

METRO ONE TELECOMMUNICATIONS INC  
Form 10-Q/A  
March 19, 2008

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q/A**

(Amendment No.1)

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the Quarterly Period Ended September 30, 2007**



or

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

**For the Transition Period From To**

**Commission File Number: 0-27024**

**METRO ONE TELECOMMUNICATIONS, INC.**

(Exact name of registrant as specified in its charter)

**OREGON**

**93-0995165**

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(State or other jurisdiction of  
incorporation or organization)

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

**11200 Murray Scholls Place, Beaverton, Oregon 97007**

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(Address of principal executive offices) (zip code)

**(503) 643-9500**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Number of shares of common stock outstanding as of November 10, 2007: 6,233,326 shares, no par value per share.

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**METRO ONE TELECOMMUNICATIONS, INC.**

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**EXPLANATORY NOTE**

Metro One Telecommunications, Inc. (the Company, our or we) filed a Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2007 (the Quarterly Report) with the Securities and Exchange Commission (SEC) on November 14, 2007. On February 20, 2008, management concluded that the Unaudited Condensed Consolidated Balance Sheet as of September 30, 2007, and the related Unaudited Condensed Consolidated Statements of Operations for the three and nine month periods ended September 30, 2007, as presented in the Quarterly Report, contained errors with respect to the accounting for the issuance of Series A convertible preferred stock (convertible preferred stock) and related stock purchase warrants (warrants) in a financing transaction, and that those Unaudited Condensed Consolidated Financial Statements should be amended and restated. The errors arising from the issuance of the convertible preferred stock and warrants did not materially affect the Unaudited Condensed Consolidated Financial Statements presented in our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007.

As more fully described in Note 6 of Notes to Condensed Consolidated Financial Statements (Unaudited), the following adjustments have been made in the restated consolidated financial statements contained in this Amendment No. 1 to the Quarterly Report:

- The convertible preferred stock has been reclassified as non-permanent equity in our Unaudited Condensed Consolidated Balance Sheet due to certain rights granted to the holders, pursuant to guidance prescribed by Rule 5-02.28 of SEC Regulation S-X and further clarified by the Emerging Issues Task Force Issue No. D-98;
- The warrants have been reclassified as long-term liabilities, also due to certain rights granted to the holders, under guidance from the Financial Accounting Standards Board Staff Position FAS 150-5;
- The beneficial conversion feature has been reclassified to common stock;
- The fair value calculation of the convertible preferred stock, warrants and the related beneficial conversion feature has been corrected;
- The warrants have been revalued to market as of the balance sheet date, as required by SFAS 150;
- The discounts to convertible preferred stock created by the valuation of the warrants and costs associated with the issuance of the convertible preferred stock and warrants have been accreted as required by Emerging Issues Task Force Issue No. D-98, and;

- The earnings per common share have been adjusted to reflect the dividends, deemed dividends and accretion costs associated with the convertible preferred stock as required by SFAS 128.

These errors have had no material effect on the Unaudited Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2007, because the mark-to-market adjustment pertaining to the warrants would have been reflected as a non-cash charge.

In addition to restating the condensed consolidated financial statements in this Amendment No. 1, we have revised Part I, Item 2 Management Discussion and Analysis of Financial Condition and Results of Operations to reflect the changes made in the restatement; revised Part I, Item 4 Controls and Procedures based upon management's reassessment of the disclosure controls and procedures in effect at September 30, 2007, and implemented since that date; and included Part II, Item 6 Exhibits to reflect the filing of currently dated certifications of our principal executive officer and our principal financial and accounting officer.

This Amendment No. 1 continues to speak as of the date of the Quarterly Report, and we have not updated or amended the disclosures contained herein to reflect events that have occurred since the filing of the Quarterly Report, or modified or updated those disclosures in any way, other than as described in the preceding paragraphs. Accordingly, this Amendment No. 1 should be read in conjunction with our filings made with the SEC subsequent to the filing of the Quarterly Report on November 14, 2007, as information in such filings may update or supersede certain information contained in this Amendment No. 1.

## Metro One Telecommunications, Inc.

## Condensed Consolidated Statement of Operations (Unaudited)

| (In thousands, except per share data)   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |             |
|---|-------------------------------------|------------|------------------------------------|-------------|
|   | 2007                                | 2006       | 2007                               | 2006        |
|   | As Restated                         |            | As Restated                        |             |
| Revenues  | \$ 4,198                            | \$ 5,205   | \$ 14,378                          | \$ 25,553   |
| Costs and expenses:   |                                     |            |                                    |             |
| Direct operating  | 3,724                               | 3,789      | 12,002                             | 15,319      |
| Selling, general and administrative   | 3,583                               | 4,465      | 11,016                             | 16,813      |
| Depreciation and amortization   | 514                                 | 686        | 1,670                              | 3,040       |
| Restructuring charges   | 221                                 | 453        | 1,130                              | 6,230       |
|   | 8,042                               | 9,393      | 25,818                             | 41,402      |
| Loss from operations  | (3,844)                             | (4,188)    | (11,440)                           | (15,849)    |
| Other income, net   | 69                                  | 187        | 297                                | 599         |
| Loss associated with revaluation of warrants  | (214)                               |            | (214)                              |             |
| Loss before income taxes  | (3,989)                             | (4,001)    | (11,357)                           | (15,250)    |
| Income tax (benefit) expense  | (6)                                 |            | (8)                                | 50          |
| Net loss  | \$ (3,983)                          | \$ (4,001) | \$ (11,349)                        | \$ (15,300) |
| Preferred stock dividends   | (122)                               |            | (128)                              |             |
| Preferred stock deemed dividends  | (2,115)                             |            | (2,115)                            |             |
| Accretion on preferred stock  | (136)                               |            | (136)                              |             |
| Net loss attributable to common shareholders  | \$ (6,356)                          | \$ (4,001) | \$ (13,728)                        | \$ (15,300) |
| Net loss per share attributable to common shareholders:   |                                     |            |                                    |             |
| Basic   | \$ (1.02)                           | \$ (0.64)  | \$ (2.20)                          | \$ (2.45)   |
| Diluted   | \$ (1.02)                           | \$ (0.64)  | \$ (2.20)                          | \$ (2.45)   |
| Weighted average shares outstanding used in computing net loss attributable to common shareholders: |                                     |            |                                    |             |
| Basic   | 6,233                               | 6,233      | 6,233                              | 6,233       |
| Diluted   | 6,233                               | 6,233      | 6,233                              | 6,233       |

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

## Metro One Telecommunications, Inc.

## Condensed Consolidated Balance Sheet (Unaudited)

| (In thousands, except share amounts)  | September 30,<br>2007<br>As Restated | December 31,<br>2006 |
|---|--------------------------------------|----------------------|
| <b>Assets</b>   |                                      |                      |
| Current assets:   |                                      |                      |
| Cash and cash equivalents   | \$ 11,267                            | \$ 11,965            |
| Restricted cash   | 3,000                                | 4,741                |
| Accounts receivable, net  | 2,621                                | 2,179                |
| Prepaid costs and other current assets  | 705                                  | 961                  |
| Total current assets  | 17,593                               | 19,846               |
| Furniture, fixtures and equipment, net  | 1,730                                | 3,014                |
| Intangible assets, net  | 4,210                                | 4,666                |
| Other assets  | 84                                   | 86                   |
| Total assets  | \$ 23,617                            | \$ 27,612            |
| <b>Liabilities and Shareholders' Equity</b>   |                                      |                      |
| Current liabilities:  |                                      |                      |
| Accounts payable  | \$ 692                               | \$ 983               |
| Accrued liabilities   | 1,595                                | 1,685                |
| Accrued payroll and related costs   | 2,405                                | 3,898                |
| Preferred stock dividend payable  | 128                                  |                      |
| Total current liabilities   | 4,820                                | 6,566                |
| Preferred stock warrants  | 813                                  |                      |
| Other long-term liabilities   | 381                                  | 470                  |
| Total liabilities   | 6,014                                | 7,036                |
| Commitments and contingencies   |                                      |                      |
| Redeemable preferred stock:   |                                      |                      |
| Preferred stock, no par value, 10,000,000 shares authorized:  |                                      |                      |
| Series A convertible preferred stock, 1,385 shares authorized 1,000 and 0 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively; liquidation preference of \$10,000 plus cumulative unpaid dividends of \$128 | 8,607                                |                      |
| Shareholders' equity:   |                                      |                      |
| Common stock, no par value; 50,000,000 shares authorized, 6,233,326 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively   | 122,215                              | 120,067              |
| Accumulated deficit   | (113,219)                            | (99,491)             |
| Total shareholders' equity  | 8,996                                | 20,576               |
| Total liabilities, redeemable preferred stock and shareholders' equity  | \$ 23,617                            | \$ 27,612            |

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

## Metro One Telecommunications, Inc.

## Condensed Consolidated Statement of Shareholders Equity (Unaudited)

| (In thousands)   | Shares | Common Stock<br>Amount<br>As Restated | Shareholders' Equity<br>Accumulated<br>(Deficit) Earnings<br>As Restated | Shareholders<br>Equity<br>As Restated |
|--|--------|---------------------------------------|--|---------------------------------------|
| Balances at December 31, 2006  | 6,233  | \$ 120,067                            | \$ (99,491)  | \$ 20,576                             |
| Stock compensation expense   |        |                                       | 33   | 33                                    |
| Beneficial conversion feature associated<br>with the June 5, 2007 and August 15,<br>2007 issuance of 1,000 shares of Series A<br>convertible preferred stock |        | 2,115                                 |  | 2,115                                 |
| Preferred stock dividends  |        |                                       | (128)  | (128)                                 |
| Preferred stock deemed dividends   |        |                                       | (2,115)  | (2,115)                               |
| Accretion on preferred stock   |        |                                       | (136)  | (136)                                 |
| Net loss   |        |                                       | (11,349)   | (11,349)                              |
| Balances at September 30, 2007   | 6,233  | \$ 122,215                            | \$ (113,219)   | \$ 8,996                              |

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



**Metro One Telecommunications, Inc.****Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2007 and 2006 (Unaudited)**

| (In thousands)  | Nine Months Ended September 30, |             |
|---|---------------------------------|-------------|
|   | 2007<br>As Restated             | 2006        |
| Cash flows used in operating activities:                                    |                                 |             |
| Net loss  | \$ (11,349)                     | \$ (15,300) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                 |             |
| Depreciation and amortization   | 1,670                           | 3,040       |
| Loss on disposal of fixed assets  | 99                              | 1,117       |
| Deferred rent   | (89)                            | 56          |
| Stock compensation expense  | 33                              | 92          |
| Loss associated with revaluation of warrants                                | 214                             |             |
| Changes in certain assets and liabilities:                                  |                                 |             |
| Accounts receivable   | (442)                           | 9,146       |
| Prepaid costs and other current assets                                      | 267                             | 575         |
| Accounts payable and other liabilities                                      | (1,874)                         | (5,390)     |
| Net cash used in operating activities                                       | (11,471)                        | (6,664)     |
| Cash flows from investing activities:                                       |                                 |             |
| Decrease in cash restricted to secure letter of credit                      | 1,741                           | 1,144       |
| Capital expenditures  | (60)                            | (233)       |
| Proceeds from sale of assets  | 22                              | 817         |
| Net cash provided by investing activities                                   | 1,703                           | 1,728       |
| Cash flows from financing activities:                                       |                                 |             |
| Proceeds from issuance of convertible preferred stock and warrants, net     | 9,070                           |             |
| Net cash provided by financing activities                                   | 9,070                           |             |
| Net decrease in cash and cash equivalents                                   | (698)                           | (4,936)     |
| Cash and cash equivalents, beginning of period                              | 11,965                          | 17,769      |
| Cash and cash equivalents, end of period                                    | \$ 11,267                       | \$ 12,833   |
| Supplemental disclosure of cash flow information:                           |                                 |             |
| Cash paid for income taxes, net   | \$ 8                            | \$ 109      |

**Non-cash financing activities:**

For the three and nine month periods ended September 30, 2007, the Company accrued a liability of approximately \$128 related to accumulated dividends payable on the convertible preferred stock.

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



**Metro One Telecommunications, Inc.**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**1. Summary of Significant Accounting Policies**

**Basis of Presentation**

The accompanying unaudited interim condensed consolidated financial statements have been prepared by Metro One Telecommunications, Inc. in conformity with accounting principles generally accepted in the United States of America ( US GAAP ) for interim financial information. Accordingly, certain financial information and footnotes have been omitted or condensed. In the opinion of management, the condensed financial statements include all adjustments necessary for a fair presentation of the results for the interim periods. These condensed consolidated financial statements and notes thereto should be read in conjunction with our audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006. The results of operations for the interim periods shown in this report are not necessarily indicative of results for future interim periods or the entire fiscal year.

The condensed consolidated financial statements include the accounts of Metro One Telecommunications, Inc. and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

On July 6, 2006, we effected a one-for-four reverse split of our common stock. All share and per share data presented in the accompanying financial statements and notes thereto have been restated for the reverse stock split.

**Cash, Cash Equivalents, and Restricted Cash**

Cash and cash equivalents include cash deposits in banks and highly liquid investments with maturity dates of three months or less at the date of acquisition. Restricted cash consists of cash restricted to secure a letter of credit related to our workers' compensation program and is invested in a bank certificate of deposit.

**Stock-Based Compensation**

Effective January 1, 2006, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards ( SFAS ) No. 123R, Share-Based Payment ( SFAS 123R ), under which compensation expense is recognized in the condensed consolidated statement of operations for the fair value of employee stock-based compensation. We elected the modified-prospective transition method as permitted by SFAS No. 123R and accordingly, prior periods have not been restated to reflect the effect of SFAS No. 123R. The modified-prospective transition method requires that stock-based compensation expense recognized in the Condensed Consolidated Statements of Operations include (1) quarterly amortization of all stock-based compensation granted prior to, but not vested as of January 1, 2006, based on the grant date fair value estimated

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in accordance with the original provisions of SFAS No. 123 and (2) quarterly amortization of all stock-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. In addition, pursuant to SFAS No. 123R, we estimate forfeitures when calculating stock-based compensation expense, rather than accounting for forfeitures as incurred, which was our previous method. Compensation expense is recognized over the requisite service (vesting) period using the straight-line attribution method.

Stock compensation expense recognized in accordance with SFAS No. 123R for the three and nine month periods ended September 30, 2007 was approximately \$12,000 and \$33,000, respectively. Stock compensation expense recorded was approximately \$92,000 for both the three and nine month periods ended September 30, 2006. The effect of recording stock-based compensation on basic and diluted earnings per share for the three and nine month periods ended September 30, 2007 and 2006 was not material to our per share loss in those periods. Costs related to stock-based compensation are recorded in selling, general, and administrative expenses in the statements of operations.

Options to purchase our common stock are granted at prices equal to or greater than the fair market value on the date of grant. Options granted to directors generally vest immediately while options granted to employees generally vest and become exercisable quarterly over a four year period. All options generally expire ten years from the date of the grant.

**Metro One Telecommunications, Inc.**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

We estimate the fair value of stock options using the Black-Scholes option pricing model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of our stock over the option's expected term, and the risk-free interest rate over the option's expected term and our expected annual dividend yield. The expected option term represents the estimated time until exercise and is based on our historical experience with similar awards, taking into consideration contractual terms, vesting schedules and expected employee behavior. The expected stock price volatility is based on the historical volatility of our stock over the most recent period equal to the expected term of the option, adjusted for activity that is not expected to occur in the future. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected term of the option. We have not yet paid a dividend, and thus the dividend yield is 0.0%. Prospectively, the assumptions will be evaluated and revised as necessary to reflect changes in market conditions and our experience.

Estimates of fair value are not intended to predict actual future events or the value ultimately realized by people who receive equity awards.

**Recent Accounting Pronouncements.**

In February 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to provide additional information that will help investors and other financial statement users to more easily understand the effect of a company's choice to use fair value on its earnings. Finally, SFAS 159 requires entities to display the fair value of those assets and liabilities for which a company has chosen to use fair value on the face of the balance sheet. SFAS 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. We are currently assessing the impact of SFAS 159 which we will be required to adopt in the first quarter of our 2008 fiscal year.

In May 2007, the FASB issued FSP FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48* ( FSP FIN 48-1 ). FSP FIN 48-1 clarifies when a tax position is considered settled under FIN 48. Per FSP FIN 48-1, a tax position is considered effectively settled upon completion of the examination by the taxing authority without being legally extinguished. For effectively settled tax positions, a company can recognize the full amount of the tax benefit. FSP FIN 48-1 is effective upon a company's adoption of FIN 48. See further discussion of FIN 48 below. FSP FIN 48-1 did not have a material impact on our consolidated financial position or results of operations.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for our fiscal year beginning January 1, 2007. The adoption of this statement has not had a material effect on our consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to increase consistency in how fair value determinations are made under various

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existing accounting standards that permit, or in some cases require, estimates of fair market value. SFAS 157 also expands financial statement disclosure requirements about a company's use of fair value measurements, including the effect of such measures on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of this statement to have a material effect on our consolidated financial position or results of operations.

**Metro One Telecommunications, Inc.****Notes to Condensed Consolidated Financial Statements (Unaudited)****2. Restructuring Charges and Exit Activities**

In the third quarter and first nine months of 2007, we have continued to focus our efforts on reducing our operating costs and establishing long-term viability and stability. To that end, we incurred approximately \$221,000 of restructuring expenses in the third quarter of 2007, which consisted primarily of payments to our strategic advisors for assistance with our operational, strategic and financial initiatives. During the first nine months of 2007, we incurred approximately \$1.1 million of restructuring expenses primarily associated with one-time termination benefits related to head-count reductions as well as other costs primarily associated with efforts to select and engage our strategic advisors.

In the first nine months of 2006, we undertook significant restructuring activities, due primarily to the loss of a major customer. We closed 13 call centers and significantly reduced the number of call center and administrative employees and recorded restructuring charges in the third quarter and first nine months of 2006 totaling \$453,000 and \$6.2 million, respectively.

Costs incurred in our restructuring activities during the third quarter and first nine months of 2007 are shown in the following table (in thousands).

| Major cost type                         | Three months ended<br>September 30, 2007 | Nine months ended<br>September 30, 2007 |
|---|--|---|
| One-time termination benefits           | \$ 13                                    | \$ 161                                  |
| Lease termination costs                 | (1)                                      | 8                                       |
| Consulting, professional and other fees | 209                                      | 961                                     |
|   | \$ 221                                   | \$ 1,130                                |

The following summarizes the provisions, payments, adjustments and liability for costs associated with our cost reduction efforts for the period shown (in thousands):

|                                | One-time<br>termination benefits | Lease<br>termination costs | Other | Total   |
|--------------------------------|----------------------------------|----------------------------|-------|---------|
| Balance at January 1, 2007     | \$ 520                           | \$ 192                     | \$    | \$ 712  |
| Provisions                     | 113                              | 24                         | 345   | 482     |
| Payments                       | (633)                            | (74)                       | (345) | (1,052) |
| Adjustments                    |                                  |                            |       |         |
| Balance at March 31, 2007      | \$                               | \$ 142                     | \$    | \$ 142  |
| Provisions                     | 35                               | (15)                       | 407   | 427     |
| Payments                       | (17)                             | (45)                       | (407) | (469)   |
| Adjustments and non-cash items |                                  | (82)                       |       | (82)    |

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|                                |    |    |    |     |       |       |
|--------------------------------|----|----|----|-----|-------|-------|
| Balance at June 30, 2007       | \$ | 18 | \$ | \$  | \$    | 18    |
| Provisions                     |    | 13 |    | (1) | 209   | 221   |
| Payments                       |    |    |    |     | (209) | (209) |
| Adjustments and non-cash items |    |    |    | 1   |       | 1     |
| Balance at September 30, 2007  | \$ | 31 | \$ | \$  | \$    | 31    |

We may undertake additional restructuring and/or consolidation efforts in the future that would cause us to incur additional restructuring charges.



**Metro One Telecommunications, Inc.**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**3. Net Loss Per Share (Restated, see Note 6):**

Basic net loss per share is computed by dividing net loss attributable to common shareholders by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by dividing net loss attributable to common shareholders by the weighted average number of shares of common stock and the dilutive potential common stock equivalents outstanding. Potential common stock equivalents consist of stock options, warrants and common shares available to convertible preferred stockholders. For all periods presented in these financial statements, the calculation of weighted-average outstanding shares is the same on both a basic and diluted basis because inclusion of potential common stock equivalents would be anti-dilutive.

Options to purchase approximately 513,000 and 568,000 shares of common stock were outstanding at September 30, 2007 and 2006, respectively, but were not included in the computation of diluted net loss per share because their effect would be anti-dilutive. In addition, approximately 5,618,000 common shares available from conversion of convertible preferred stock and approximately 1,966,300 shares resulting from the exercise and conversion of warrants described in Note 5 under Financing arrangement below were not included in the computation of diluted net loss per share because their effect would be anti-dilutive.

**4. Commitments and Contingencies**

From time to time, we are party to various legal actions and administrative proceedings arising in the ordinary course of business. We believe the disposition of these matters will not have a material adverse effect on our financial position, results of operations or cash flows.

From time to time, in the normal course of our business, we issue standby letters of credit and bank guarantees. At September 30, 2007, we had one letter of credit outstanding in the amount of \$3,000,000 related to our workers' compensation program. The letter of credit is secured by a certificate of deposit for the same amount that is recorded as restricted cash. This letter of credit expires in March 2008. In August 2007, the benefactor of the letter of credit agreed to a reduction in the amount of the letter of credit from \$4.7 million to \$3.0 million based on lower than expected workers' compensation claims. The result was a reduction in the restricted cash balance and certificate of deposit securing the letter which released \$1.7 million of funds for our use.

**5. Significant Events**

**Financing arrangement (Restated, see Note 6)**

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On June 5, 2007, we entered into a private financing transaction ( financing transaction ) pursuant to a Securities Purchase Agreement (the Purchase Agreement ) by and among Metro One and Columbia Ventures Corporation ( Columbia ) and Everest Special Situations Fund L.P. ( Everest , together with Columbia, the investors ). Pursuant to the Purchase Agreement, on June 5, 2007, we issued to the investors (i) 220 shares of our newly authorized Series A Convertible Preferred Stock, no par value (the convertible preferred stock ), at a stated value of \$10,000 per share, (ii) Stock Purchase Warrants to purchase an additional 77 shares of the convertible preferred stock at an initial exercise price of \$10,000 per share of convertible preferred stock (the warrants ) and (iii) Senior Secured Convertible Revolver Bridge Notes having a maximum principal amount of \$7.8 million and, subject to approval of our shareholders, convertible into shares of convertible preferred stock (the notes and together with the convertible preferred stock and the warrants, the securities ). We received \$2.2 million in gross proceeds in the initial closing.

At the annual meeting of shareholders held on August 14, 2007, the holders of our common stock approved, among other things, the issuance of additional shares in the financing, permitting the second closing to take place. At a second closing held on August 15, 2007, we drew down the maximum principal amount of \$7.8 million under the notes, and the notes were immediately converted into 780 shares of convertible preferred stock and the security interest we granted in certain of our assets as security for repayment of the notes was released. No amounts had been drawn under the notes prior to the second closing. In addition, we issued warrants to the investors for the purchase

**Metro One Telecommunications, Inc.**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

of an additional 273 shares of convertible preferred stock at an initial exercise price of \$10,000 per share. We received \$7.8 million in gross proceeds at the second closing.

The number of shares of convertible preferred stock that can be purchased on exercise of the warrants represents 35% of the number of shares of convertible preferred stock issued in the financing. The warrants are currently exercisable over a two year period at an initial all cash exercise price of \$10,000 per share. If all of the convertible preferred stock issued to the investors is converted into shares of common stock, the warrants will be exchanged for warrants to purchase common stock.

At the initial conversion price, the 1,000 shares of convertible preferred stock currently outstanding are convertible into an aggregate of 5,617,977 shares of our common stock and, if the warrants are exercised in full, we will receive an additional \$3.5 million and the 350 shares of convertible preferred stock purchased on exercise of the warrants will be convertible into an aggregate of 1,966,292 shares of common stock at the initial conversion price. A cumulative dividend of 4% is payable on each share of outstanding convertible preferred stock on June 5<sup>th</sup> of each year with the first dividend payment due on June 5, 2008.

In connection with the sale of the securities to the investors, we entered into a Registration Rights Agreement with the investors dated as of June 5, 2007 (the Registration Rights Agreement), which requires us to use our best efforts to register on Form S-3 under the Securities Act of 1933, as amended (the Securities Act), the shares of common stock issuable upon conversion of the convertible preferred stock (including those shares of convertible preferred stock issuable on exercise of warrants). Should it be determined that we are not eligible to register these shares on Form S-3, we will be required to register the shares on Form S-1 and will be required to file the Form S-1 within 60 days after it is determined that the Form S-3 registration is not available. Under the Registration Rights Agreement, as currently amended, we will incur penalties if, among other things, the Form S-3 registration statement is not declared effective by the Securities and Exchange Commission (SEC) on or prior to March 31, 2008, or if the registration is on Form S-1, within 120 days after being first filed on Form S-1. The penalties, payable to the holders of the convertible preferred stock and warrants proportionately to their holdings, is 1.25% of the purchase price of the preferred stock (or \$125,000) for each 30-day period during which the effectiveness of the registration statement is delayed beyond the applicable final date, which amount is prorated for any partial period of delay. Penalties may not exceed 20% of the purchase price of the convertible preferred stock (or \$2,000,000). The Registration Rights Agreement also provides the investors with demand and piggyback registration rights under the Securities Act for shares of common stock issuable upon conversion of the convertible preferred stock (including shares of convertible preferred stock issuable on exercise of warrants or conversion of the notes).

Due to certain rights granted to its holders, the convertible preferred stock is classified as non-permanent equity in the Condensed Consolidated Balance Sheets, pursuant to Rule 5-02.28 of the Securities and Exchange Commission's Regulation S-X and as further clarified by the Emerging Issues Task Force Issue No. D-98, *Classification and Measurement of Redeemable Securities*. The fair value of the warrants, as based on intrinsic value, was approximately \$598,000 at the time of their issuance. Pursuant to FASB Staff Position FAS 150-5, *Issuer's Accounting Under FAS 150 for Freestanding Warrants and Other Similar Instruments That Are Redeemable*, the warrants are classified as liabilities also due to certain rights granted to its holders. The warrants are subject to periodic mark-to-market adjustments which are recorded in the Unaudited Condensed Consolidated Statements of Operations.

The convertible preferred stock is convertible into shares of our common stock at an initial conversion price of \$1.78 per share. In accordance with EITF Issue 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios* we had evaluated if the convertible preferred stock had a beneficial conversion feature as the conversion price was less than the fair value of our

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common stock on the measurement date. Under paragraph 6 of EITF 98-5, the discount related to the beneficial conversion feature would be calculated based on its intrinsic value which was approximately \$2.1 million. The value of the beneficial conversion feature was recorded in Common stock and the offsetting discount to the convertible preferred stock was immediately written-off to Accumulated deficit as a deemed dividend to preferred shareholders because the convertible preferred stock is immediately convertible.

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We incurred costs of approximately \$930,000 related to the issuance of the convertible preferred stock. These costs were recorded as a discount to the convertible preferred stock and, along with the discount associated with the warrants, will be accreted to Accumulated deficit over the 2-year non-redemption period of the convertible preferred stock. This accretion reduces net income available to common shareholders.

**Nasdaq listing issues**

On June 27, 2007, we received a Nasdaq Staff Deficiency Letter informing us that we no longer comply with Nasdaq's audit committee requirements for continued listing as set forth in Marketplace Rule 4350. Marketplace Rule 4350(d)(2)(A) requires that the audit committee of each Nasdaq issuer have at least three members, each of whom, among other things, must be independent as defined under Marketplace Rule 4200(a)(15) and meets the criteria for independence set forth in SEC Rule 10A-3(b)(1) under the Securities Exchange Act of 1934, as amended. Currently, our Audit Committee is comprised of two independent members.

We were advised in the letter that we will be provided a cure period in order to regain compliance until December 3, 2007. The letter also stated that, in the event we do not regain compliance within this period, we will be provided written notification that our securities will be delisted.

Our Board of Directors intends to take the necessary action to appoint an independent member to the Audit Committee within the cure period provided so as to maintain continued Nasdaq listing.

**Termination of contract**

In February 2005, we entered into a Master Services Agreement for Directory Assistance Services (the "Services Agreement") with Nextel Operations, Inc., acting on behalf of certain affiliates (collectively "Nextel") of Nextel Communications, Inc. The Services Agreement superseded our previous services agreement dated in June 1999. Under the Services Agreement, we agreed to provide directory assistance services to Nextel's customers on a non-exclusive basis, and Nextel could transition call volume away from us on short notice and/or terminate services entirely.

In October 2005, we received notification from Nextel that it would be terminating the Services Agreement effective January 9, 2006. In February 2006, we entered into a Settlement Agreement and Disentanglement Transition Plan (the "Plan") with Nextel that resolved certain disputed matters in connection with the termination of the Services Agreement. Under the Plan, we continued to provide services to Nextel callers through March 31, 2006 in return for the payment by Nextel of approximately \$5.75 million. Those payments were in addition to \$2.5 million previously paid by Nextel in December 2005 in connection with the transition and in addition to the contractual payments by Nextel for normal service provided by Metro One to Nextel callers through the transition period. Calls from Nextel were substantially transitioned away from us by March 31, 2006, and we have received all amounts due from Nextel as of the date of this filing. Including the \$5.75 million received in the first quarter of 2006 as part of the settlement payments, Nextel represented approximately 44% of our revenues for the first nine months of 2006.

**Other Information**

Termination of the Services Agreement and other customer losses has had, and will continue to have, a significant adverse impact on our results of operations and cash flows. We have experienced net losses in each of the quarterly and annual periods beginning with the second quarter of 2003. It is likely that we will continue to experience operating losses in the fourth quarter of 2007 and parts or all of 2008. Our management is working to aggressively pursue new and additional sources of revenues to support our reduced cost structure, further reduce the direct cost of delivering our services and reduce our general and administrative overhead, and develop and grow our data services business. There can be no assurance that management's plans will be successful. In that case, we may need additional cash to fund our operations and/or pursue our business initiatives during 2008. We may attempt to establish borrowing arrangements or otherwise raise additional funds in order to maintain adequate liquidity. We cannot provide assurance that borrowing or other funding will be available in amounts or on terms acceptable to us. If we are unable to execute our operations according to our plan or obtain additional financing, we may be forced to cease operations. For the remainder of 2007, we expect to meet our cash requirements using our existing cash and cash equivalents including proceeds from our recently completed sale of convertible preferred stock.

**Metro One Telecommunications, Inc.**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**Significant new contract**

In August 2006, we entered into a Telecom Information Services Agreement (the Agreement) with Jingle Networks, Inc. (Jingle). Under the Agreement, we are a preferred directory assistance provider for 1-800-FREE411. In addition to per call charges, the Agreement includes financial commitments from Jingle based on call volume expansion and other financial incentives. The Agreement is for three years and will automatically renew annually for up to two additional years unless either party provides notice of termination at least 60 days prior to the commencement of such renewal period. Under the Agreement, as a preferred directory provider we will be allocated no fewer calls than any other vendor providing similar services. The Agreement provides that our status as a preferred provider may be terminated by Jingle but, in such event, the warrants described below will be terminated. Jingle accounted for approximately 18% and 33% of our revenue in the third quarter and first nine months of 2007, respectively. As a result of Jingle's increased automation of its call volume in September 2007, revenues in October declined to \$0. We do not expect to service additional Jingle calls for the remainder of 2007.

In connection with the Agreement, we issued to Jingle two warrants to purchase shares of our common stock. The first warrant was for the purchase of up to 623,250 shares of common stock at an exercise price of \$2.60 per share. The warrant was exercisable under the condition that Jingle meet certain revenue and payment thresholds through February 28, 2007. We concluded that there was no cost related to issuance of these warrants to a nonemployee due to the fact that future services were required to be performed and it was not probable that the revenue targets would be met. The revenue and payment targets were not met, and accordingly, the first warrant expired and terminated unexercised effective as of February 28, 2007.

The second warrant is for the purchase of up to 870,075 shares of our common stock; provided, however, that shares represented by the sum of the first and second warrants, if exercised, cannot exceed 19.98% of our total shares outstanding after the warrants are exercised. The exercise price for the second warrant is \$4.55, which was the July 1, 2006 book value of our common stock determined on the basis of our US GAAP financial statements. The second warrant will not be exercisable unless and until certain revenue and payment thresholds are achieved by Jingle during specified time periods as outlined in the Agreement. The second warrant terminates on July 1, 2009. Since we are not obligated to accept call volume from Jingle in any month that exceed by a certain percentage the call volume from Jingle in the immediately preceding month, unless we were to waive this limitation on increased call volume, Jingle will not be able to meet the revenue and payment thresholds necessary for the second warrant to become exercisable. Since Jingle did not meet the revenue targets necessary for the first warrants to become exercisable and it is not likely that they will meet the revenue targets for the second warrants to become exercisable, we have not recognized any expense amounts in our financial statements related to the value of the first or the second warrants.

**6. Restatement of Previously Issued Financial Statements**

As part of management's analysis of comments made by BDO Seidman in BDO Seidman's review of a draft of an amendment to a registration statement previously filed by us with the SEC, we discovered errors in the accounting treatment of the financing transaction in the Unaudited Condensed Consolidated Balance Sheet as of September 30, 2007, and the related Unaudited Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2007, that were presented in our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2007. Accordingly, management determined on February 20, 2008, that these Unaudited Condensed Consolidated Financial Statements should be restated. These errors were as follows:

a) We did not correctly classify the securities in the Unaudited Condensed Consolidated Balance Sheet at September 30, 2007. We erroneously classified the convertible preferred stock and related warrants in the Shareholders' equity section of the Unaudited Condensed Consolidated Balance Sheet. However, pursuant to Rule 5-02.28 of the SEC's Regulation S-X and as further clarified by the Emerging Issues Task Force (EITF) Issue No. D-98: *Classification and Measurement of Redeemable Securities*, the convertible preferred stock should be classified as Non-permanent equity due to certain rights granted to its holders. Secondly, in accordance with the Financial Accounting Standards Board (the FASB) Staff Position 150-5: *Issuer's Accounting under FASB Statement No. 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable (FSP 150-5)*, the warrants should be reclassified as Long-term liabilities, also due to certain rights granted to the holders. As such, we did not re-value the warrants to market value at September 30, 2007 as required by SFAS 150: *Accounting for Certain Financial Instruments*



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**Notes to Condensed Consolidated Financial Statements (Unaudited)**

*Characteristics of both Liabilities and Equity.* The revaluation amount of \$214,000 at September 30, 2007 should have been recorded as a charge to Other income, net in the Unaudited Condensed Consolidated Statements of Operations.

b) We did not correctly assess the fair market value of the securities and related beneficial conversion feature at the time of issuance. The Black-Sholes method was used in the valuation of the warrants; however errors were made in the utilization of that model which, in addition to incorrectly assessing the fair market value of the warrants, led to an incorrect calculation of the intrinsic value of both the warrants and the beneficial conversion feature. These intrinsic values are interrelated due to the relative fair market value concept for calculating the beneficial conversion feature as prescribed by EITF Issue No. 98-05: *Accounting for Convertible Securities with Beneficial Conversion Features*, and clarified by EITF Issue No. 00-27: *Application of Issue No.98-5 to Certain Convertible Instruments*. Further, EITF 00-27 was incorrectly applied to the calculation of the intrinsic value of beneficial conversion feature. These errors collectively also affected the fair value calculation of the convertible preferred stock. Finally, the beneficial conversion feature should have been recorded as a credit to Common stock.

c) We did not accrete the discounts to convertible preferred stock created by the valuation of the warrants and costs associated with the issuance of the securities (the Issuance Costs ) as required by EITF Issue No. D-98: *Classification and Measurement of Redeemable Securities*. The convertible preferred stock is conditionally redeemable by us anytime on or after the two-year anniversary of the first issuance. Therefore, the discounts to the convertible preferred stock should be written-off ratably over the two-year non-redemption period to Accumulated deficit. We had previously written-off the full value of the discount to convertible preferred stock created by the warrants directly to Accumulated deficit and did not accrete any of the discount to convertible preferred stock created by the Issuance Costs. This accretion increases net loss attributable to common shareholders and should have been recorded as a line-item on the face of the Unaudited Condensed Consolidated Statements of Operations as noted in item d) below.

d) Net loss per common share as presented on the face of the Unaudited Condensed Consolidated Statements of Operations did not include the charges against Accumulated deficit for both accrued dividends and deemed dividends to preferred shareholders and was incorrectly stated.

## Metro One Telecommunications, Inc.

## Notes to Condensed Consolidated Financial Statements (Unaudited)

The effect of the above errors on the Unaudited Condensed Consolidated Financial Statements as previously presented in our Form 10-Q for the quarterly period ended September 30, 2007 was as follows:

*((Dollar amounts in thousands except per share amounts))*

| Line items on the<br>Condensed Consolidated<br>Balance Sheet  | As Reported as of<br>September 30, 2007<br>(Unaudited) | As Restated as of<br>September 30, 2007<br>(Unaudited) | Difference |
|---|--|--|------------|
| <b>Liabilities:</b>   |  |  |            |
| Preferred stock warrants                                      | \$   | \$ 813   | \$ 813     |
| <b>Redeemable Preferred Stock:</b>                            |  |  |            |
| Preferred stock   |  | 8,607  | 8,607      |
| <b>Shareholders' equity:</b>                                  |  |  |            |
| Preferred stock   | 9,070  |  | (9,070)    |
| Preferred stock discount and beneficial<br>conversion feature | 3,472  |  | (3,472)    |
| Common stock  | 120,100  | 122,215  | 2,115      |
| Accumulated deficit   | (114,226)  | (113,219)  | 1,007      |

| Line items on the<br>Condensed Consolidated Statements<br>Of Operations | As Reported for the<br>Three Months Ended<br>September 30, 2007<br>(Unaudited) | As Reported for the<br>Three Months Ended<br>September 30, 2007<br>(Unaudited) | Difference |
|---|--|--|------------|
| Net loss  | \$ (3,769)   | \$ (3,983)   | \$ (214)   |
| Preferred stock dividends   |  | (122)  | (122)      |
| Preferred stock deemed dividends  |  | (2,115)  | (2,115)    |
| Accretion on preferred stock  |  | (136)  | (136)      |
| Net loss attributable to common shareholders                            | \$ (3,769)   | \$ (6,356)   | \$ (2,587) |
| <b>Net loss per common share:</b>                                       |  |  |            |
| Basic   | \$ (0.60)  | \$ (1.02)  | \$ (0.42)  |
| Diluted   | \$ (0.60)  | \$ (1.02)  | \$ (0.42)  |

| Line Items on the<br>Condensed Consolidated Statements<br>Of Operations | As Reported for the<br>Nine Months Ended<br>September 30, 2007<br>(Unaudited) | As Reported for the<br>Nine Months Ended<br>September 30, 2007<br>(Unaudited) | Difference |
|---|---|---|------------|
| Net loss  | \$ (11,135)   | \$ (11,349)   | \$ (214)   |
| Preferred stock dividends   |   | (128)   | (128)      |
| Preferred stock deemed dividends  |   | (2,115)   | (2,115)    |
| Accretion on preferred stock  |   | (136)   | (136)      |
| Net loss attributable to common shareholders                            | \$ (11,135)   | \$ (13,728)   | \$ (2,593) |
| <b>Net loss per common share:</b>                                       |   |   |            |
| Basic   | \$ (1.79)   | \$ (2.20)   | \$ (0.41)  |
| Diluted   | \$ (1.79)   | \$ (2.20)   | \$ (0.41)  |

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There was no material effect on the Unaudited Condensed Consolidated Statement of Cash Flows as a result of these changes because the mark-to-market adjustment pertaining to the warrants would have been reflected as a non-cash charge.



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



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All statements and trend analyses contained in this item and elsewhere in this report on Form 10-Q relative to the future constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may, but do not necessarily, also include words such as believes, expects, anticipates, plans, estimates, may, will, should, could, and other expressions. Forward-looking statements are not guarantees. They involve known and unknown business and economic risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These risks, uncertainties and other factors include the expiration or pricing of customer contracts, the successful execution of our cost reduction efforts and current business strategy, and our ability to generate cash from operations, and other risks, including those discussed in our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC) and those described in our other filings with the SEC, press releases and other communications. Any forward-looking statement in this report reflects our expectations at the time of this report only. We undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

### Overview





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We are a provider of Enhanced Directory Assistance® and other information services delivered through live operators and by electronic means. We contract primarily with wireless carriers, Voice over Internet Protocol ( VoIP ) providers, cable companies, Competitive Local Exchange Carriers ( CLEC ), Incumbent Local Exchange Carriers ( ILEC ), free directory assistance providers, prepaid carriers, and payphone operators to provide our services to their subscribers and users. Our proprietary Enhanced Directory Assistance platform provides comprehensive directory assistance listings and other informational content and services. Other non-directory assistance services and content include access to movie listings and a variety of other unique services. Our special return-to-operator features, StarBack® and AutoBack®, make the telephone easier to use and are offered exclusively by Metro One. All of our services are provided by operators located only in the United States or electronically. Many of our features or aspects thereof are the subject of patents or pending patent applications. Revenues are derived principally through fees charged to telecommunications carriers and other customers.

In addition to voice-based services, we also provide Enhanced Directory Assistance services in electronic format. These services are provided to customers who electronically issue directory assistance queries and use the returned information to complete and correct their own data records. We currently provide electronic directory assistance services in a number of delivery formats to meet customer needs including automated file processing and real-time individual look ups. We contract with a broad range of companies that require electronic directory assistance including companies in the service, marketing, and financial sectors. Our data services business represents an emerging business based on infrastructure originally developed to support our voice-based call center business.

Under a typical wholesale contract, a carrier agrees to route some or all of their directory assistance calls to us. We offer our services to multiple carriers within the same market. When a carrier's subscribers dial a typical directory assistance number, such as 411, 555-1212 or 00, the calls are routed to and answered by our live operators or the automated equivalent, identifying the service by that carrier's brand name.

Each carrier customer establishes its own directory assistance fee structure for its subscribers. Wireless subscribers typically pay fees ranging from \$1.25 to \$1.79 plus airtime charges for our services. We bear no subscriber collection risk with respect to carrier subscribers; however, there may be collection risk to the extent growth and profitability in the telecommunications industry decreases and to the extent we provide services to other types of customers.

We charge our carrier customers on a per call basis. Prices for services provided to other types of customers, including businesses, governmental units or customers who receive our services in electronic form, may vary based on the nature of the service, volume and other circumstances.

As discussed in Note 5 of Notes to Condensed Consolidated Financial Statements (Unaudited), as a result of the termination of contracts with significant customers, we have experienced significant financial losses and reduction of cash flows over the last several years. These losses have had, and will continue to have, a significant adverse impact

on our results of operations and cash flows. We have experienced net losses in each of the quarterly and annual periods beginning with the second quarter of 2003. It is likely that we will continue to experience operating losses in the fourth quarter of 2007 and parts or all of 2008. Our management is working to aggressively pursue new and additional sources of revenues to support our reduced cost structure, further reduce the direct cost of delivering our services and reduce our general and administrative overhead, and develop and grow our data services business. There can be no assurance that management's plans will be successful. In that case, we may need additional cash to fund our operations and/or pursue our business initiatives during 2008. We may attempt to establish borrowing arrangements or otherwise raise additional funds in order to maintain adequate liquidity. We cannot provide assurance that borrowing or other funding will be available in amounts or on terms acceptable to us. If we are unable to execute our operations according to our plan or obtain additional financing, we may be forced to cease operations. For the remainder of 2007, we expect to meet our cash requirements using our existing cash and cash equivalents including proceeds from our recently completed sale of convertible preferred stock.

### Significant Events **Restructuring.**

In the third quarter and first nine months of 2007, we have continued to focus our efforts on reducing our operating costs and establishing long-term viability and stability. To that end, we incurred approximately \$221,000 of restructuring expenses in the third quarter of 2007, which consisted primarily of payments to our strategic advisors for assistance with our operational, strategic and financial initiatives. During the first nine months of 2007, we incurred approximately \$1.1 million of restructuring expenses primarily associated with one-time termination benefits related to head-count reductions as well as other costs primarily associated with efforts to select and engage our strategic advisors.

### Other significant events.

See Note 5 of Notes to Condensed Consolidated Financial Statements (Unaudited) for a discussion of the financing arrangement, Nasdaq listing issues, termination of contract, and significant new contract.

### Results of Operations

This table shows selected items from our statements of operations expressed as a percentage of revenues:

|  | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|--|-------------------------------------|--------|------------------------------------|--------|
|  | 2007<br>As Restated                 | 2006   | 2007<br>As Restated                | 2006   |
| Revenues                                     | 100.0%                              | 100.0% | 100.0%                             | 100.0% |
| Direct operating costs                       | 88.7                                | 72.8   | 83.5                               | 59.9   |
| Selling, general and administrative costs    | 85.4                                | 85.8   | 76.6                               | 65.8   |
| Depreciation and amortization                | 12.2                                | 13.2   | 11.6                               | 11.9   |
| Restructuring charges                        | 5.3                                 | 8.7    | 7.9                                | 24.4   |
| Loss from operations                         | (91.6)                              | (80.5) | (79.6)                             | (62.0) |
| Other income, net                            | 1.6                                 | 3.6    | 2.1                                | 2.3    |
| Loss associated with revaluation of warrants | (5.0)                               |        | (1.5)                              |        |

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|                          |         |         |         |         |
|--------------------------|---------|---------|---------|---------|
| Loss before income taxes | (95.0)  | (76.9)  | (79.0)  | (59.7)  |
| Income tax (benefit)     | (0.1)   | 0.0     | (0.1)   | 0.2     |
| Net loss                 | (94.9)% | (76.9)% | (78.9)% | (59.9)% |

*Comparison of third quarter 2007 to third quarter 2006*

Revenues decreased 19.3% to \$4.2 million from \$5.2 million due to lower average revenue per call offset by a slight increase in call volume. Average revenue per call was approximately \$0.20 in the third quarter of 2007 compared with \$0.25 in the third quarter of 2006. Call volume was 19.5 million and 19.2 million in the third quarter of 2007 and 2006, respectively. Average revenue per call was lower in the third quarter of 2007 reflecting the effect of new customer additions and existing customer contract renewals, both at rates below the average revenue per call earned in third quarter of 2006. We expect market rates will continue to trend downward in the near term and to negatively affect our average revenue per call as we continue to sign new agreements.

Direct operating costs consist of salaries, wages, benefits and payroll taxes relating to call center personnel plus the costs of listings data and content acquisition. These costs decreased 1.7% to \$3.7 million in the third quarter of 2007 compared with \$3.8 million in the third quarter of 2006. This decrease was due to an approximate 10% decrease in the average hourly fully loaded labor rate for servicing those calls offset by an approximate 9% decrease in operator productivity. As a percentage of revenues, direct operating costs increased to approximately 88.7% from 72.8% in the third quarter of 2007, primarily resulting from the decrease in the average revenue per call. We will continue to work to find the optimal balance between labor rates and productivity in our efforts to reduce costs faster than the declines in average revenue per call.

Selling, general and administrative costs decreased 19.8% to \$3.6 million from \$4.5 million. This decrease resulted primarily from continued overall efforts to reduce administrative costs including network and facilities costs, legal and other professional services and administrative payroll. As a percentage of revenues, selling, general and administrative costs were unchanged due to lower revenue.

Depreciation and amortization expense decreased 25.1% to \$ 514,000 from \$686,000. The decrease in depreciation and amortization was due primarily to the overall reduction in acquisition of fixed assets in the last several years as operations have been reduced. Depreciation and amortization decreased to 12.2% from 13.2% of revenue as a result of our reduced operations facilities in place.

Restructuring charges in the quarter ended September 30, 2007 were \$221,000 and consisted primarily of payments to our strategic advisors for assistance with our operational, strategic and financial initiatives. Net restructuring costs in the third quarter of 2006 were \$453,000 and consisted primarily of one-time termination benefits for employees of approximately \$342,000, and dismantling costs related to the closed call centers of approximately \$171,000, partially offset by lower costs incurred on lease settlements than were previously accrued for those leases.

Other income was \$69,000 and \$187,000 in the third quarter of 2007 and 2006, respectively, and consisted primarily of interest income earned on cash and cash equivalents. The reduction in interest income was due to a decrease in cash available for investing. Loss associated with revaluation of warrants was \$214,000 in the third quarter of 2007 and \$-0- in the third quarter of 2006 and represents the mark-to-market value of the warrant liability incurred in connection with the issuance of 1,000 shares of convertible preferred stock. See Note 5 of Notes to Condensed Consolidated Financial Statements (Unaudited).

Because of our operating losses in the third quarters of 2007 and 2006, we recorded no net federal or state income tax expense. We have a valuation allowance against deferred tax assets associated with operating losses in this and prior quarters and other deferred tax assets because it is deemed more likely than not that these assets will not be realized. Accordingly, no federal income tax benefit has been recorded with respect to these deferred tax assets.

## **Liquidity and Capital Resources**

As of September 30, 2007, we had approximately \$14.3 million in cash and cash equivalents and restricted cash (including \$3.0 million of restricted cash) compared to approximately \$16.7 million (including \$4.7 million of restricted cash) at December 31, 2006. As noted above under Financing arrangement in Note 5 of Notes to Condensed Consolidated Financial Statements (Unaudited), during the second and third quarters of 2007, we received net proceeds of approximately \$9.1 million from our convertible preferred stock sale. In addition, during the third quarter of 2007, we received a release of \$1.7 million from the restricted cash account that secures our letter of credit for our formerly self-insured workers compensation program. Excluding these non-recurring events, our operations consumed approximately \$11.5 million of cash in the first nine months of 2007 primarily from net operating losses and restructuring costs. Management's goal is to restructure our operations to achieve positive, sustainable cash flow and earnings and we believe we have made significant progress toward that goal. There can be, however, no assurances that our cash resources will be sufficient to achieve that goal in the near term or ever.

Cash and cash equivalents and restricted cash are recorded at cost which approximates their fair market value. We have no outstanding debt, but we must pay a 4% cumulative dividend on the outstanding convertible preferred stock on June 5<sup>th</sup> of each year beginning in 2008.

*Cash flow from operations.* Net cash used in operations was \$11.5 million in the first nine months of 2007 compared to net cash used in operations of \$6.7 million in the first nine months of 2006. This difference of approximately \$4.8 million resulted primarily from a net decrease in cash received from customers of approximately \$20.8 million partially offset by net decreases in cash paid to or on behalf of employees of \$7.9 million, decrease of \$3.8 million in

cash paid to suppliers and cash paid for restructuring activities of \$4.2 million.

*Cash flow from investing activities.* Cash flow from investing activities was \$1.7 million in the first nine months of 2007 resulting primarily from the release of cash securing our letter of credit as discussed above. Cash flow from investing activities was \$1.7 million in the first nine months of 2006 as well, primarily resulting from the release of \$1.1 million of cash securing our letter of credit and receipt of proceeds from the sale of assets of approximately \$800,000.

*Cash flow from financing activities.* Cash flow from financing activities was \$9.1 million in the first nine months of 2007 resulting from the financing transaction noted above. Cash flow from financing activities was not significant in the first nine months of 2006.

*Future capital needs and resources.* The uses of our capital in the near future are expected to be primarily for working capital. We expect to adjust personnel, call centers and network capacities in order to address varying business circumstances, including changes in volume and pricing and other provisions of customer contracts.

Cash on hand (including restricted cash) and short-term investments at September 30, 2007 was approximately \$14.3 million. However, our operations and future activities, including additional restructuring efforts, if any, will likely reduce available cash.

We have experienced net losses in each of the quarterly and annual periods beginning with the second quarter of 2003. Excluding non-recurring events described above, our operations consumed approximately \$11.5 million of cash in the first nine months of 2007 primarily from net operating losses and restructuring costs. Our independent registered public accounting firm included a going concern explanatory paragraph in its report on our consolidated financial statements as of and for the year ended December 31, 2006. The high ratio of cash used in operations compared to our current cash resources will likely result in a similar going concern explanatory paragraph from our independent registered public accounting firm in its report on our consolidated financial statements as of and for the year ended December 31, 2007.

Our management is working to aggressively pursue new and additional sources of revenues to support our reduced cost structure, further reduce the direct cost of delivering our services and reduce our general and administrative overhead, and develop and grow our data services business. There can be no assurance that management's plans will be successful. In that case, we may need additional cash to fund our operations and/or pursue our business initiatives during 2008. We may attempt to establish borrowing arrangements or otherwise raise additional funds in order to maintain adequate liquidity. We cannot provide assurance that borrowing or other funding will be available in amounts or on terms acceptable to us. If we are unable to execute our operations according to our plan or obtain additional financing, we may be forced to cease operations.

#### **Critical Accounting Policies**

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of

revenues and expenses during the periods presented. Management believes that of our significant accounting policies (see Note 1 of Notes to Condensed Consolidated Financial Statements (Unaudited)), those governing accounts receivable, the lives and recoverability of the carrying amount of equipment and other long-lived assets, such as existing intangibles, estimates involving the levels of our contingent liabilities for workers' compensation and medical self-insurance and estimates of current and deferred taxes owed may involve a higher degree of judgment, estimation and uncertainty.

*Accounts receivable.* Our wholesale customer base has primarily consisted of large telephone carriers in the United States. As such, we have had minimal risk of uncollectibility, at any point in time, related to outstanding accounts receivable with these customers. We have not experienced significant collection issues or write-offs related to these customers. Since our accounts receivable are concentrated in relatively few of these wholesale customers, a significant change in the liquidity or financial position of any one of them could adversely impact collection of our accounts receivable and therefore have a material adverse effect on our financial position and future operating results. In addition, our data services business is generating receivables from customers that may not be as financially stable as our large carrier customers which to date has not, but may in the future, expose us to greater risk of uncollectible receivables than we have experienced in the past.

*Long-lived assets and intangibles.* We evaluate the remaining life and recoverability of equipment and other assets, including patents and trademarks and internally developed software, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. At such time, we estimate the future cash flows expected from use of such assets and their eventual disposition and, if lower than the carrying amounts, adjust the carrying amount of the assets to their estimated fair value. Because of our changing business conditions, including lower wholesale prices and dependence on a relatively small number of customers for a significant portion of our revenues, our estimates of future cash flows to be generated from our operations could change materially, resulting in the need for us to record additional impairment charges. In addition, as a result of our changing business conditions, we expect to adjust personnel, call centers and network capacities. If any of these activities result in certain of our assets no longer being used in operations, we may need to record an additional impairment charge. As a result of the decision by Nextel to terminate its contract with us, as discussed under *Termination of contract* in Note 5 of Notes to Condensed Consolidated Financial Statements (Unaudited), and because of continuing operating losses, we evaluated our fixed assets and intangibles as of December 31, 2006 for impairment in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 144. Our evaluation determined that the assets were not impaired as of December 31, 2006.

*Self-insurance reserves.* In the past, we have self-insured a portion of our workers' compensation and employee medical insurance programs. In some periods we purchased stop loss coverage at varying levels in order to mitigate our potential future losses. The nature of the liabilities associated with these self-insurance programs, which may not fully manifest themselves for several years, requires significant judgment. We evaluate open workers' compensation and medical claims under these policies periodically to determine the reasonableness of the reserves we have recorded for such claims. Our evaluation includes estimates of potential incurred-but-unreported claims as well as factors that may cause original estimates of such claims to increase over time, such as available claims data and historical trends and experience, as well as future projections of ultimate losses, expenses, premiums and administrative costs. We adjust these reserves if events or changes in circumstances indicate that ultimate payments related to the claims will be more than the recorded reserves. At September 30, 2007, we have reserved approximately \$1.2 million and \$147,000 related to these self-insured workers' compensation and medical programs, respectively. While we believe that the amounts reserved for these obligations are sufficient, any significant change in the status of open claims or costs associated with claims made under these plans could have a material adverse effect on our financial position, results of operations or cash flows.

*Income taxes.* Accounting for income taxes requires us to estimate our income taxes in each jurisdiction in which we operate. Due to differences in the recognition of items included in income for accounting and tax purposes, temporary differences arise which are recorded as deferred tax assets or liabilities. We estimate the likelihood of recovery of these assets, which is dependent on future levels of profitability and enacted tax rates. Should any amounts be determined not to be recoverable, or assumptions change, we would be required to take a charge to establish a valuation allowance against such deferred tax assets, which could have a material effect on our financial position, results of operations or cash flows. At September 30, 2007 and 2006, a valuation allowance reduced net deferred tax assets to zero.



**Recent Accounting Pronouncements**

In February 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Standards ( SFAS ) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to provide additional information that will help investors and other financial statement users to more easily understand the effect of a company's choice to use fair value on its earnings. Finally, SFAS 159 requires entities to display the fair value of those assets and liabilities for which a company has chosen to use fair value on the face of the balance sheet. SFAS 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. We are currently assessing the impact of SFAS 159 which we will be required to adopt in the first quarter of our 2008 fiscal year.

In May 2007, the FASB issued FSP FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48* ( FSP FIN 48-1 ). FSP FIN 48-1 clarifies when a tax position is considered settled under FIN 48. Per FSP FIN 48-1, a tax position is considered effectively settled upon completion of the examination by the taxing authority without being legally extinguished. For effectively settled tax positions, a company can recognize the full amount of the tax

benefit. FSP FIN 48-1 is effective upon a company's adoption of FIN 48. See further discussion of FIN 48 below. FSP FIN 48-1 did not have a material impact on our consolidated financial position or results of operations.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for our fiscal year beginning January 1, 2007. The adoption of this statement has not had a material effect on our consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to increase consistency in how fair value determinations are made under various existing accounting standards that permit, or in some cases require, estimates of fair market value. SFAS 157 also expands financial statement disclosure requirements about a company's use of fair value measurements, including the effect of such measures on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of this statement to have a material effect on our consolidated financial position or results of operations.

#### **ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures (as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2007. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of the end of the period covered by that Quarterly Report on Form 10-Q because of the material weakness discussed below.

##### **Identification of a Material Weakness**

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

As part of management's analysis of comments made by BDO Seidman in BDO Seidman's review of a draft of an amendment to a registration statement previously filed by us with the Securities and Exchange Commission, our Chief Financial Officer began an internal review of the accounting treatment of the issuance of Series A convertible preferred stock and related warrants in a financing transaction. Based on the results of this internal review, on February 20, 2008, our management concluded that the Unaudited Condensed Consolidated Balance Sheet as of September 30, 2007, and the related Unaudited Condensed Consolidated Statements of Operations for the three and nine month periods ended September 30, 2007, that were presented in our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2007, contained errors relating to the accounting of this financing transaction, and that these Unaudited Condensed Consolidated Financial Statement should be amended and restated. See Note 6 of Notes to Condensed Consolidated Financial Statements for a discussion of the nature of these errors.

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As a result of the restatement described above, our management has determined that a material weakness existed in our internal controls over financial reporting with respect to the analysis of and accounting for the financing transaction. Due to this material weakness in internal control over financial reporting, our Chief Executive Officer and our Chief Financial Officer concluded that, as of September 30, 2007, our disclosure controls and procedures were not effective.

### **Remediation of Material Weakness**

In January 2008, we identified the need to establish a part-time position of Director of Financial Reporting. At that time, we began discussions with a professional financial services consulting firm and engaged Tatum LLC to provide a part-time professional to fulfill the role of Director of Financial Reporting. Tatum LLC provided a candidate who is a CPA with extensive experience with big four public accounting firms as well as substantial public company experience at the management level in the areas of finance and accounting, including the accounting for and

reporting of complex financial transactions. In January 2008, the candidate began performing consulting services for us on a part-time basis as Director of Financial Reporting. The Director of Financial Reporting is performing a major role in ensuring the accuracy and completeness of our financial reporting and the effectiveness of our disclosure controls and procedures. We believe that the addition of this individual in this key position has remediated the material weakness in internal control over financial reporting described above.

Other than that described above, there has not been any change in our internal control over financial reporting, that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 6. EXHIBITS**

(a) Exhibits

- 31.1 Certification of Principal Executive Officer pursuant to Securities and Exchange Commission Rule 13a-14(a)
- 31.2 Certification of Principal Financial Officer pursuant to Securities and Exchange Commission Rule 13a-14(a)
- 32.1 Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002

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.

Date: March 19, 2008

METRO ONE TELECOMMUNICATIONS, INC.

By: /s/ William K. Hergenhan  
William K. Hergenhan  
Senior Vice President,  
Chief Financial Officer  
(Principal Financial and Accounting Officer)