company is currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. The Company continues to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund the Company s liquidity. There can be no assurance that the Company will be able to obtain additional capital on satisfactory terms, or at all, or on terms that will not dilute the shareholders interests.

NOTE B SUMMARY OF ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows.

Table of Contents

1. Consolidation

The consolidated financial statements include the accounts of FullNet Communications, Inc. and its wholly owned subsidiaries. All material inter-company accounts and transactions have been eliminated.

2. Revenue Recognition

The Company recognizes revenue in accordance with Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* . Access service revenues are recognized on a monthly basis over the life of each contract as services are provided. Contract periods range from monthly to yearly. Carrier-neutral telecommunications co-location revenues are recognized on a monthly basis over the life of the contract as services are provided. Revenue that is billed in advance of the services provided is deferred until the services are provided by the Company. Revenue related to set up charges is also deferred and amortized over the life of the contract.

In June 2004, the Company billed SBC approximately $97,000 for reciprocal compensation (fees for terminating SBC customers local calls onto our network). This is the first reciprocal compensation billing that the Company presented to SBC and it covered the period March 1, 2003 through May 31, 2004. Subsequent to June 2004, and without explanation SBC failed to pay approximately $38,000 of the billing. The Company is pursuing SBC for the balance due, however there is significant uncertainty as to whether or not it will be successful. Consequently, the Company has established a reserve of $38,000 and has not recorded any revenue associated with the reserve. Upon the ultimate resolution of its challenge, the Company will recognize the associated revenue, if any.

On a going forward basis the Company does not believe that reciprocal compensation revenues will be material. The Company recorded $18,000 in revenue for the period of June 1, 2004 through December 31, 2004 and expects to submit this billing to SBC during April 2005.

3. Accounts Receivable

Accounts receivable consist of the following as of December 31:

	2004	2003
Accounts receivable	$ 144,685	$ 54,393
Less allowance for doubtful accounts	(85,473)	(24,883)
	$ 59,212	$ 29,510

Accounts receivable, other than certain large customer accounts which are evaluated individually, are considered past due for purposes of determining the allowance for doubtful accounts as follows:

1 29 days	1.5%
30 59 days	30%
60 89 days	50%
> 90 days	100%

4. Property and Equipment

Property and equipment are stated at cost. Depreciation is computed primarily using the straight-line method over the estimated useful lives of the related assets as follows:

Table of Contents

Software	3 years
Computers and equipment	5 years
Furniture and fixtures	7 years
Leasehold improvements	Shorter of estimated life of improvement or the lease term

5. Intangible Assets

Intangible assets consist primarily of acquired customer bases and covenants not to compete and are carried net of accumulated amortization. Upon initial application of SFAS 142 as of January 1, 2002, the Company reassessed useful lives and began amortizing these intangible assets over their estimated useful lives and in direct relation to any decreases in the acquired customer bases to which they relate. Management believes that such amortization reflects the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up.

6. Long-Lived Assets

The Company follows the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-lived Assets in determining impairment losses on long-term assets. All long-lived assets held and used by the Company, including intangible assets, are reviewed to determine whether any events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The Company bases its evaluation on such impairment indicators as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. If such impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable the Company determines whether an impairment has occurred through the use of an undiscounted cash flows analysis of the asset. If an impairment has occurred, the Company recognizes a loss for the difference between the carrying amount and the estimated value of the asset.

7. Accrued and Other Current Liabilities

Accrued and other current liabilities consist of the following as of December 31:

	2004	2003
Accrued interest	$ 303,058	$ 226,874
Accrued deferred compensation	305,086	261,515
Accrued other liabilities	117,046	59,638
	$ 725,190	$ 548,027

Accrued net deferred compensation consists of the following as of December 31, 2004:

Accrued in:	
2004	$ 43,571
2003	56,793
2000-2002	204,722
	$ 305,086

All of the Company s executive officers have voluntarily agreed to defer a portion of their compensation. This compensation is vested and is subject to payment based upon improvement in the Company s financial condition.

Table of Contents

During 2004, the Board approved a modification of the vacation policy to provide for the accumulation of unused vacation hours earned by the executive officers. At December 31, 2004 the amount of unused vacation earned and payable is $20,977 and is included in accrued other liabilities.

8. Income Taxes

The Company follows the liability method of accounting for income taxes. Under the liability method, deferred income taxes are provided on temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated financial statements and carry forwards that will result in taxable or deductible amounts in future years. Deferred income tax assets or liabilities are determined by applying the presently enacted tax rates and laws. Additionally, the Company provides a valuation allowance on deferred tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

9. Income (loss) per share

Income (loss) per share basic is calculated by dividing net income (loss) by the weighted average number of shares of stock outstanding during the period, including shares issuable without additional consideration. Income per share assuming dilution is calculated by dividing net income by the weighted average number of shares outstanding during the period adjusted for the effect of dilutive potential shares calculated using the treasury stock method.

	2004	2003
Numerator:		
Net income (loss)	$ 226,006	$ (678,608)
Denominator:		
Weighted average shares outstanding basic	6,715,718	6,665,218
Effect of dilutive stock options	244,932	
Effect of dilutive warrants	839,146	
Weighted average shares outstanding assuming dilution	7,799,796	6,665,218
Net income (loss) per share basic	$ .03	$ (.10)
Net income (loss) per share assuming dilution	$ .03	$ (.10)

Stock options exercisable for the purchase of 1,554,588 common stock shares at exercise prices ranging from $.05 to $3.00 per share were outstanding for the year ended December 31, 2004, but were not included in the calculation of income per share assuming dilution because the options were not dilutive.

Warrants exercisable for the purchase of 1,053,248 common stock shares at exercise prices ranging from $.05 to $2.77 per share were outstanding for the year ended December 31, 2004, but were not included in the calculation of income per share assuming dilution because the warrants were not dilutive.

Convertible promissory notes convertible into 1,036,992 common stock shares at conversion prices ranging from $.15 to $.51 per share were outstanding for the year ended December 31, 2004, but were not included in the calculation of income per share assuming dilution because the convertible notes were not dilutive.

Basic and diluted loss per share were the same for the year ended December 31, 2003 because the outstanding convertible promissory notes, stock options and warrants were not dilutive.

Table of Contents

10. Stock Options and Warrants

The Company s employee stock options are accounted for under APB Opinion No. 25 and related interpretations. Had compensation cost for the Company s stock options been determined based on the fair value at the grant dates consistent with the method of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, the Company s net income (loss) and income (loss) per share in 2004 and 2003 would have changed to the pro forma amounts indicated below:

	2004	2003
Net income (loss)		
As reported	$ 226,006	$ (678,608)
Pro forma	$ 178,616	$ (805,030)
Basic income (loss) per share		
As reported	$ .03	$ (.10)
Pro forma	$ .03	$ (.12)
Diluted income (loss) per share		
As reported	$ .03	$ (.10)
Pro forma	$ .02	$ (.12)

The fair value of each option grant prior to February 2000 was estimated on the date of grant using the minimum value method because there was no public trading market for the Company s securities. During February 2000, the Company s common stock began trading on the OTC Bulletin Board under the symbol FULO. The fair values of the options granted subsequent to February 2000 have been estimated at the date of grant using the Black-Scholes option pricing model.

The following weighted average assumptions were used:

	2004	2003
Risk free interest rate	4.5%	4.3%
Expected lives (in years)	5	5
Expected volatility	122.5%	132.5%
Dividend yield	0%	0%

The following table summarizes the Company s employee stock option activity for years ended December 31, 2004 and 2003:

	2004	Weighted Average Exercise Price	2003	Weighted Average Exercise Price
Options outstanding, beginning of year	2,903,366	$ .45	1,589,252	$ .80
Options granted during the year	118,000	.05	1,478,948	.04
Options exercised during the year			(50,000)	.04

Options cancelled during the year	(6,666)		.04	(114,834)		.16
Options outstanding, end of year	3,014,700	$	.43	2,903,366	$	.45
Options exercisable at end of year	2,528,535	$	.51	1,549,258	$	.79
Weighted average fair value of options granted during the year		$	.05		$	.04

Table of Contents

The following table summarizes information about employee stock options outstanding at December 31, 2004:

	Options outstanding				Options exercisable		
Range of exercise prices	Number outstanding at 12/31/04	Weighted-average remaining contractual life	Weighted-average exercise price		Number exercisable at 12/31/2004	Weighted-average exercise price	
$ 0.01 - $ 0.70	2,219,277	8.27 years	$	0.12	1,733,112	$	0.14
$ 1.00 - $ 1.50	671,290	5.85 years	$	1.07	671,290	$	1.07
$ 1.81 - $ 3.00	124,133	5.32 years	$	2.62	124,133	$	0.51
	3,014,700	7.61 years	$	0.43	2,528,535	$	0.51

Common Stock Warrants and Certain Stock Options A summary of common stock purchase warrant and certain stock option activity for the years ended December 31, 2004 and 2003 follows:

Common stock warrants and certain stock options exercisable for 82,375 shares of common stock expired during 2004 (weighted average exercise price $1.71 per share).

Common stock warrants and certain stock options exercisable for 50,000 shares of common stock were issued during 2003 in connection with financing (weighted average exercise price $.01 per share).

Outstanding common stock purchase warrants and certain stock options issued to non-employees outstanding at December 31, 2004 are as follows:

Number of shares	Exercise price	Expiration year
10,000	2.55	2005
70,000	1.00	2005
560,000	.01	2005
436,748	2.00	2006
311,000	1.00	2006
73,500	.13	2006
100,000	.11	2006
456,058	.01	2006
6,000	.12	2007
20,000	.05	2007
50,000	.01	2008
14,000	.10	2012

12,000	.08	2012
2,119,306		

Table of Contents

The following table summarizes the Company s common stock purchase warrant and certain stock option activity for the years ended December 31, 2004 and 2003:

	2004	Weighted Average Exercise Price	2003	Weighted Average Exercise Price
Warrants and certain stock options outstanding, beginning of year	2,201,681	$ .68	2,151,681	$ .68
Warrants and certain stock options issued during the year			50,000	.01
Warrants and certain stock options expired during the year	(82,375)	1.71		
Warrants and certain stock options outstanding, end of year	2,119,306	$ .62	2,201,681	$ .66

11. Advertising

The Company expenses advertising production costs as they are incurred and advertising communication costs the first time the advertising takes place. Advertising expense for the years ended December 31, 2004 and 2003 was $33,218 and $15,546, respectively.

12. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures; accordingly, actual results could differ from those estimates.

13. Recently Issued Accounting Standards

In December 2004, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standard (SFAS) No. 123R *Share-Based Payment.* The standard amends SFAS No. 123 *Accounting for Stock Based Compensation* and supersedes APB No. 25 *Accounting for Stock Issued to Employees.* SFAS No. 123R requires entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. FAS No. 123R eliminates the alternative to use APB Opinion No. 25 s intrinsic value method of accounting that was provided in Statement 123 as originally issued. FAS No. 123R will be effective for the Company for the first interim or annual reporting period beginning after December 31, 2005. As permitted by SFAS No. 123, the Company currently accounts for share-based payments to employees using the APB No. 25 intrinsic value method and recognizes no compensation cost for employee stock options. Accordingly, the provisions of FAS No. 123R will reduce earnings upon adoption. The Company will adopt FAS No. 123R within the prescribed time and is currently reviewing the provisions to determine its impact on the financial statements.

14. Reclassifications

Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation.

Table of Contents

NOTE C PROPERTY AND EQUIPMENT

Property and equipment consist of the following at December 31:

	2004	2003
Computers and equipment	$ 1,172,768	$ 972,866
Leasehold improvements	930,861	921,827
Software	56,512	50,187
Furniture and fixtures	19,153	19,153
	2,179,294	1,964,033
Less accumulated depreciation	(1,188,431)	(968,303)
	$ 990,863	$ 995,730

Depreciation expense for the years ended December 31, 2004 and 2003 was $252,295 and $238,728, respectively.

NOTE D INTANGIBLE ASSETS

Intangible assets consist primarily of acquired customer bases and covenants not to compete and relate to the purchases of certain business operations as follows:

	December 31,	
	2004	2003
CWIS acquisition	$ 41,442	$
LAWTONNET acquisition	65,000	65,000
SONET acquisition	42,547	42,547
IPDatacom acquisition	137,849	137,849
FOT acquisition	93,649	93,649
FOB acquisition	194,780	194,780
FON acquisition	139,650	139,650
Harvest merger	2,009,858	2,009,858
Animus acquisition	318,597	318,597
Tulsa acquisition	70,000	70,000
	3,113,372	3,071,930
Less accumulated amortization	(2,953,362)	(2,802,448)
	$ 160,010	$ 269,482

The Company s previously recognized intangible assets consist primarily of customer bases and covenants not to compete relating to those customer bases. Upon initial application of SFAS 142 as of January 1, 2002, the Company reassessed useful lives and began amortizing these intangible assets over their estimated useful lives and in direct relation to any decreases in the acquired customer bases to which they relate. Management believes that such amortization reflects the pattern in which the economic benefits of the intangible asset are consumed or otherwise used.

Amortization expense for the years ended December 31, 2004 and 2003 relating to intangible assets was $150,914 and $228,755, respectively.

Table of Contents

NOTE E NOTES PAYABLE

During the year ended December 31, 2004, the Company negotiated and settled a note obligation (including accrued interest) in the amount of $28,193. The Company paid $10,000 in cash and issued 10,000 shares of common stock valued at $500. This settlement generated $17,693 of forgiveness of debt income.

Notes payable consist of the following:

	December 31, 2004	December 31, 2003
Three notes payable to a bank, payable in monthly installments aggregating $10,010, including interest ranging from 9.5% to 11.5%, maturing September 2008; collateralized by property and equipment, accounts receivable and Company common stock owned by the founder and CEO of the Company; guaranteed by the founder and CEO of the Company; partially guaranteed by the Small Business Administration	$ 291,390	$ 394,600
Interim loan, interest at 10%, requires payments equal to 50% of the net proceeds received by the Company from its private placement of convertible promissory notes, matured December 2001; unsecured (1)	320,000	320,000
Convertible promissory notes; interest at 12.5% of face amount, payable quarterly; these notes are unsecured and are matured at December 31, 2004 ($510,636 face amount less unamortized discount of $1,439 for 2003); (convertible into approximately 1,003,659 shares at December 31, 2004 and December 31, 2003) (2)	510,636	509,197
Note payable to an individual, payable in monthly installments of $1,277 until paid in full, including interest at a variable rate (prime plus 2.25%; 7.4% at December 31, 2004), matures September 2014; collateralized by substantially all assets acquired in conjunction with the acquisition of Harvest Communications, Inc.	9,580	23,775
Note payable to the Company s founder and CEO, payable in monthly installments of $1,034 including interest at 8.5%, maturing May 2006; unsecured	16,289	26,818
Note payable, interest at 10%, requires monthly installments of $9,330 for 12 months then $18,209 for the remainder of the note, maturing August 2004, secured by a telephone switch (3)		122,818
Other notes payable	26,000	117,959
	1,173,895	1,515,167
Less current portion	968,825	1,184,845

	$	205,070	$	330,322

Table of Contents

(1) This loan and accrued interest of $120,197 was past due on December 31, 2004; the Company has not made payment or negotiated an extension of the loan and the lender has not made any demands.
(2) During 2000 and 2001, the Company issued 11% convertible promissory notes or converted other notes payable or accounts payable to convertible promissory notes in an amount totaling $2,257,624. The terms of the Notes are 36 months with limited prepayment provisions. Each of the Notes may be converted by the holder at any time at $1.00 per common stock share and by the Company upon registration and when the closing price of the Company s common stock has been at or above $3.00 per share for three consecutive trading days. Additionally, the Notes are accompanied by warrants exercisable for the purchase of the number of shares of Company common stock equal to the number obtained by dividing 25% of the face amount of the Notes purchased by $1.00. These warrants are exercisable at any time during the five years following issuance at an exercise price of $.01 per share. Under the terms of the Notes, the Company was required to register the common stock underlying both the Notes and the detached warrants by filing a registration statement with the Securities and Exchange Commission within 45 days following the Final Expiration Date of the Offering (March 31, 2001). On May 31, 2001, the Company exchanged 2,064,528 shares of its common stock and warrants (exercisable for the purchase of 436,748 shares of common stock at $2.00 per share) for convertible promissory notes in the principal amount of $1,746,988 (recorded at $1,283,893) plus accrued interest of $123,414. The warrants expire on May 31, 2006. This exchange was accounted for as an induced debt conversion and a debt conversion expense of $370,308 was recorded.

Pursuant to the provisions of the convertible promissory notes, the conversion price was reduced from $1.00 per share on January 15, 2001 to $.49 per share on December 31, 2004 for failure to register under the Securities Act of 1933, as amended, the common stock underlying the convertible promissory notes and underlying warrants on February 15, 2001. Reductions in conversion price are recognized at the date of reduction by an increase to additional paid-in capital and an increase in the discount on the convertible promissory notes. Furthermore, the interest rate was increased to 12.5% per annum from 11% per annum because the registration statement was not filed before March 1, 2001. At December 31, 2004, the outstanding principal and interest of the convertible promissory notes was $691,047.

On January 1, 2002, the Company recorded 11,815 shares of common stock issuable in payment of $11,815 accrued interest on a portion of the Company s convertible promissory notes.

In November and December 2003 and March 2004, $455,000, $50,000 and $5,636, respectively, of these convertible promissory notes matured. The Company has not made payment nor negotiated an extension of these notes, and the lenders have not made any demands. The Company is currently developing a plan to satisfy these notes subject to the approval of each individual note holder.

(3) During February 2003, upon the receipt and installation of a telephone switch the Company made a down payment of $14,950. The remaining balance of $202,200 was financed by the supplier at 10% interest to be paid in 18 monthly payments beginning in March 2003.

Aggregate future maturities of notes payable at December 31, 2004 are as follows:

Year ending December 31	
2005	$ 968,825
2006	107,621
2007	96,070
2008	1,379
2009	
	$ 1,173,895

Table of Contents

NOTE F LEASE AGREEMENTS

Capital Lease

The Company has one capital lease for equipment. The lease term is for 36 months and the annual lease rental payment including applicable taxes is $17,976.

The property and equipment accounts include $50,000 and $138,428 for leases that have been capitalized at December 31, 2004 and 2003, respectively. Related accumulated amortization amounted to $8,333 and $56,095 at December 31, 2004 and 2003, respectively.

The schedule of future minimum lease payments below reflects all payments under the capital lease in effect at December 31, 2004.

Year ending December 31	
2005	$ 16,584
2006	$ 16,584
2007	4,146
Total minimum lease payments	$ 37,314
Less amount representing interest	5,728
Present value of net minimum lease payments	$ 31,586
Less current portion	12,761
Long-term capital lease obligations	$ 18,825

Operating Leases

The Company leases certain office facilities used in its operations under non-cancelable operating leases expiring in 2009. Future minimum lease payments required at December 31, 2004 under non-cancelable operating leases that have initial lease terms exceeding one year are presented in the following table:

Year ending December 31	
2005	$ 170,284
2006	176,807
2007	183,330
2008	189,853
2009	196,376
	$ 916,650

Rental expense for all operating leases for the years ended December 31, 2004 and 2003 was approximately $159,774 and $163,125, respectively.

The Company s long-term non-cancelable operating lease includes scheduled base rental increases over the term of the lease. The total amount of the base rental payments is charged to expense on the straight-line method over the term of the lease. The Company has recorded a deferred credit of $84,727 and $82,103 at December 31, 2004 and 2003, respectively, which is reflected in Other Long-term Liabilities on the Balance Sheet to reflect the net excess of rental expense over cash payments since inception of the lease. In addition to the base rent payments the Company pays a monthly allocation of the building s operating expenses.

Table of Contents

NOTE G INCOME TAXES

The Company s effective income tax rate on net loss differed from the federal statutory rate of 34% as follows at December 31:

	2004	2003
Income taxes at federal statutory rate	$ 79,000	$ (230,000)
Change in valuation allowance	(70,000)	101,000
Nondeductible expenses	3,000	155,000
State income taxes, net of federal benefit	9,000	(38,000)
Effect of graduated rates	(5,000)	
Other	(16,000)	12,000
Total tax expense	$	$

The components of deferred income tax assets were as follows at December 31:

	2004	2003
Deferred income tax assets		
Basis difference in property and equipment and intangible assets	$ 364,000	$ 318,000
Deferred revenue	71,000	137,000
Net operating loss	1,001,000	1,090,000
Deferred compensation and other	148,000	109,000
Valuation allowance	(1,584,000)	(1,654,000)
Net deferred income tax asset	$	$
Change in valuation allowance	$ (70,000)	$ 101,000

A valuation allowance is provided for deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized. At December 31, 2004, the Company has a net operating loss carry forward of approximately $2,600,000 that will expire at various dates through 2021. As such carry forward can only be used to offset future taxable income of the Company, management has provided a valuation allowance until it is more likely than not that taxable income will be generated.

NOTE H STOCKHOLDERS DEFICIT

Common Stock In September 2004, as part of a settlement of a $28,193 note payable (including accrued interest), the Company issued 10,000 shares of common stock.

Options for 50,000 shares of the Company s common stock were exercised in December 2003 for $2,000.

NOTE I RELATED PARTY TRANSACTIONS

The Company is in default on an operating lease for certain equipment which is leased from one of its significant shareholders who also holds a $320,000 interim loan which is also in default (see Note E Notes Payable). The original lease was dated November 21, 2001 and the terms were $6,088 per month for 12 months with a fair market purchase option at the end of the lease. Upon default on the lease, the Company was allowed to continue leasing the equipment on a month-to-month basis at the same monthly rate as the original lease. The Company has been unable to make the month-to-month payments and at December 31, 2004 had recorded $145,921 in unpaid lease payments. The lessor has not made any demands.

Table of Contents

In connection with his employment, during October 2003, the Company issued stock options exercisable for the purchase of 452,000 shares of common stock to the founder and CEO of the Company of which 120,000 options were 100% vested and exercisable immediately and 182,000 options vested and became exercisable in November 2004. The remaining 150,000 options will vest and become exercisable one-third on each of the first three anniversary dates of the issuance. These options have an exercise price of $.04 per share and expire during October 2013.

In connection with his employment, during October 2003, the Company issued stock options exercisable for the purchase of 370,848 shares of common stock to the President and CFO of the Company of which 34,651 options were 100% vested and exercisable immediately and 261,197 options vested and became exercisable in November 2004. The remaining 75,000 options will vest and become exercisable one-third on each of the first three anniversary dates of the issuance. These options had an exercise price of $.04 per share and expire during October 2013.

In connection with his employment, during December 2003, the Company issued stock options exercisable for the purchase of 50,000 shares of common stock to the President and CFO of the Company that were 100% vested and exercisable immediately. These options had an exercise price of $.04 per share and expire during March 2012. Subsequently, the President and CFO exercised these options for $2,000.

In connection with his employment, during March 2002, the Company issued stock options exercisable for the purchase of 80,000 shares of common stock to the founder and CEO of the Company that were one-third vested and exercisable immediately and will vest and become exercisable one-third on each annual anniversary of the issue. These options have an exercise price of $.05 per share and expire during March 2012.

In connection with his employment, during March 2002, the Company issued stock options exercisable for the purchase of 60,000 shares of common stock to one of its officers and directors that were one-third vested and exercisable immediately and will vest and become exercisable one-third on each annual anniversary of the issue. These options have an exercise price of $.05 per share and expire during March 2012.

On August 2, 2000, the Company obtained a short-term loan of $100,000 from its founder and CEO through the issuance of a 14% promissory note. The terms of the financing additionally provided for the issuance of five-year warrants exercisable for the purchase of 50,000 shares of the Company s common stock at $.01 per share, and provided for certain registration rights. The promissory note required monthly interest payments, matured on the earlier of (i) the date which is within five days of receipt of funds by the Company of any offering raising gross proceeds to the Company of at least $1,000,000 or (ii) in three months, and was extendible for two 90-day periods upon issuance of additional warrants exercisable for the purchase of 50,000 shares of the Company s common stock exercisable at $.01 per share for each extension. In the fourth quarter of 2000, the Company s founder and CEO agreed to reduce the interest rate on the promissory note to 9% and waive the warrant provisions relating to extensions of the loan. The Company repaid $50,000 on this note during 2000 and the note was due in May 2001. In May 2001 the Company s founder and CEO agreed to a replacement note with an interest rate of 8.5% with monthly principal and interest payments and the note is due in May 2006.

Table of Contents

NOTE L FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company s financial instruments are held for purposes other than trading. The estimated fair value of notes payable is the discounted amount of future cash flows using the estimated current rate for similar borrowings.

	2004		2003	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial liabilities				
Notes payable	$ 1,174,000	$ 1,088,000	$ 1,515,000	$ 1,406,000

NOTE M SIGNIFICANT CUSTOMER

During the years ended December 31, 2004 and 2003, the Company had one customer that comprised approximately 30% and 33%, respectively, of total revenues. The contract pursuant to which the Company provides services to this customer expires on December 31, 2005. The customer has notified the Company that they will not renew their contract. Therefore the Company will experience a loss of this revenue without a corresponding reduction in expense.

NOTE N CREDITOR SETTLEMENTS AND DEBT FORGIVENESS

During the year ended December 31, 2004, the Company negotiated and settled the following liabilities for less than their carrying values. The basic and diluted per share amount of the aggregate gain on debt forgiveness for the year ended December 31, 2004 was $.02.

	Carrying Value	Settlement Amount	Gain
Notes payable including accrued interest	$ 96,208	$ 36,536	$ 59,672
Accounts payable	115,519	17,474	98,045
Accrued liabilities	5,663		5,663
Total	$ 217,390	$ 54,010	$ 163,380

NOTE O ACQUISITION

On July 30, 2004, the Company purchased approximately 1,300 of the dial-up Internet access customers of CWIS Internet Services, Inc. (CWIS), an Oklahoma corporation. In addition to paying $25,000 at closing, the Company will pay CWIS an amount based upon the future collected revenues received from all active CWIS customers transferred at the time of closing for eighteen months following the closing. The aggregate purchase price has been allocated to the underlying net assets purchased, including an intangible asset, which consists of the acquired customer base, based on their estimated fair values at the acquisition date. The intangible asset is being amortized based on decreases of the acquired customer base. As of December 31, 2004 an additional $30,920 had been paid based on collected revenues and was recorded as an increase to the intangible asset.

NOTE P CONTINGENCIES

As a telecommunications company, the Company is affected by regulatory proceedings in the ordinary course of its business at the state and federal levels. These include proceedings before both the Federal Communications Commission and the Oklahoma Corporation Commission (OCC). For example, the Company along with many

Table of Contents

other telecommunications companies in Oklahoma is currently a party to one or more proceeding before the OCC relating to the terms of its interconnection agreement with SBC Communications and an anticipated successor to this interconnection agreement. These proceedings were initiated due to the unreasonable changes that SBC was proposing be incorporated in the successor interconnection agreement. The regulatory proceeding concerning the terms of the Company s interconnection agreement with SBC Communication, which is based upon their standard interconnection agreement, and the anticipated successor thereto is ongoing and is not expected to conclude until early next year. The Company cannot anticipate the outcome of this regulatory proceeding at this time but a negative outcome with any of these regulatory proceedings could have a material adverse effect on its business, financial condition or results of operations.