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CYPOST CORP
Form 10QSB
November 14, 2001

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-QSB

(Mark One)

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

For the quarterly period ended: September 30, 2001

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from _____ to _____

Commission file number 000-26751

CyPost Corporation

(Exact Name of Small Business Issuer as Specified in Its Charter)

Delaware

98-0178674

(State or other jurisdiction (IRS Employer Identification Number)
of incorporation or organization)

900-1281 West Georgia St., Vancouver, British Columbia, Canada V6E 3J7

(Address of Principal Executive Offices) (Zip Code)

(604) 904-4422

(Issuer's Telephone Number, Including Area Code)

Not Applicable

(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 the latest practicable date: 21,559,525 as of October 31, 2001.

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

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission ("Commission"). While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for fair presentation of the results of the interim period, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the financial statements and footnotes thereto, which are included in the Company's Annual Report on Form 10-KSB, as amended, for the fiscal year ended December 31, 2000, previously filed with the Commission.

The accompanying notes are an integral part of these consolidated financial statements.

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CYPOST CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2001 AND DECEMBER 31, 2000
(U.S. DOLLARS)

| | September 30, 2001 |
|--|----------------------|
| | ----- (Unaudited) |
| ASSETS | |
| CURRENT ASSETS | |
| CASH | \$ 155,003 |
| ACCOUNTS RECEIVABLE, NET OF ALLOWANCE | 273,585 |
| INSURANCE PROCEEDS RECEIVABLE | - |
| PREPAIDS AND DEPOSITS | 149,806 |
| | ----- |
| TOTAL CURRENT ASSETS | 578,394 |
| PROPERTY AND EQUIPMENT, NET | 544,189 |
| GOODWILL AND OTHER INTANGIBLES, NET OF ACCUMULATED AMORTIZATION | 1,819,127 |
| NOTE RECEIVABLE & ACCRUED INTEREST | 109,361 |
| OTHER ASSETS | 8,557 |
| | ----- |
| | \$ 3,059,628 |
| | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | |
| CURRENT LIABILITIES | |
| ACCOUNTS PAYABLE & ACCRUED LIABILITIES | \$ 1,313,189 |
| STOCKHOLDERS' LOANS | - |
| DEFERRED REVENUE | 494,739 |
| | ----- |
| TOTAL CURRENT LIABILITIES | 1,807,928 |
| | ----- |
| COMMITMENTS AND CONTINGENCIES | |
| STOCKHOLDERS' EQUITY | |
| SHARE CAPITAL | |

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AUTHORIZED

5,000,000 PREFERRED STOCK WITH A PAR VALUE OF \$.001
 30,000,000 COMMON STOCK WITH A PAR VAUE OF \$.001

ISSUED AND OUTSTANDING

| | |
|---|--------------|
| PREFERRED STOCK - NONE | - |
| COMMON STOCK 21,559,493 - 2001, 21,556,993 - 2000 | 21,560 |
| PAID-IN CAPITAL | 14,048,816 |
| ACCUMULATED DEFICIT | (12,824,092) |
| CURRENCY TRANSLATION ADJUSTMENT | 5,416 |
| | ----- |
| TOTAL STOCKHOLDERS' EQUITY (DEFICIT) | 1,251,700 |
| | ----- |
| | \$ 3,059,628 |
| | ===== |

The accompanying notes are an integral part of these consolidated statements.

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CYPOST CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000
 (U.S. DOLLARS)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|--------------|------------------------------------|--------------|
| | 2001 | 2000 | 2001 | 2000 |
| | ----- | ----- | ----- | ----- |
| REVENUE | \$ 856,644 | \$ 1,292,162 | \$ 2,875,843 | \$ 3,686,816 |
| DIRECT COSTS | (545,458) | (620,714) | (1,458,487) | (1,917,487) |
| | ----- | ----- | ----- | ----- |
| | 311,186 | 671,448 | 1,417,856 | 1,768,330 |
| | ----- | ----- | ----- | ----- |
| EXPENSES | | | | |
| SELLING, GENERAL AND ADMINISTRATIVE | 492,164 | 683,271 | 1,838,163 | 3,094,816 |
| AMORTIZATION AND DEPRECIATION | 517,122 | 843,746 | 1,584,583 | 2,350,000 |
| | ----- | ----- | ----- | ----- |
| | 1,009,286 | 1,527,017 | (3,422,746) | 5,445,116 |
| | ----- | ----- | ----- | ----- |
| LOSS BEFORE OTHER INCOME (EXPENSE) | (698,100) | (855,569) | (2,005,390) | (3,676,816) |
| | ----- | ----- | ----- | ----- |
| SETTLEMENT INCOME | 2,498,599 | | 2,498,599 | |
| NET PROCEEDS FROM FIRE INSURANCE | - | 55,627 | - | 185,000 |
| GAIN ON SALE OF INVESTMENT ON CYPOST KK | - | 36,202 | - | 36,202 |
| INTEREST EXPENSE | | | | |
| Beneficial conversion feature | - | - | - | (1,927,000) |
| Accrued interest expense | (37,348) | (41,210) | (120,291) | (117,000) |
| Interest expense | - | (136) | - | - |
| MINORITY INTEREST | - | - | - | 108,000 |
| | ----- | ----- | ----- | ----- |

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| | | | | |
|---|--------------|--------------|------------|----------------|
| NET GAIN (LOSS) | \$ 1,763,151 | \$ (805,086) | \$ 372,914 | \$ (5,391,667) |
| EARNINGS (LOSS) PER SHARE BASIC & DILUTED | \$ 0.08 | \$ (0.04) | \$ 0.02 | \$ (0.02) |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING | 21,559,493 | 21,395,319 | 21,558,660 | 21,061,000 |

The accompanying notes are an integral part of these consolidated statements.

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CYPOST CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000
(U.S. DOLLARS)

| | SEPTEMBER 30, 2001 | SEPTEMBER 30, 2000 |
|---|-----------------------|-----------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| NET INCOME (LOSS) | \$ 372,914 | \$ (5,391,667) |
| Adjustments to reconcile net loss to cash used by operating activities: | | |
| Settlement income and interest | (2,498,599) | - |
| Amortization and depreciation | 1,584,583 | 2,350,394 |
| Net proceeds from fire insurance | - | (185,172) |
| Beneficial conversion feature | - | 1,927,500 |
| Accrued interest expense | - | 117,161 |
| Gain on sale of investment on CyPost KK | - | 36,202 |
| | (541,102) | (1,145,582) |
| Changes in non-cash operating accounts | 559,509 | 86,710 |
| NET CASH USED BY OPERATING ACTIVITIES | (18,407) | (1,058,872) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of capital assets, net | (77,221) | (332,628) |
| Software development | - | (87,193) |
| Acquisition of Playa Corporation | - | (300,000) |
| Proceeds from sale of Investment in CyPost KK | - | 220,000 |
| NET CASH USED IN INVESTING ACTIVITIES | (77,221) | (499,821) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Loan proceeds | | |
| Blue Heron Venture Fund, Ltd | - | 1,175,000 |
| Pacific Gate Capital Ltd. | - | 125,000 |
| CyPost KK management | - | 78,589 |
| Loan repayment | | |
| Pacific Gate Capital Ltd. | - | (100,000) |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | - | 1,278,589 |

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| | | |
|---------------------------|------------|------------|
| NET INCREASE IN CASH | (95,628) | (280,104) |
| CASH, BEGINNING OF PERIOD | 250,631 | 415,779 |
| | ----- | ----- |
| CASH, END OF PERIOD | \$ 155,003 | \$ 135,675 |
| | ===== | ===== |

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CYPOST CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2001
(UNAUDITED)

(U.S. DOLLARS)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

GOING CONCERN

These financial statements have been prepared on the basis of accounting principles applicable to a "going concern" which assume that Cypost Corporation (the "Company") will continue in operation for at least one year and will be able to realize its assets and discharge its liabilities in the normal course of operations.

Several conditions and events cast doubt about the Company's ability to continue as a going concern. The Company has incurred net losses of approximately \$12.8 million for the period from inception September 5, 1997 to September 30, 2001, has a working capital deficit of approximately \$1.2 million at September 30, 2001, and requires additional financing for its business operations.

The Company is streamlining operations and consolidating its ISP's to enhance efficiency and reduce operating expenses. As a result of the foregoing efforts, the operations of Intouch Internet Inc. and NetRover Office Inc. have been fully condensed consolidated into the Company's wholly-owned subsidiary, NetRover Inc.

These condensed consolidated financial statements do not reflect adjustments that would be necessary if the Company were unable to continue as a going concern. While management believes that the actions already taken or planned, as described above, will mitigate the adverse conditions and events which raise doubts about the validity of the "going concern" assumption used in preparing these financial statements, there can be no assurance that these actions will be successful.

If the Company were unable to continue as a going concern, then substantial adjustments would be necessary to the carrying values of assets, the reported amounts of its liabilities, the reported revenues and expenses.

INTERIM FINANCIAL STATEMENTS

The interim condensed consolidated financial statements presented have been prepared by the Company without audit and, in the opinion of the management, reflect all adjustments of a normal recurring nature necessary for a fair statement of (a) the consolidated results of operations for the three and nine months ended September 30, 2001 and 2000, (b) the condensed consolidated financial position at September 30, 2001 and (c) the condensed consolidated cash flows for the nine months ended September 30, 2001 and

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2000. Interim results are not necessarily indicative of results for a full year.

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The condensed consolidated balance sheet presented as of December 31, 2000 has been derived from the condensed consolidated financial statements that have been audited by the Company's independent auditors. The consolidated financial statements and notes are condensed as permitted by Form 10-QSB and do not contain certain information included in the annual financial statements and notes of the Company. The condensed consolidated financial statements and notes included herein should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-KSB.

CONSOLIDATION

The condensed consolidated financial statements include the accounts of CyPost Corporation and its subsidiaries. In 2000, the subsidiaries include CyPost KK, Playa Corporation, NetroverUSA Online Inc. (formerly known as ePost Innovations Inc. see Canada Post Litigation below), Netrover Inc., Netrover Office Inc., Hermes Net Solutions Inc., and Intouch.Internet Inc. All of the subsidiaries, except CyPost KK, are wholly owned. Later in 2000, the Company sold its investment in CyPost KK and abandoned its investment in Playa Corporation. Connect Northwest and Internet Arena are DBA of CyPost Corporation. All significant inter-company transactions and balances have been eliminated in consolidation.

2. LOANS

On June 18, 2001 at the request of Blue Heron Venture Fund, Ltd. (Blue Heron), Blue Heron Notes in the aggregate principal amount of \$2,085,000 were cancelled and on June 19, 2001 new promissory notes (the "Blue Heron Shareholder Notes") in the aggregate principal amount of \$2,319,788 were issued to the shareholders of Blue Heron and Blue Heron's fund manager, Monet Management Group Ltd. The principal amount of the Blue Heron Shareholder Notes was comprised of the \$2,085,000 principal amount of the Blue Heron Notes and the \$234,788 in interest due on the Blue Heron Notes at the time of cancellation. The Blue Heron Shareholder Notes were unsecured and were payable on demand. \$2,085,000 in principal amount of the Blue Heron Shareholder Notes bore interest at 8% per annum. The balance of the Blue Heron Shareholder Notes did not provide for the payment of interest.

On September 20, 2001 the Company entered into a Settlement Agreement (the "Settlement Agreement") with Kelly Shane Montalban with regard to a lawsuit it had instituted against him on June 15, 2001 in the United States District Court for the Southern District of New York seeking recovery of short swing profits realized by Mr. Montalban and other persons whose purchases and sales of Company common stock were attributed to Mr. Montalban in violation of Section 16(b)] of the Securities Exchange Act of 1934, as amended (see Shane Montalban Litigation below). Pursuant to the Settlement Agreement, Mr. Montalban paid the Company an aggregate of approximately \$2,498,449 (the "Recovery Amount"), which amount represented recovery in full of Mr. Montalban's short swing profits. He did so by delivering to the Company for cancellation (1) the Blue Heron Shareholder Notes in the aggregate principal amount of \$2,319,788, which notes had been previously purchased by or assigned to Mr. Montalban; (2) the accrued

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interest of \$42,384 due on the principal portion of the Blue Heron Shareholder Notes at the time of cancellation; (3) 8% demand notes of the Company dated August 25, 2000 and September 11, 2000, respectively, in the aggregate principal amount of \$25,000 issued to Pacific Gate Capital Corporation, a corporation owned by Mr. Montalban (the "Pacific Gate Capital Notes"); and (4) the accrued interest of \$2,066 due on the principal portion of the Pacific Gate Capital Notes at the time of cancellation. The balance of the Recovery Amount was paid by Mr. Montalban's issuance to the Company of a five (5) year, 5% promissory note, dated September 20, 2001, in the principal amount of \$109,211. In consideration of the execution of the Settlement Agreement and payment of the Recovery Amount, on October 9, 2001 the Company voluntarily dismissed its action.

The Company has accrued interest of \$150 for the period September 20 to September 30, 2001.

3. COMMITMENTS AND CONTINGENCIES

CANADA POST LITIGATION

On June 20, 2001 ePost Innovations, Canada Post and the Company entered into a Settlement and Release Agreement effective as of May 30, 2001 (the "Settlement Agreement"). Pursuant to the Settlement Agreement, the parties executed mutual releases and discontinued their respective claims. The release by Canada Post to ePost Innovations was made subject to the Company and ePost Innovations ceasing all use of the trade name EPOST within Canada within 90 days of the effective date of the Settlement Agreement and transferring all right, title and interest they had with respect to the trade name and trademark EPOST and any goodwill associated therewith to Canada Post upon execution of the Settlement Agreement. On August 30, 2001 the Company changed the name of its subsidiary to NetRoverUSA Online Inc. All other terms of the Settlement Agreement have been complied with.

STEVEN BERRY LITIGATION

On March 31, 2000, the Company commenced suit in the Supreme Court of British Columbia, Action #S001822, Vancouver Registry against Tia Berry (the "Tia Action"), the wife of Steven Berry ("Berry"), the former President and Chief Executive Officer of the Company. In the Tia Action,

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the Company claims Cdn\$42,516 from Tia Berry on account of monies paid to her by the Company which she was not entitled to receive. Tia Berry has filed a Statement of Defense in the Tia Action in which she alleges that the payments which she received from the Company were to reimburse her for business expenses which she had charged to her credit cards on behalf of Berry. The Tia Action has not yet been set for trial.

On April 4, 2000, Berry commenced an action in the Supreme Court of the State of New York, County of New York (Index No. 601448/2000), against the Company and Continental Stock Transfer & Trust Company ("Continental"), (the "New York Action"). In the New York Action, Berry claimed damages for alleged conversion, fraud, breach of contract and breach of fiduciary duty all arising from the alleged wrongful Stop Transfer Order which the Company placed relating to 75,000 shares of the Company's Common Stock registered in Berry's name and the Company's cancellation of a further 600,000 shares (the "Contingent Shares"). The complaint in the New York Action claims damages in excess of \$3,000,000 with the precise amount to be determined at

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trial.

Berry received the 600,000 Contingent Shares upon condition that he would remain in the Company's employ as Chief Executive Officer for at least two years. Berry commenced his employment with the Company on January 4, 1999, and resigned his employment with the Company on January 17, 2000. Following Berry's resignation, the Company attempted to have a Stop Transfer Order issued with respect to the 75,000 shares registered in Berry's name and cancel the 600,000 Contingent Shares. The Stop Transfer Order was not effective and Berry subsequently sold the 75,000 shares.

On May 19, 2000 CyPost and ePost Innovations commenced suit in the Supreme Court of British Columbia, Action #S002798, Vancouver Registry, against Berry and his wife, Tia Berry (the "BC Action"). In the BC Action, the Company seeks an order directing Berry to return the 600,000 Contingent Shares to the Company for cancellation or an order entitling the Company to cancel the same on the basis that Berry did not fulfill the employment conditions which were the condition precedent to his becoming the beneficial owner of the Contingent Shares.

In the BC Action, the Company also claims at least Cdn\$800,000 from Berry on account of breach of fiduciary duty, negligence, breach of statutory duties and breach of contract arising from Berry's failure to properly carry out his employment responsibilities. In the BC Action, the Company also claims Cdn\$34,013 from Berry and Tia Berry on account of conspiracy to defraud and injure the Company and ePost Innovations by causing certain personal expenses to be paid by the Company rather than by Berry and Tia Berry personally. The Company also claims punitive and exemplary damages from Berry and Tia Berry in the BC Action.

On May 25, 2000, the Company moved in the New York Action for an order dismissing the action against the Company for lack of jurisdiction or, in the alternative, on the basis of forum non conveniens. On September 5, 2000, the court dismissed the New York Action on forum non conveniens grounds, subject to the Company making certain stipulations in the New York Action. Those stipulations have been made and the appeal period in the New York Action has expired without Berry or any other party appealing the September 5, 2000 order.

The issues raised by Berry and the Company in the New York Action will be litigated in the BC Action together with the further issues raised by the Company in the BC Action. The Company feels that Berry's claims in the New York Action were without merit and that the Company will be successful in obtaining an order declaring that Berry's 600,000 Contingent Shares be cancelled and further entitling the Company to substantial damages. The Company will vigorously pursue its position in all respects.

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On December 21, 2000, Berry and Tia Berry commenced suit in the Supreme Court of British Columbia, Action #S006790, Vancouver Registry, against CyPost, ePost Innovations, Kelly Shane Montalban, J. Thomas W. Johnston, Carl Whitehead and Robert Sendoh (the "Berry Action"). Statements of Defense have been filed on behalf of the Company and the other defendants.

The Plaintiffs in the Berry Action allege that the Tia Action, the BC Action, and the action by Kelly Shane Montalban (Supreme Court of British Columbia, Action #S002147, Vancouver Registry), against Berry for specific performance of an option agreement (the "Montalban Action"), collectively, amount to an abuse of process, malicious prosecution, unlawful interference with the Plaintiffs' economic rights, or were commenced pursuant to a civil

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conspiracy to injure the Plaintiffs.

In the Berry Action, the Plaintiffs seek a declaration that Berry is entitled to the 600,000 Contingent Shares and claim unspecified damages which are estimated at Cdn\$2,000,000 based on the Statement of Claim. They also claim punitive or aggravated damages and costs. The Company believes that the allegations in the Berry Action are without merit and they will be vigorously defended.

It is expected that the Tia Action, the BC Action and the Berry Action will be consolidated for the purposes of trial due to the fact that there are numerous issues of fact and law which are common to all of these actions. The Company believes that trial will likely take place in the fall of 2002.

A loss by the Company of the claim against it for monetary damages would have a material adverse effect on the Company's future results of operations, financial condition and liquidity; however, the Company does not expect to lose this action and believes additionally that it would be able to negotiate reasonable payment terms should it lose this suit.

SHANE MONTALBAN LITIGATION

On June 15, 2001 the Company filed a Summons and Complaint against Kelly Shane Montalban in the United States District Court for the Southern District of New York (CyPost Corp. v. Kelly Shane Montalban, Civ. 5447). The Complaint alleged that, between September 1999 and June 15, 2001 (the "Recovery Period"), numerous purchases and sales of the Company's common stock were made in violation of the short swing profit recovery provisions of Section 16(b) of the Securities Exchange Act of 1934, as amended. ("Section 16(b)").

Section 16(b) imposes strict liability on corporate insiders, including principal stockholders, for engaging in short swing trading activities (a sale and purchase or purchase and sale occurring within any six (6) month period) without regard as to whether true profits were realized by the insider from such trading activities. During the Recovery Period, numerous purchases and sales of the Company's common stock were made in violation of Section 16(b). Although the Company did not believe that any of such purchases and sales were based on non-public information, the Company

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nonetheless required by the strict liability provisions of Section 16(b) to seek recovery. The Company ultimately determined that the amount of short swing profits realized within the Recovery Period was \$2,498,449 (the "Recovery Amount"). Mr. Montalban cooperated fully with the Company's investigation and agreed to make payment in full of the Recovery Amount. Pursuant thereto, on September 20, 2001 the Company entered into a Settlement Agreement. Part of the Recovery Amount was paid by Mr. Montalban by way of his delivery to the Company for cancellation, on September 20, 2001, various promissory notes of the Company on which the Company owed an aggregate of \$2,344,788 in principal and \$44,450 in interest or a total of \$2,389,238.

The notes delivered for cancellation included a note which had been assigned to Mr. Montalban by the holder to satisfy an obligation of the holder to Mr. Montalban, notes which had been purchased by Mr. Montalban from various individuals, and a note held by Pacific Gate Capital Corporation, a corporation owned by Mr. Montalban. The balance of the Recovery Amount was paid by the issuance to the Company of his five (5) year, 5% promissory note, dated September 20, 2001, in the principal amount

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of \$109,211. In consideration of the execution of the Settlement Agreement and payment of the Recovery Amount, on October 9, 2001 the Company voluntarily dismissed its action.

WORLDCOM DISPUTE

On June 30, 1999 Netrover Inc ("Netrover") entered into a Virtual Internet Provider Agreement with WorldCom Canada Ltd ("WorldCom"). A dispute arose between the parties regarding certain credits claimed by Netrover and amounts claimed as owed by Netrover to WorldCom in the amount of Cdn\$633,368.

The Netrover and WorldCom are presently engaged in settlement discussions to resolve the dispute. No assurance can be given, however, that the parties will reach a settlement. A loss by the Company would have a material adverse effect on the Company's future results of operations.

On November 8, 2001 Netrover entered into a Settlement Agreement ("Settlement") with WorldCom. The parties have agreed to a settlement of Cdn\$91,000 to be paid in three installments.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is provided to increase the understanding of, and should be read in conjunction with, the Condensed Consolidated Financial Statements of the Company and Notes thereto included elsewhere in this Report. Historical results and percentage relationships among any amounts in these financial statements are not necessarily indicative of trends in operating results for any future period. The statements which are not historical facts contained in this Report, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, and Notes to the Condensed Consolidated Financial Statements, constitute "forward-looking statements" within the

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meaning of the Private Securities Litigation Reform Act of 1995. Such statements are based on currently available operating, financial and competitive information, and are subject to various risks and uncertainties. Future events and the Company's actual results may differ materially from the results reflected in these forward-looking statements. Factors that might cause such a difference include, but are not limited to, dependence on existing and future key strategic and strategic end-user customers, limited ability to establish new strategic relationships, ability to sustain and manage growth, variability of operating results, the Company's expansion and development of new service lines, marketing and other business development initiatives, the commencement of new engagements, competition in the industry, general economic conditions, dependence on key personnel, the ability to attract, hire and retain personnel who possess the technical skills and experience necessary to meet the service requirements of its clients, the potential liability with respect to actions taken by its existing and past employees, risks associated with international sales, and other risks described herein and in the Company's other SEC filings.

OVERVIEW

The Company is engaged in the business of providing Internet service provider ("ISP") services ("ISP Services") for business and personal use. Previously, the Company was also involved in developing certain software

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products, which activities the Company no longer pursues.

The Company was a development stage company until the first quarter of 1999, when it began to broaden its strategic focus through the acquisition of six ISPs. Currently, providing ISP Services is the focus of the Company's business. The Company's business operations are presently conducted in the United States and Canada.

The Company derives virtually all of its revenues from its ISP Services. At present, most of the revenue from ISP Services can be attributed to connectivity, although the Company's network of ISP Services is moving towards focusing on Web hosting and server co-location, anticipating a strong hold over connectivity by the larger ISPs in a few years' time.

During 2000, the Company began streamlining and consolidating its ISP Services operations to enhance efficiency and reduce operating expenses. The Company has embarked on a program to centralize ISP Services to the greatest extent possible, as follows:

- Customer Support. During the second half of 2000, the Company began -----
consolidating all aspects of customer support (including end user technical issues) into the Chatham, Ontario facility. In early 2001, customer support for Oregon ISP Services customers were consolidated into the Chatham facility and by late-2001 it is expected that customer support for all of the Company's ISP Services customers will be handled by the Chatham facility.

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- Billing and Collections. During the second half of 2000, the Chatham -----
facility took over billing and collections for British Columbia customers, in addition to continuing billing and collections for all other Canadian customers. In early 2001 the billing and collections for the Oregon ISP customers were consolidated into the Chatham facility, billing and collections for the Washington ISP Services customers will be consolidated in late-2001.
- Network Operations. During 2000, the Company reduced four maintenance -----
and repair teams to two regionally-based teams. A team based in Toronto provides primary monitoring and repair of all servers and routers covering all Canadian ISP Services customers and provides overflow assistance to the Pacific Northwest, while a Seattle team provides primary monitoring and repair of all servers and routers covering all of the Pacific Northwest ISP Services customers and provides overflow assistance to Canada.

The Company is also consolidating Web hosting and dedicated services into Toronto, a process which began in late-2000 and is expected to be completed by late-2001. Other ISP Services such as e-mail and user authentication (i.e., customer security) will continue to be handled from regional data centers. Beginning in early 2001, all new Web hosting customers, wherever located, will be hosted from Toronto.

The Company is also considering implementing other consolidated services to achieve greater efficiency and cost savings.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2001
COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2000

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Substantially all of the Company's revenue was earned from its ISP operations during the three months ended September 30, 2001. These revenues are attributable virtually entirely to the operations of the Company's ISP businesses (Hermes Net Solutions, Inc., Intouch.Internet Inc., Netrover Inc., Connect Northwest Internet Services and Internet Arena) which the Company acquired beginning late in the second quarter of 1999. The Company generated net sales of \$856,644 for the three months ended September 30, 2001 compared to \$1,292,162 for the three months ended September 30, 2000. The decrease in the above noted revenue, for the three months ended September 30, 2001 compared to the three months ended September 30, 2000, are primarily due to a decrease in marketing related activities, and the softening of technology related sector spending.

Direct costs, which consist primarily of telecommunications charges in respect of providing Internet connection services to customers, of \$545,458, were incurred for the three months ended September 30, 2001, compared to \$620,714 for the three months ended September 30, 2000. The decrease in the above noted expenses for the three months ended September 30, 2001 compared to the three months ended September 30, 2000 results primarily reflect the renegotiation of several telecommunication contracts to the Company's benefit.

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Selling, general and administrative expenses were \$492,164 for the three months ended September 30, 2001 compared to \$683,271 for the three months ended September 30, 2000. The decrease in the above noted expenses for the three months ended September 30, 2001 compared to the three months ended September 30, 2000 results primarily from a further reduction in salaries and benefits, consolidation of the operation of the Company's ISP businesses and a decrease in marketing related activities.

The Company had accrued interest expenses of \$37,348 for the three months ended September 30, 2001, compared to \$41,210 for the three months ended September 30, 2000. The interest expense is in respect of promissory notes issued by the Company to Blue Heron Venture Fund Ltd., the Company's former principal creditor ("Blue Heron") and following assignment of such notes, on June 18, 2001, is in respect of promissory notes issued by the Company to the shareholders of Blue Heron and Blue Heron's fund manager. See "Liquidity and Capital Resources" below.

The Company had a net gain of \$1,763,151, or \$.08 per share, for the three months ended September 30, 2001, compared to a net loss of \$805,086, or \$.04 per share, for the three months ended September 30, 2000. The increase in net gain for the three months ended September 30, 2001 was primarily a result of the increase in other revenue due to a recovery of short swing profits from a principal shareholder as well as a decrease in direct costs; selling, general and administrative expenses; amortization and depreciation of the assets acquired in the fiscal year 1999; and interest expense.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2000

Substantially all of the Company's revenue was earned from its ISP operations during the nine months ended September 30, 2001. These revenues are attributable virtually entirely to the operations of the Company's ISP businesses (Hermes Net Solutions, Inc., Intouch.Internet Inc., Netrover Inc., Connect Northwest Internet Services and Internet Arena) which the Company acquired beginning late in the second quarter of 1999. The Company generated net sales of \$2,875,843 for the nine months ended September 30,

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2001 compared to \$3,686,467 for the nine months ended September 30, 2000. The decrease in the above noted revenue, for the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000, a decrease in marketing related activities, the softening of technology related sector spending and the discontinuance of Playa Corporation during the fourth quarter of 2000.

Direct costs, which consist primarily of telecommunications charges in respect of providing Internet connection services to customers, of \$1,458,487, were incurred for the nine months ended September 30, 2001, compared to \$1,917,641 for the nine months ended September 30, 2000. The decrease in the above noted expenses for the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000 primarily reflect the renegotiation of several telecommunication contracts to the Company's benefit.

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Selling, general and administrative expenses were \$1,838,163 for the nine months ended September 30, 2001 compared to \$3,094,888 for the nine months ended September 30, 2000. The decrease in the above noted expenses for the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000 results primarily from a reduction in salaries and benefits, consolidation of the operation of the Company's ISP businesses and a decrease in marketing related activities.

The Company had accrued interest expenses of \$120,291 for the nine months ended September 30, 2001, compared to \$117,161 for the nine months ended September 30, 2000. The interest expense is in respect of promissory notes issued by the Company to Blue Heron Venture Fund Ltd., the Company's former principal creditor ("Blue Heron") and following assignment of such notes, on June 18, 2001, is in respect of promissory notes issued by the Company to the shareholders of Blue Heron and Blue Heron's fund manager. See "Liquidity and Capital Resources" below.

The Company had a net gain of \$372,914, or \$.02 per share, for the nine months ended September 30, 2001, compared to a net loss of \$5,391,667, or \$.26 per share, for the nine months ended September 30, 2000. The increase in net gain for the nine months ended September 30, 2001 was primarily a result of the increase in other revenue due to a recovery of short swing profits from a principal shareholder as well as a decrease in direct costs; selling, general and administrative expenses; amortization and depreciation of the assets acquired in the fiscal year 1999; and interest expense.

LIQUIDITY AND CAPITAL RESOURCES

The accompanying financial statements have been prepared on a going concern basis, which assumes that the Company will continue in operation for at least one year and will be able to realize its assets and discharge its liabilities in the normal course of business. The Company had a net gain for the nine months ended September 30, 2001 of \$372,914, compared to a net loss for the nine months ended September 30, 2000 of \$5,391,667. At September 30, 2001, the Company had a working capital deficit of approximately \$1.2 million, which is primarily due to the Company's general operating activities and professional fees. These factors indicate that the Company's continuation as a going concern is dependent upon its ability to obtain adequate financing.

The Company has obtained most of its financing through Blue Heron. The loans were made under agreements pursuant to which the Company could borrow up to \$16,000,000 in unsecured loans from Blue Heron. Effective June 18,

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2001 Blue Heron has withdrawn this credit facility. The loans were evidenced by the Company's Convertible Demand Notes (the "Blue Heron Demand Notes"). The Blue Heron Demand Notes bore interest at 8% per annum, were payable on demand and were convertible into shares of the Company's Common Stock at the lender's option, in which case Blue Heron would have waived its right to be paid interest under the Blue Heron Demand Notes. On June 18, 2001 the Blue Heron Demand Notes were cancelled and subsequently replaced by the Blue Heron Shareholder Notes. During 1999, \$4,000,000 of outstanding loans were converted into 4,500,000 shares of the Company's

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Common Stock. On August 16, 1999, \$1,000,000 aggregate principal amount of Blue Heron Demand Notes were converted into 1,500,000 shares of Common Stock, at a conversion price of \$0.67 per share. On November 24, 1999, an aggregate additional principal amount of \$3,000,000 of Blue Heron Demand Notes were converted into an additional 3,000,000 shares of Common Stock, at a conversion price of \$1.00 per share.

During the fiscal year ended December 31, 2000, the Company borrowed an additional \$1,210,000 from Blue Heron, resulting in an aggregate outstanding principal amount of the loans of \$2,085,000 as of December 31, 2000. The Company did not borrow any additional funds during the nine months ended September 30, 2001.

During the fiscal year ended December 31, 2000, the Company borrowed an aggregate of \$125,000 from Pacific Gate Capital Corporation ("Pacific Gate"), a corporation owned by Kelly Shane Montalban, a principal shareholder of the Company, of which amount \$25,000 was outstanding on September 20, 2001, at which time pursuant to the Montalban Settlement Agreement the loan balance was deemed to have been paid in full.

On September 20, 2001 the Company entered into a Settlement Agreement with Shane Montalban, a principal shareholder of the Company, with respect to a lawsuit instituted against him seeking recovery of short swing profits realized by Mr. Montalban between September 20, 1999 and June 15, 2001 in violation of Section 16(b) of the Securities Exchange Act of 1934, as amended. Pursuant to the Settlement Agreement, Mr. Montalban paid the Company an aggregate of approximately \$2,498,449 (the "Recovery Amount"), which amount represented recovery in full of Mr. Montalban's short swing profits. Part of the Recovery Amount was paid by Mr. Montalban's delivery to the Company for cancellation, on September 20, 2001, various promissory notes of the Company on which the Company owed an aggregate of \$2,344,788 in principal and \$44,450 in interest or a total of \$2,389,238. The notes delivered for cancellation included a note which had been assigned to Mr. Montalban by the holder to satisfy an obligation of the holder, notes which had been purchased by Mr. Montalban from various individuals, and a note held by Pacific Gate Capital Corporation, a corporation owned by Mr. Montalban. See "Part II - Other Information, Item 1. Legal Proceedings" below.

The Company's cash position at September 30, 2001 was \$155,003, compared to \$250,631 on December 31, 2000. This decrease is primarily due to the Company not borrowing additional funds during the nine months ended September 30, 2001.

The Company's net cash used in operating activities totaled \$18,407 during the nine months ended September 30, 2001, compared to \$1,058,872 during the nine months ended September 30, 2000. This decrease is primarily due to the settlement income for the nine months ended September 30, 2001.

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The Company's net cash used in investing activities totaled \$77,221 during the nine months ended September 30, 2001, compared to \$499,821 during the nine months ended September 30, 2000. This decrease is primarily due to the Company not being as aggressive as previous years in acquisitions.

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The Company did not have any proceeds from financing activities during the nine months ended September 30, 2001, compared to \$1,278,589 of such proceeds during the nine months ended September 30, 2000.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Canada Post Litigation

On June 11, 1999, Canada Post Corporation ("Canada Post") filed a Statement of Claim in the Federal Court of Canada (Court File No. T-1022-99) in which it sought injunctive and unspecified monetary relief for the allegedly "improper" use by the Company's subsidiary, ePost Innovations, Inc., ("ePost Innovations"), of certain marks and names which contain the component "post". On October 18, 1999, ePost Innovations filed its Defense and Counterclaim. In a motion heard November 24, 1999, Canada Post Corporation challenged certain parts of the Counterclaim and the Federal Court reserved judgment.

On May 25, 1999, ePost Innovations filed a statement of Claim in the British Columbia Court (Court File No. C992649) seeking a declaration that the public notice of Canada Post's adoption and use of CYBERPOSTE and CYBERPOST on November 18, 1998 and December 9, 1998 respectively, did not affect the Company's use of CyPost and ePost Innovations as trademarks and trade-names prior to said dates. ePost Innovations sought summary judgment for such a declaration and on September 14, 1999, the BC Court rejected summary judgment on the basis that no right of ePost Innovations was being infringed and that a trial of the issues was more appropriate.

On June 20, 2001 ePost Innovations, Canada Post and the Company entered into a Settlement and Release Agreement effective as of May 30, 2001 (the "Settlement Agreement"). Pursuant to the Settlement Agreement, the parties executed mutual releases and discontinued their respective claims. The release by Canada Post to ePost Innovations was made subject to the Company and ePost Innovations ceasing all use of the trade name EPOST within Canada within 90 days of the effective date of the Settlement Agreement and transferring all right, title and interest they had with respect to the trade name and trademark EPOST and any goodwill associated therewith to Canada Post upon execution of the Settlement Agreement. On August 30, 2001 the Company changed the name of its subsidiary to NetRoverUSA Online Inc. All other terms of the Settlement Agreement have been complied with.

Berry Litigation

On March 31, 2000, the Company commenced suit in the Supreme Court of British Columbia, Action #S001822, Vancouver Registry against Tia Berry (the "Tia Action"), the wife of Steven Berry ("Berry"), the former President and Chief Executive Officer of the Company. In the Tia Action,

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the Company claims \$42,516 (CDN) from Tia Berry on account of monies paid

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to her by the Company which she was not entitled to receive. Tia Berry has filed a Statement of Defense in the Tia Action in which she alleges that the payments which she received from the Company were to reimburse her for business expenses which she had charged to her credit cards on behalf of Berry. The Tia Action has not yet been set for trial.

On April 4, 2000, Berry commenced an action in the Supreme Court of the State of New York, County of New York (Index No. 601448/2000), against the Company and Continental Stock Transfer & Trust Company ("Continental"), (the "New York Action"). In the New York Action, Berry claimed damages for alleged conversion, fraud, breach of contract and breach of fiduciary duty all arising from the alleged wrongful Stop Transfer Order which the Company placed relating to 75,000 shares of the Company's Common Stock registered in Berry's name and the Company's cancellation of a further 600,000 shares (the "Contingent Shares"). The complaint in the New York Action claims damages in excess of \$3,000,000 with the precise amount to be determined at trial.

Berry received the 600,000 Contingent Shares upon condition that he would remain in the Company's employ as Chief Executive Officer for at least two years. Berry commenced his employment with the Company on January 4, 1999, and resigned his employment with the Company on January 17, 2000. Following Berry's resignation, the Company attempted to have a Stop Transfer Order issued with respect to the 75,000 shares registered in Berry's name and cancel the 600,000 Contingent Shares. The Stop Transfer Order was not effective and Berry subsequently sold the 75,000 shares.

On May 19, 2000 CyPost and ePost Innovations commenced suit in the Supreme Court of British Columbia, Action #S002798, Vancouver Registry, against Berry and his wife, Tia Berry (the "BC Action"). In the BC Action, the Company seeks an order directing Berry to return the 600,000 Contingent Shares to the Company for cancellation or an order entitling the Company to cancel the same on the basis that Berry did not fulfill the employment conditions which were the condition precedent to his becoming the beneficial owner of the Contingent Shares.

In the BC Action, the Company also claims at least Cdn\$800,000 from Berry on account of breach of fiduciary duty, negligence, breach of statutory duties and breach of contract arising from Berry's failure to properly carry out his employment responsibilities. In the BC Action, the Company also claims Cdn\$34,013 from Berry and Tia Berry on account of conspiracy to defraud and injure the Company and ePost Innovations by causing certain personal expenses to be paid by the Company rather than by Berry and Tia Berry personally. The Company also claims punitive and exemplary damages from Berry and Tia Berry in the BC Action.

On May 25, 2000, the Company moved in the New York Action for an order dismissing the action against the Company for lack of jurisdiction or, in the alternative, on the basis of forum non conveniens. On September 5, 2000, the court dismissed the New York Action on forum non conveniens grounds, subject to the Company making certain stipulations in the New York Action. Those stipulations have been made and the appeal period in the New York Action has expired without Berry or any other party appealing the September 5, 2000 order.

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The issues raised by Berry and the Company in the New York Action will be litigated in the BC Action together with the further issues raised by the Company in the BC Action. The Company feels that Berry's claims in the New York Action were without merit and that the Company will be successful in

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obtaining an order declaring that Berry's 600,000 Contingent Shares be cancelled and further entitling the Company to substantial damages. The Company will vigorously pursue its position in all respects.

On December 21, 2000, Berry and Tia Berry commenced suit in the Supreme Court of British Columbia, Action #S006790, Vancouver Registry, against CyPost, ePost Innovations, Kelly Shane Montalban, J. Thomas W. Johnston, Carl Whitehead and Robert Sendoh (the "Berry Action"). Statements of Defense have been filed on behalf of the Company and the other defendants.

The Plaintiffs in the Berry Action allege that the Tia Action, the BC Action, and the action by Kelly Shane Montalban (Supreme Court of British Columbia, Action #S002147, Vancouver Registry), against Berry for specific performance of an option agreement (the "Montalban Action"), collectively, amount to an abuse of process, malicious prosecution, unlawful interference with the Plaintiffs' economic rights, or were commenced pursuant to a civil conspiracy to injure the Plaintiffs.

In the Berry Action, the Plaintiffs seek a declaration that Berry is entitled to the 600,000 Contingent Shares and claim unspecified damages which are estimated at Cdn\$2,000,000 based on the Statement of Claim. They also claim punitive or aggravated damages and costs. The Company believes that the allegations in the Berry Action are without merit and they will be vigorously defended.

It is expected that the Tia Action, the BC Action and the Berry Action will be consolidated for the purposes of trial due to the fact that there are numerous issues of fact and law which are common to all of these actions. The Company believes that trial will likely take place in the fall of 2002.

A loss by the Company of the claim against it for monetary damages would have a material adverse effect on the Company's future results of operations, financial condition and liquidity; however, the Company does not expect to lose this action and believes additionally that it would be able to negotiate reasonable payment terms should it lose this suit.

Shane Montalban Litigation

On June 15, 2001 the Company filed a Summons and Complaint against Kelly Shane Montalban in the United States District Court for the Southern District of New York (CyPost Corp. v. Kelly Shane Montalban, Civ. 5447). The Complaint alleged that, between September 1999 and June 15, 2001 (the "Recovery Period"), numerous purchases and sales of the Company's common stock were made in violation of the short swing profit recovery provisions of Section 16(b) of the Securities Exchange Act of 1934, as amended. ("Section 16(b)").

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Section 16(b) imposes strict liability on corporate insiders, including principal stockholders, for engaging in short swing trading activities (a sale and purchase or purchase and sale occurring within any six (6) month period) without regard as to whether true profits were realized by the insider from such trading activities. During the Recovery Period, numerous purchases and sales of the Company's common stock were made in violation of Section 16(b). Although the Company did not believe that any of such purchases and sales were based on non-public information, the Company nonetheless required by the strict liability provisions of Section 16(b) to seek recovery. The Company ultimately determined that the amount of short swing profits realized within the Recovery Period was \$2,498,449 (the "Recovery Amount"). Mr. Montalban cooperated fully with the Company's

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investigation and agreed to make payment in full of the Recovery Amount. Pursuant thereto, on September 20, 2001 the Company entered into a Settlement Agreement. Part of the Recovery Amount was delivered to the Company for cancellation on September 20, 2001, various promissory notes of the Company on which the Company owed an aggregate of \$2,344,788 in principal and \$44,450 in interest or a total of \$2,389,238.

The notes delivered for cancellation included a note which had been assigned to Mr. Montalban by the holder to satisfy an obligation of the holder, notes which had been purchased by Mr. Montalban from various individuals, and a note held by Pacific Gate Capital Corporation, a corporation owned by Mr. Montalban. The balance of the Recovery Amount was paid by the issuance to the Company of a five (5) year, 5% promissory note, dated September 20, 2001, in the principal amount of \$109,211. In consideration of the execution of the Settlement Agreement and payment of the Recovery Amount, on October 9, 2001 the Company voluntarily dismissed its action.

ITEM 5. OTHER INFORMATION

Subsequent to the period covered by this Report, effective October 12, 2001, Sandra Warren was appointed as a director of the Company. Ms. Warren joined the Company in 1998 serving in various administrative and accounting capacities for the Company.

Subsequent to the period covered by this Report, effective October 30, 2001, Ms. Warren was appointed as the Company's president, secretary, treasurer and principal financial officer.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

| Exhibit No. | Description |
|-------------|-------------|
| ----- | ----- |

- | | |
|------|---|
| 4.1 | Promissory Note dated September 20, 2001 in the principal amount of \$109,210.95 issued by Shane Montalban to CyPost Corporation. |
| 10.1 | Settlement Agreement dated as of September 20, 2001 by and among CyPost Corporation, Kelly Shane Montalban, and Pacific Gate Capital Corporation. |

(b) Reports on Form 8-K

None.

SIGNATURE

In accordance with the requirements of the Exchange Act, the registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

CYPOST CORPORATION

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DATE: November 14, 2001

By: /s/ Sandra Warren

Sandra Warren
President and Treasurer
(Principal Financial Officer)

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