

SITESTAR CORP
Form 10QSB
August 20, 2003

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

FORM 10-QSB

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

For the quarterly period ended June 30, 2003

[]
TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____

000-27763

(Commission file number)

SITESTAR CORPORATION

(Exact name of small business issuer as specified in its charter)

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NEVADA

(State or other jurisdiction of
incorporation or organization)

88-0397234

(I.R.S. Employer Identification No.)

7109 Timberlake Road, Lynchburg, VA 24502

(Address of principal executive offices)

(434) 239-4272

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the 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 No

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity. As of June 30, 2003:
101,593,147 shares of Common Stock

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

#

SITESTAR CORPORATION

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PART I.

FINANCIAL INFORMATION

Item 1.

Financial Statements

SITESTAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

JUNE 30, 2003

ASSETS

CURRENT ASSETS

Cash and cash equivalents

\$

14,061

Accounts receivable, net of allowance of \$514,052

84,093

Inventory

143,246

Total current assets

241,400

PROPERTY AND EQUIPMENT, net

373,961

CUSTOMER LIST, net

734,258

GOODWILL

1,122,719

OTHER ASSETS

13,641

TOTAL ASSETS

\$ 2,485,979

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SITESTAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET, Continued

JUNE 30, 2003

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES

Bank overdraft

\$

52,102

Accounts payable and accrued expenses

395,406

Deferred revenue

328,098

Convertible debenture

139,412

Note payable stockholders, current portion

668,906

Notes payable, current portion

296,807

Capital lease obligations

3,515

Total current liabilities

1,884,246

NOTES PAYABLE STOCKHOLDERS, less current portion

445,628

NOTES PAYABLE, less current portion

102,458

TOTAL LIABILITIES

2,432,332

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY

Preferred Stock, \$.001 par value, 10,000,000 shares

authorized, 0 shares issued and outstanding

-

Common Stock, \$.001 par value, 300,000,000 shares

authorized, 101,593,147 shares issued and 69,109,801 outstanding

101,593

Additional paid-in capital

13,635,272

Treasury stock, 32,483,346 common shares, at cost

(681,854)

Accumulated deficit

(13,001,364)

Total stockholders' equity

53,647

TOTAL LIABILITIES AND

STOCKHOLDERS' EQUITY

\$ 2,485,979

See the accompanying notes to the consolidated financial statements

SITESTAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED JUNE 30, 2003 AND 2002

	<u>2003</u>	<u>2002</u>
REVENUE	\$ 966,164	\$ 995,682
COST OF REVENUE	<u>448,643</u>	<u>542,024</u>
GROSS PROFIT	517,521	453,658
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	<u>427,442</u>	<u>529,611</u>
INCOME (LOSS) FROM OPERATIONS	90,079	(75,953)
OTHER INCOME (EXPENSES)		
Other income	-	2,016
Interest expense	<u>(66,471)</u>	<u>(49,833)</u>
INCOME (LOSS) BEFORE INCOME TAXES	23,608	(123,770)
INCOME TAXES	<u>-</u>	<u>-</u>
NET INCOME (LOSS)	<u>\$ 23,608</u>	<u>\$ (123,770)</u>

BASIC AND DILUTED LOSS PER SHARE	\$ <u>0.00</u>	\$ <u>(0.00)</u>
WEIGHTED AVERAGE SHARES		
OUTSTANDING - BASIC AND DILUTED	<u>101,593,147</u>	<u>98,624,892</u>

See the accompanying notes to the consolidated financial statements

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SITESTAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE SIX MONTHS ENDED JUNE 30, 2003 AND 2002

	<u>2003</u>	<u>2002</u>
REVENUE	\$1,860,076	\$2,130,914
COST OF REVENUE	<u>887,708</u>	<u>1,070,189</u>

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GROSS PROFIT	972,368	1,060,725
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	<u>845,800</u>	<u>1,166,064</u>
INCOME (LOSS) FROM OPERATIONS	126,568	(105,339)
OTHER INCOME (EXPENSES)		
Other income	-	2,016
Interest expense	<u>(153,000)</u>	<u>(104,306)</u>
INCOME (LOSS) BEFORE INCOME TAXES	(26,432)	(207,629)
INCOME TAXES	<u>-</u>	<u>-</u>
NET INCOME (LOSS)	<u>\$ (26,432)</u>	<u>\$ (207,629)</u>
BASIC AND DILUTED LOSS PER SHARE	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>
WEIGHTED AVERAGE SHARES		
OUTSTANDING - BASIC AND DILUTED	<u>101,593,147</u>	<u>98,372,064</u>

See the accompanying notes to the consolidated financial statements

SITESTAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2003 AND 2002

	<u>2003</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ (26,432)	\$ (207,629)
Adjustments to reconcile net loss to net		
cash provided by operating activities:		
Depreciation and amortization expense	228,750	237,297
Stock issued in lieu of compensation		
and professional fees	-	125,000
(Increase) decrease in:		
Accounts receivable	55,137	58,103
Inventory	(15,356)	(4,950)
Other assets	-	(21,308)
Increase (decrease) in:		
Accounts payable and accrued expenses	87,373	8,011
Deferred revenue	<u>(36,076)</u>	<u>48,531</u>
Net cash provided by operating activities	<u>293,396</u>	<u>243,055</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(6,517)	(24,231)
Purchase of investments	<u>-</u>	<u>(35,500)</u>
Net cash used in investing activities	<u>(6,517)</u>	<u>(59,731)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		

Net change in line of credit	-	(2,316)
Net change in bank overdraft	(12,853)	
Net proceeds from notes payable stockholders	31,550	-
Repayment of notes payable	(122,048)	(59,124)
Repayment of convertible debenture	-	(325,000)
Repayment of notes payable stockholders	(191,066)	(55,340)
Payment on capital lease obligation	<u>(10,484)</u>	<u>(21,577)</u>
Net cash used in financing activities	<u>(304,901)</u>	<u>(463,357)</u>
NET DECREASE IN CASH		
AND CASH EQUIVALENTS	(18,022)	(280,033)
CASH AND CASH EQUIVALENTS		
BEGINNING OF PERIOD	<u>32,083</u>	<u>378,707</u>
CASH AND CASH EQUIVALENTS		
END OF PERIOD	<u>\$ 14,061</u>	<u>\$ 98,674</u>

See the accompanying notes to the consolidated financial statements

SITESTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2003 AND 2002 (continued)

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

During the six months ended June 30, 2003 and 2002, the Company paid no income taxes and interest of approximately \$153,000 and \$104,306, respectively.

NON-CASH INVESTING AND FINANCING TRANSACTIONS:

During the six months ended June 30, 2002, the Company issued 3,720,238 shares of common stock for executive compensation of \$ 125,000 and issued 2,000,000 shares of common stock to the original Sitestar.net shareholders that represented the contingent shares to be issued if no additional liabilities arose during the first two years after the acquisition. The value of these shares issued was \$60,000 which is recorded as additional goodwill.

See the accompanying notes to the consolidated financial statements

SITESTAR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

The unaudited Condensed Consolidated Financial Statements have been prepared by Sitestar Corporation (the Company or Sitestar), pursuant to the rules and regulations of the Securities and Exchange Commission. The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments) which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally present in annual consolidated financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the audited consolidated financial statements and footnotes for the year ended December 31, 2002 included in the Company s Annual Report on Form 10-KSB. The

results of the three months and six months ended June 30, 2003 are not necessarily indicative of the results to be expected for the full year ending December 31, 2003.

Certain expenses previously reported in the financial statements for the quarter ended March 31, 2003 have been reclassified to conform to the three and six month periods ended June 30, 2003 financial statement presentation.

NOTE 2 EARNINGS PER SHARE

In 1997, the Financial Accounting Standard Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share." SFAS No. 128 replaced the previously reported primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants, and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. Basic earnings per share is computed using the weighted-average number of common shares outstanding during the period. Common equivalent shares are excluded from the computation if their effect is anti-dilutive.

NOTE 3 CONVERTIBLE DEBENTURE

On May 11, 2000, the Company issued two convertible debentures aggregating \$500,000. The debentures bear interest at 12% per annum and were due on May 1, 2001. The debenture holders voluntarily decided to hold on to the debentures. The debentures are convertible into shares of the Company's common stock at a rate equal to the lowest of \$.70 or 60% of the average of the three lowest closing bid prices for the Company's common stock during the 20 trading days immediately preceding the conversion date. In addition, the Company also issued three-year warrants to purchase an aggregate of 250,000 shares of common stock at an initial exercise price of \$0.77 per share. Due to the preferential conversion feature of these debentures the Company recognized a financing charge of \$242,857 (which represents the value of additional shares issuable upon conversion at the \$.70 conversion price versus the number of shares issuable upon conversion at the market value at the date of issuance). In addition, the warrants issued in connection with these debentures have been valued at \$121,543 using the Black-Scholes model. Since these debentures were convertible on issuance preferential conversion costs were expensed immediately and the value of the warrant was recognized as financing costs over the term of the debentures.

On August 14, 2000, the Company issued two additional convertible debentures aggregating \$500,000 to the holders of the above-mentioned debentures for the same terms described above, except for the due date of August 14, 2001.

In connection with these debentures, the Company recognized a financing charge in 2000 in connection with the preferential conversion feature of \$333,333 and valued the 250,000 warrants issued in connection with these debentures at \$13,332 using the Black-Scholes model. Since these debentures were convertible on issuance the preferential conversion costs were expensed immediately and the value of the options was recognized as financing costs over the term of the debentures.

During the six months ended June 30, 2003, the holders of the debentures converted no shares of the Company's common stock.

On a cumulative basis through June 30, 2003, the holders of the debentures converted \$525,588 of principal and \$99,820 of accrued interest into 14,319,156 and 5,176,352, respectively, shares of the Company's common stock. Also as of June 30, 2003, the Company has repaid \$335,000 of these debentures in cash.

As of June 30, 2003, the convertible debentures are past their maturity and callable at any time by the debenture holders. The debenture holders have served notice to the Company that the convertible debentures are in default.

As of June 30, 2003, there is a discrepancy between the balance maintained by the Company and the balance calculated by the debenture holders. The balance the Company has disclosed in its consolidated financial statements is derived from all the conversion notices and cash payments.

The Company believes that it has proper documentation to support its position in this matter; however, in the event the Company is not successful in reconciling and resolving this matter, the outstanding balance of the convertible debenture could increase significantly. As of June 30, 2003, the Company has disclosed that the outstanding principal balance is \$139,412. This outstanding balance could increase to over \$300,000 if the debenture holders are able to demonstrate that their balance is the correct balance.

On December 31, 2002, the debenture holders filed a complaint against the Company alleging breach of contract and breach of fiduciary duties. Management intends to vigorously contest the allegations. It is too early to make an evaluation of the matter as to outcome and potential loss, if any, although damages are alleged at approximately \$425,000.

SITESTAR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, continued

NOTE 4 COMMON STOCK

During the three months and six months ended June 30, 2003, the Company issued no shares of common stock.

NOTE 5 SEGMENT INFORMATION

The Company has four business units that have separate management and reporting infrastructures that offer different products and services. The business units have been aggregated into four reportable segments: Corporate, Internet, Development and Retail. The Corporate group is the holding company and oversees the operating of the other business units. The Corporate group also arranges financing for the entire organization. The Internet group provides Internet access to customers in the Martinsville and Lynchburg, Virginia and Mt. Airy, North Carolina areas. The Development group provides customer software programming to companies, principally in the manufacturing industries. The Retail group operates a retail computer store in Lynchburg, Virginia and in Mt. Airy, North Carolina as well as providing toner cartridge remanufacturing services in Lynchburg, Virginia. (<http://www.recharge.net>)

The Company evaluates the performance of its operating segments based on income from operations, before income taxes, accounting changes, non-recurring items, and interest income and expense.

Summarized financial information concerning the Company's reportable segments is shown in the following table for the six months ended June 30, 2003 and 2002:

June 30, 2003

Corporate

Internet

Development

Retail

Consolidated

Revenue

\$

-

\$

1,571,605

\$

67,557

\$

220,914

\$

1,860,076

Operating income (loss)

\$

(71,565)

\$

174,233

\$

(4,340)

\$

28,241

\$

126,569

Depreciation and
amortization

\$

-

\$

227,195

\$

-

\$

1,555

\$

228,750

Interest expense

\$

(41,909)

\$

(111,018)

\$

-

\$

(74)

\$

(153,000)

Intangible assets

\$

-

\$

1,870,618

\$

-

- \$

1,870,618

Identifiable assets

\$

-

\$

2,346,761

\$

-

\$

139,217

\$

2,485,978

June 30, 2002

Corporate

Internet

Development

Retail

Consolidated

Revenue

\$

-

\$

1,692,223

\$

144,861

\$

293,830

\$

2,130,914

Operating Income (loss)

\$

(415,863)

\$

249,727

\$

9,573

\$

51,224

\$

(105,339)

Depreciation and
amortization

\$

2,639

\$

226,202

\$

6,516

\$

1,940

\$

237,297

Interest expense

\$

(12,014)

\$

(92,292)

\$

-

\$

-

\$

(104,306)

Intangible assets

\$ -

\$

3,423,092

\$ -

\$ -

\$

3,423,092

Identifiable assets

\$ 334,247

\$

4,106,180

\$

28,880

\$

165,317

\$

4,634,624

SITESTAR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, continued

NOTE 6 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Recently Issued Accounting Pronouncements

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Instruments with Characteristics of both Liabilities and Equity." SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or as an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company's financial instruments outstanding on June 30, 2003 are grandfathered in under the then existing standards. This statement also does not affect the classification or measurement of convertible bonds, puttable stock, or other outstanding shares that are conditionally redeemable.

In June 2001, the FASB issued SFAS No. 141, "Business Combinations." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Goodwill and certain intangible assets will remain on the balance sheet and not be amortized. On an annual basis, and when there is reason to suspect that their values have been diminished or impaired, these assets must be tested for impairment, and writedowns may be necessary. The Company adopted SFAS No. 141 on July 1, 2001 and has accounted for its acquisition of Advanced Internet Services, Inc. and the assets of Digital Data Connections, Inc. using the purchase method.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 changed the accounting for goodwill from an amortization method to an impairment-only approach. Amortization of goodwill, including goodwill recorded in past business combinations, ceased upon adoption of this statement on January 1, 2002. Further, the Company did not amortize the goodwill established as a result of the acquisition of Advanced Internet Services, Inc. on July 1, 2001.

In October 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which requires companies to record the fair value of a liability for asset retirement obligations in the period in which they are incurred. The statement applies to a company's legal obligations associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, and development or through the normal operation of a long-lived asset. When a liability is initially recorded, the company would capitalize the cost, thereby increasing the carrying amount of the related asset. The capitalized asset retirement cost is depreciated over the life of the respective asset while the liability is accreted to its present value. Upon settlement of the liability, the obligation is settled at its

recorded amount or the company incurs a gain or loss. The statement is effective for fiscal years beginning after June 30, 2002. The Company does not expect the adoption to have a material impact on the Company's financial position or results of operations.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Statement 144 addresses the accounting and reporting for the impairment or disposal of long-lived assets. The statement provides a single accounting model for long-lived assets to be disposed of. New criteria must be met to classify the asset as being held-for-sale. This statement also establishes standards for reporting the effects of a disposal of a segment of a business. This statement is effective for fiscal years beginning after December 15, 2001.

SITESTAR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, continued

NOTE 6 RECENTLY ISSUED ACCOUNTING PRONCEMENTS, continued

In April 2002, the FASB issued Statement No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. This Statement rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements and FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers. This Statement amends FASB Statement No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The Company does not expect the adoption to have a material impact to the Company's financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. This statement nullifies Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). This

statement requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred instead of at the date an entity commits to an exit plan. The statement is effective for exit and disposal activities entered into after December 31, 2002. The Company does not expect the adoption of this statement to have a material impact on its financial position or the results of its operations.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. This interpretation sets forth expanded disclosure requirements in the financial statements about a guarantor's obligations under certain guarantees that it has issued. It also clarifies that, under certain circumstances, a guarantor is required to recognize a liability for the fair value of the obligation at the inception of the guarantee. Certain types of guarantees, such as product warranties, guarantees accounted for as derivatives, and guarantees related to parent-subsidary relationships are excluded from the liability recognition provisions of Interpretation No. 45, however, they are subject to the disclosure requirements.

The initial liability recognition provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements of Interpretation No. 45 are effective for financial statements for interim or annual periods ending after December 15, 2002. The Company has no guarantees of third party indebtedness and it does not believe the adoption of these new rules will have a material impact on its financial position or results of operations.

SITESTAR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, continued

NOTE 6 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS, continued

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123. This statement amends SFAS 123, Accounting for Stock-Based Compensation to allow for alternative methods of transition for a voluntary change to the fair value based method of accounting for stock issued to team members. This statement also amends FASB No. 123 to require disclosure of the accounting method used for valuation in both annual and interim financial statements. This statement permits an entity to recognize compensation expense under the prospective method, modified prospective method or the retroactive restatement method. If an entity elects to adopt this statement, fiscal years beginning after December 15, 2003 must include this change in accounting for stock-based team member compensation. The Company is currently evaluating the effect of voluntarily adopting the fair value provisions of SFAS No. 123 and will elect a transition method if the fair value method is adopted.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51, Consolidated Financial Statements. Interpretation No. 46 prescribes how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. This interpretation requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. Interpretation No. 46 is effective immediately for variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. The interpretation applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Company does not have interests in variable Interest entities and it does not believe the adoption of Interpretation No. 46 will have a material impact on its financial position or results of operations.

In November 2002, the Emerging Issues Task Force reached a consensus on Issue No. 00-21 ("EITF 00-21"), "Revenue Arrangements with Multiple Deliverables." EITF 00-21 provides guidance on how to account for Arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company does not believe the adoption of EITF 00-21 will have a material impact on its financial position or results of operations.

NOTE 7 PRIOR INTERIM PERIOD ADJUSTMENT

During the three months ended June 30, 2003 an adjustment was posted to the Company's accumulated deficit as of March 31, 2003 to properly recognize revenue and to properly state accounts receivable. The effects of these adjustments have been incorporated in the financial statements presented for the six months ended June 30, 2003. Accounts receivable and revenue were both overstated by \$264,208 as of and for the quarter ended March 31, 2003. These adjustments decreased net income for the three months ended March 31, 2003 from net income of \$214,168 to net loss of \$50,040 and as of March 31, 2003 accounts receivable decreased \$264,208 from \$607,693 to \$343,485 before allowances for doubtful accounts. Accumulated deficit increased by \$264,208 from \$12,760,764 to \$13,024,972 as of March 31, 2003. There was no material effect on basic and diluted earnings or loss per share.

General

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related footnotes for the year ended December 31, 2002 included in our Annual Report on Form 10-KSB. The discussion of results, causes and trends should not be construed to imply any conclusion that such results or trends will necessarily continue in the future.

Overview

We are a mid-Atlantic Internet Service Provider and Computer Services company offering a broad range of services to business and residential customers. We serve primarily the Virginia and North Carolina markets. We utilize our own infrastructure and have affiliations that allow us to expand our network and services to most of the United States and Canada.

The products and services we provide include:

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Internet access services;

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Web design services;

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Web hosting services;

.

End-to-end e-commerce solutions;

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Online marketing consulting;

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Computer and related products sales and services;

Toner and ink cartridge remanufacturing services; and

Computer programming and consulting services.

Our Internet Service Provider (ISP) division has three sites of operation (<http://www.sitestar.net>, <http://www.lynchburg.net>, <http://www.advi.net>). These are located in Lynchburg, Virginia, Martinsville, Virginia and Mt. Airy, North Carolina. We provide both narrow-band (dial-up) services and broadband services (ISDN, DSL, satellite, cable and wireless) utilizing our own infrastructure and affiliations to provide services to thousands of service locations throughout the United States. Our web design, web hosting and related services provide a way to help businesses market their products and services over the Internet.

Our Computer Sales and Service division (<http://www.computersbydesign.com>) also provides sales and services out of our three office locations. We sell and manufacture computer systems, computer hardware, computer software, networking services, repair services and toner and ink cartridge remanufacturing services. We are a factory authorized service center for many national-brand computer equipment companies. Our toner and ink cartridge remanufacturing service (<http://www.recharge.net>) takes empty toner cartridges and remanufactures them to provide savings to our customers over buying brand new cartridges. This service is available locally and nationwide.

Our computer programming and consulting services helps companies automate their businesses. Our primary focus is providing software and programming services for the manufacturing industry. Our flagship product is a software package called Sales Force Automation (SFA).

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The following tables show financial data for the six months ended June 30, 2003 and 2002. Operating results for any period are not necessarily indicative of results for any future period.

	<u>For the six months ended June 30, 2003</u>				
	<u>Corporate</u>	<u>Internet</u>	<u>Development</u>	<u>Retail</u>	<u>Total</u>
Revenue	-	\$1,571,605	\$67,557	\$220,914	\$1,860,076
Cost of Revenue	-	678,896	71,897	136,915	887,708
	-----	-----	-----	-----	-----
Gross profit	-	892,709	(4,340)	83,999	972,368
Operating expenses	71,565	718,475	-	55,759	845,799
	-----	-----	-----	-----	-----
Income (loss) from operations	(71,565)	174,234	(4,340)	28,240	126,569
Other income (expense)	(41,909)	(111,018)	-	(74)	(153,000)
	-----	-----	-----	-----	-----
Net income (loss)	\$(113,474)	\$63,216	\$(4,340)	\$28,166	\$(26,432)
	=====	=====	=====	=====	=====
EBITDA(1)	\$(71,565)	\$401,428	\$(4,340)	\$29,796	\$355,319
Corporate expenses paid					
With common stock	-	-	-	-	-
	-----	-----	-----	-----	-----
Actual cash generated	\$(71,565)	\$401,428	\$(4,340)	\$29,796	\$355,319
	=====	=====	=====	=====	=====

	<u>For the six months ended June 30, 2002</u>				
	<u>Corporate</u>	<u>Internet</u>	<u>Development</u>	<u>Retail</u>	<u>Total</u>
Revenue	-	\$1,692,223	\$144,861	\$293,830	\$2,130,914
Cost of Revenue	-	811,903	76,429	181,857	1,070,189
	-----	-----	-----	-----	-----
Gross profit	-	880,320	68,432	111,973	1,060,725
Operating expenses	415,863	630,593	58,859	60,749	1,166,064
	-----	-----	-----	-----	-----
Income (loss) from operations	(415,863)	249,727	9,573	51,224	(105,339)
Other income (expense)	(10,105)	(92,046)	(180)	41	(102,290)
	-----	-----	-----	-----	-----
Net income (loss)	\$(425,968)	\$157,681	\$9,393	\$51,265	\$(207,629)
	=====	=====	=====	=====	=====

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EBITDA(1)	\$(413,224)	\$475,924	\$16,089	\$53,164	\$131,953
Corporate expenses paid					
With common stock	125,000	-	-	-	125,000
	-----	-----	-----	-----	-----
Actual cash generated	\$(288,224)	\$475,924	\$16,089	\$53,164	\$256,953
	=====	=====	=====	=====	=====

(1)

EBITDA (earnings before interest, taxes, depreciation and amortization) consists of revenue less cost of revenue and operating expense. EBITDA is provided because it is a measure commonly used by investors to analyze and compare companies on the basis of operating performance. EBITDA is presented to enhance an understanding of our operating results and is not intended to represent cash flows or results of operations in accordance with GAAP for the periods indicated. EBITDA is not a measurement under GAAP and is not necessarily comparable with similarly titled measures for other companies. See Liquidity and Capital Resources section for further discussion of cash generated from operations.

SIX MONTHS ENDED JUNE 30, 2003 COMPARED TO JUNE 30, 2002

REVENUE. Revenue for the six months ended June 30, 2003 decreased by \$270,838 or 12.7% from \$2,130,914 for the six months ended June 30, 2002 to \$1,860,076 for the same period in 2003. This decrease is a result of price decreases in certain markets in order to make us more competitive with our competition and to standardize our rates across our different ISP locations, offset in part by the acquisition of Digital Data Connections customer base. Retail and Development sales for the six months ended June 30, 2003 decreased by \$72,916 and \$77,304 or 24.8% and 53.4% from \$293,830 and \$144,861 for the six months ended June 30, 2002 to \$220,914 and \$67,557 for the same period ended in 2003. Retail revenue decreased due primarily to soft economic conditions while Development revenue decreased due to applications of resources to new internal projects.

COST OF REVENUE. Costs of revenue for the six months ended June 30, 2003 decreased by \$182,481 or 17.1% from \$1,070,189 for the six months ended June 30, 2002 to \$887,708 for the same period in 2003. As a percentage of revenue the cost of revenue decreased from 50.2% to 47.7%. The decrease compared to the six months ended June 30, 2002 and as a percentage of revenue are principally due to cost control measures.

OPERATING EXPENSES. Operating expenses for the six months ended June 30, 2003 decreased by \$320,264 or 27.5% from \$1,166,064 for the six months ended June 30, 2002 to \$845,800 for the same period in 2003. In the fourth quarter of 2002, the operations of the corporate office in California were closed and transferred to the Virginia facilities. Corporate operations under new management resulted in a decrease of \$344,298 of occupancy, payroll and executive costs.

INTEREST EXPENSE. Interest expense for the six months ended June 30, 2003 increased by \$48,694 or 46.7% from \$104,306 for the six months ended June 30, 2002 to \$153,000 for the same period in 2003. This increase is a result of increased levels of borrowing.

EBITDA. EBITDA for the six months ended June 30, 2003 increased by \$223,366 from \$131,953 for the six months ended June 30, 2002 to \$355,319 for the same period in 2003. The primary reason for the increase is the Corporate division's increase of \$341,659 due to the closing the California office and the related occupancy, payroll and executive expenses.

BALANCE SHEET. Goodwill on June 30, 2003 decreased by \$1,350,000 due to the write down, for the year ended December 31, 2002, in accordance with SFAS No. 142. Accounts receivable decreased by \$55,137 on June 30, 2003 from \$139,229 on December 31, 2002 to \$84,093 on June 30, 2003. The primary reason for this decrease is an increase in the level of allowances for doubtful accounts from older accounts. Accounts payable increased \$74,520 from \$182,397 on December 31, 2002 to \$286,123 on June 30, 2003. The primary reason for this increase is to facilitate cash flow and improve financing activities. Notes payable decreased by a net \$316,631 on June 30, 2003 from \$1,830,430 on December 31, 2002 to 1,513,799 on June 30, 2003.

LIQUIDITY AND CAPITAL RESOURCES. For the six months ended June 30, 2003, we generated EBITDA at our operating subsidiary level of \$426,884. This amount was offset by EBITDA at the corporate level of (\$113,474).

We believe that our existing cash, cash equivalents, and cash flow from operations and our ability to obtain favorable financing will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months. If such sources of financing are insufficient or unavailable, or if we experience shortfalls in anticipated revenue or increases in anticipated expenses, we may need to slow down or stop the expansion of our Internet Service Providers and reduce our marketing and development efforts. Any of these events could harm our business, financial condition or results of operations. We currently have no off-balance sheet financing nor do we anticipate any.

Forward looking statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Stockholders are cautioned that all forward-looking statements involve risks and uncertainty, including without limitation, our ability to expand our customer base, make strategic acquisitions, general market conditions, and competition and pricing. Although we believe the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore, there can be no assurance that the forward-looking statements contained in the report will prove to be accurate.

Item 3. Controls and Procedures

Our President and Chief Financial Officer (the Certifying Officers) are responsible for establishing and maintaining disclosure controls and procedures for the Company. The Certifying Officers have designed such disclosure controls and procedures to ensure that material information is made known to them, particularly during the period in which this report was prepared. The Certifying Officers have evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report and believe that the Company's disclosure controls and procedures are effective based on the required evaluation. During the period covered by this report, there were no changes in internal controls that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II.

OTHER INFORMATION

Item 1.

Legal Proceedings

On December 31, 2002, New Millennium Capital Partners II, LLC and AJW Partners, LLC filed a complaint against the Company, its former officers and its current officers at the Supreme Court of the State of New York in the county of Nassau. The complaint alleges the Company breached their contract and fiduciary duties. This proceeding is a dispute over the amount we owe on a convertible debenture. This dispute has arisen over a significant payment we issued by a conversion of stock that was neither applied to the penalties, principal or interest. The Plaintiff is seeking approximately \$425,000 in principal, interest and damages. Although we feel we have adequate documentation to support our claim, if we cannot, the balance of the debenture could increase significantly.

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Item 2.

Change in Securities

None

Item 3.

Defaults Upon Senior Securities

None

Item 4.

Submission of Matters to a Vote of Security Holders

None

Item 5.

Other Information

None

Item 6.

Exhibits and Reports on Form 8-K

(a)

Exhibits

31.1

Certification of President Pursuant to the Securities Exchange Act of 1934, Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2

Certification of Chief Financial Officer Pursuant to the Securities Exchange Act of 1934, Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.

Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b)

Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SITESTAR CORPORATION

Date: August 20, 2003

By: /s/ Frank Erhartic, Jr.

Frank Erhartic, Jr.

President, Chief Financial Officer

(Principal Executive Officer, Principal Financial Officer, and Principal Accounting Officer)

