

PERVASIP CORP
Form 10-Q
April 19, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended February 28, 2011.

TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934.

For the transition period from to .

Commission file number 0-4465

Pervasip Corp.

(Exact name of registrant as specified in its charter)

New York

13-2511270

(State or other jurisdiction of incorporation or organization)

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

75 South Broadway, Suite 400, White Plains, New York

10601

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: 914-620-1500

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

Indicate by check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities and 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

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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 Non-Accelerated
Filer

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

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: 19,977,750 shares of common stock, par value \$.10 per share, as of March 31, 2011.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

Pervasip Corp. and Subsidiaries
Condensed Consolidated Balance Sheets

	Feb. 28, 2011 (Unaudited)	Nov. 30, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$26,273	\$31,653
Accounts receivable, net	100,417	90,038
Prepaid expenses and other current assets	31,895	40,961
Total current assets	158,585	162,652
Other assets		
Total assets	\$199,996	\$206,471
Liabilities and Stockholders' Equity Deficiency		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	\$14,438,910	\$14,130,578
Accounts payable and accrued expenses	2,548,525	2,515,769
Total current liabilities	16,987,435	16,646,347
Accrued pension obligation	1,381,395	1,369,395
Total liabilities	18,368,830	18,015,742
Stockholders' equity deficiency:		
Preferred stock, \$.10 par value; 1,000,000 shares authorized, none issued and outstanding	-	-
Common stock, \$.10 par value; 150,000,000 shares authorized, 15,870,359 and 6,871,605 shares issued and outstanding in 2011 and 2010	1,587,036	687,161
Capital in excess of par value	31,381,115	31,852,584
Deficit	(51,139,294)	(50,350,805)
Accumulated comprehensive income	2,309	1,789
Total stockholders' equity deficiency	(18,168,834)	(17,809,271)
Total liabilities and stockholders' equity deficiency	\$199,996	\$206,471

See notes to the condensed consolidated financial statements.

Pervasip Corp. and Subsidiaries
Condensed Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

	For the Three Months Ended Feb. 28, 2011	Feb. 28, 2010
Revenues	\$319,671	\$374,767
Cost and expenses:		
Costs of services	197,405	311,444
Selling, general and administrative	436,113	583,243
Total costs and expenses	633,518	894,687
Loss from operations	(313,847)	(519,920)
Other income (expense):		
Interest expense	(482,161)	(328,127)
Other, net	7,520	-
Total other income (expense)	(474,641)	(328,127)
Net income (loss)	(788,488)	(848,047)
Other comprehensive loss-		
foreign currency translation adjustment	520	(73)
Comprehensive income (loss)	\$(787,968)	\$(848,120)
Basic earnings (loss) per share	\$(0.08)	\$(0.29)
Diluted earnings (loss) per share	\$(0.08)	\$(0.29)
Weighted average number of common shares outstanding:		
Basic	10,234,574	2,906,938
Diluted	10,234,574	2,906,938

See notes to the condensed consolidated financial statements.

Pervasip Corp. and Subsidiaries
 Condensed Consolidated Statements of Cash Flows
 (Unaudited)

	For the Three Months Ended	
	Feb. 28, 2011	Feb. 28, 2010
Net cash used in operating activities:	\$(154,832)	\$(124,024)
Cash flows from financing activities:		
Repayment of long-term debt	(1,048)	(2,415)
Proceeds from short-term borrowing	58,000	47,000
Proceeds from exercise of options	7,500	10,000
Proceeds from the sale of stock	85,000	35,500
Net cash provided by financing activities	149,452	90,085
Decrease in cash and cash equivalents	(5,380)	(33,939)
Cash and cash equivalents at beginning of period	31,653	35,993
Cash and cash equivalents at the end of period	\$26,273	\$2,054

See notes to the condensed consolidated financial statements.

PERVASIP CORP.

Notes To Condensed Consolidated Financial Statements (Unaudited)

Note 1-Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended February 28, 2011 are not necessarily indicative of the results that may be expected for the year ended November 30, 2011. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended November 30, 2010.

Note 2 – Going Concern Matters and Realization of Assets

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. However, we have sustained substantial losses from operations in recent years and we have negative working capital and a stockholders' equity deficiency. In addition, we are experiencing difficulty in generating sufficient cash flow to meet our obligations and sustain our operations. We have been unable to provide our Chief Executive Officer and our Chief Information Officer with the cash compensation levels that we agreed to pay them. If either officer ceases to work for us, we may have to discontinue our operations. We expect our operating losses and cash deficits to continue until we are able to generate sufficient revenues to cover our operating costs. We need to raise additional cash through some combination of borrowings, sales of equity or debt securities or sales of assets to enable us to meet our cash requirements.

We may not be able to raise sufficient additional debt, equity or other cash on acceptable terms, if at all. Failure to generate sufficient revenues, achieve certain other business plan objectives or raise additional funds could have a material adverse effect on our results of operations, cash flows and financial position, including our ability to continue as a going concern, and may require us to significantly reduce, reorganize, discontinue or shut down our operations.

In view of the matters described above, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon continued operations of our company which, in turn, is dependent upon our ability to meet our financing requirements on a continuing basis, and to succeed in our future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should we be unable to continue operating. Management's plans include:

1. Seeking to raise \$150,000 in debt or equity in the near term, and additional equity later in the year. With additional cash available to us, we can cover monthly cash losses and allocate funds toward marketing our products to achieve additional sales and consequently cut monthly operating losses.
2. Seeking to raise debt or equity to replace our current lender. Our lender has come to terms with a non-affiliated strategic investor (the "Investor") to sell all of our debt at a discount of approximately 75%. The Investor, our lender and we have signed a purchase and assignment agreement that requires the Investor to make a down payment of \$200,000 and then monthly payments over a 24-month period to purchase half of our debt for \$1,625,000. The

agreement also grants an option to the Investor, which expires on February 28, 2012, to purchase the remaining half of our debt for \$1,625,000. Among other things, the agreement prevents our lender from attempting to collect any payments from us or from attempting to foreclose on our assets, as long as the Investor continues to make the specified monthly payments. We believe the Investor has sent a first payment of \$100,000 and plans to remit an additional payment that will render the agreement effective. The Investor has indicated to us that they will restructure such debt in a manner that is significantly favorable to us; however, there can be no assurance that they will do so.

3. Continuing to develop new uses and distribution channels for our voice-over-IP-enabled mobile phone service ("Mobile VoIP"). Our Mobile VoIP product currently runs on several Nokia smart phones. It is also an application that can be downloaded to hundreds of mobile devices, and industry analysts estimate that more than 100 million of such devices are currently in use by consumers.

4. Continue to develop new distribution channels for the Worldgate Ojo Vision VoIP video phone. We estimate that positive cash flow from operations will be reached upon the addition of 5,000 video phone customers utilizing our VoIP service. We sell this product on various web sites, through agents and through a multi-level marketing firm.

There can be no assurance that we will be able to achieve our business plan objectives or that we will achieve or maintain cash-flow-positive operating results. If we are unable to generate adequate funds from operations or raise additional funds, we may not be able to repay our existing debt, continue to operate our network, respond to competitive pressures or fund our operations. As a result, we may be required to significantly reduce, reorganize, discontinue or shut down our operations. Our financial statements do not include any adjustments that might result from this uncertainty.

Note 3 – Recent Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board ("FASB") issued accounting standard ASU 2010-28, "Intangibles-Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a consensus of the FASB Emerging Issues Task Force)." ASU 2010-28 provides amendments to Topic 350 that modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. As a result, goodwill impairments may be reported sooner than under current practice. ASU 2010-28 is effective for fiscal years and interim periods within those years, beginning after December 15, 2010, with early adoption not permitted. We do not expect that the adoption of ASU 2010-28 will have a material impact on our consolidated results of operation and financial condition.

In December 2010, FASB issued accounting standard ASU 2010-29, "Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations (a consensus of the FASB Emerging Issues Task Force)." ASU 2010-29 provides amendments to subtopic 805-10 of the FASB ASC, that requires a public entity to disclose pro forma information for business combinations that occurred in the current reporting period. ASU 2010-29 is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010, with early adoption permitted. We do not expect that the adoption of ASU 2010-28 will have a material impact on our consolidated results of operation and financial condition.

Note 4-Major Customers

During the three-month periods ended February 28, 2011 and 2010, one customer accounted for approximately 27% and 15% of our revenues, respectively. At February 28, 2011 and November 30, 2010, monies owed to us from our major customer accounted for 15% and 5%, respectively, of our total accounts receivable balances.

Note 5-Net Loss Per Common Share

Basic loss per common share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period.

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Approximately 4,627,000 and 16,879,000 shares of common stock issuable upon the exercise of our outstanding stock options or warrants were excluded from the calculation of diluted net loss per share for the three-month periods ended February 28, 2011 and February 28, 2010, respectively, because the effect would be anti-dilutive.

Note 6-Risks and Uncertainties

We have created a proprietary Internet Protocol (“IP”) telephony network and have transitioned from being a reseller of traditional wireline telephone services into a voice over IP service provider to take advantage of the network cost savings that are inherent in an IP network and the growth of the mobile IP industry. While the IP telephony business continues to grow, we face strong competition. We have built our IP telephony business with significantly less financial resources than many of our competitors. The survival of our business currently is dependent upon the success of our IP operations. Future results of operations involve a number of risks and uncertainties. Factors that could affect future operating results and cash flows and cause actual results to vary materially from historical results include, but are not limited to:

- The availability of additional funds to successfully pursue our business plan;
- The cooperation of our lender, which has not demanded repayment of our debt that was due in September 2010;
 - The cooperation of industry service partners that have signed agreements with us;
- Our ability to market our services to current and new customers and to generate customer demand for our products and services in the geographical areas in which we operate;
- The impact of changes the Federal Communications Commission or State Public Service Commissions may make to existing telecommunication laws and regulations, including laws dealing with Internet telephony;
 - Our ability to comply with provisions of our financing agreements;
 - The highly competitive nature of our industry;
 - The acceptance of telephone calls over the Internet by mainstream consumers;
 - Our ability to retain key personnel;
 - Our ability to maintain adequate customer care and manage our churn rate;
- The impact of adverse tax or regulatory rulings or actions affecting our operations, including the imposition of taxes, fees and penalties;
- Our ability to maintain, attract and integrate internal management, technical information and management information systems;
 - Our ability to manage rapid growth while maintaining adequate controls and procedures;
- The availability and maintenance of suitable vendor relationships, in a timely manner, at reasonable cost;
 - The decrease in telecommunications prices to consumers; and
 - General economic conditions.

Note 7-Stock-Based Compensation Plans

We issue stock options to our employees, consultants and outside directors pursuant to stockholder-approved and non-approved stock option programs and record the applicable expense in accordance with the authoritative guidance of the Financial Accounting Standards Board. This expense is a non-cash expense and it derives from the issuance of stock options, stock purchase warrants and restricted stock (see Note 13). For the three-month periods ended February 28, 2011 and February 28, 2010, we recorded approximately \$24,000 and \$20,000, respectively, in employee stock-based compensation expense, which was included in our selling, general and administrative expenses. As of February 28, 2011, there was approximately \$126,000 of unrecognized stock-compensation expense that will be expensed over the next two years.

Note 8-Accounts Payable and Accrued Expenses

At February 28, 2011 and November 30, 2010, included in the caption accounts payable and accrued expenses, were liabilities of approximately \$796,000 for items in conjunction with transactions related to the sale of former subsidiaries. We believe the total remaining liability is significantly less, based upon public disclosures made by the entity that purchased our former subsidiaries. However, the purchaser has not confirmed the reduction to us directly and, accordingly, we have not reduced the amount of the liability. One of our former subsidiaries filed for bankruptcy protection on September 23, 2008, and is now in a Chapter 7 liquidation. We believe the bankruptcy filing further decreases our potential liability to the purchaser. However, there can be no assurance that we will be successful in reducing such potential liabilities and, ultimately, we may have to pay such amounts.

Note 9-Defined Benefit Plan

We sponsor a defined benefit plan covering a number of former employees. Our funding policy with respect to the defined benefit plan was to contribute annually not less than the minimum required by applicable law and regulation to cover the normal cost and to fund supplemental costs, if any, from the date each supplemental cost was incurred. Contributions are intended to provide not only for benefits attributable to service to date, but also for those expected in the future.

We do not expect to make the required quarterly contributions to the defined benefit plan in fiscal 2011 and we reported to the Pension Benefit Guarantee Corporation (“PBGC”) that we were unable to pay all the required quarterly contributions in fiscal 2009 and that the plan no longer can make monthly pension payments to the plan participants. Beginning in October 2010, the PGBC has funded the pension payments due to the plan participants.

Note 10 – Principal Financing Arrangements

The following table summarizes components of long-term debt and capital lease obligations as of February 28, 2011 and November 30, 2010:

	Feb. 28, 2011	Nov. 30, 2010	Interest Rate	
Principal lender:				
Note dated November 30, 2005	\$2,289,224	\$2,261,281	5.25	%
Note dated May 31, 2006	1,662,350	1,642,059	5.25	%
Note dated September 28, 2007	5,266,564	5,153,932	9.75	%
Note dated May 28, 2008	2,320,846	2,230,658	20.00	%
Note dated October 29, 2008	1,460,031	1,414,968	15.00	%
Note date February 15, 2009	811,653	792,164	20.00	%
Note dated October 6, 2009	12,010	11,634	5.25	%
Note dated November, 2009	53,506	52,849	5.25	%
Total principal lender debt	13,876,184	13,559,545		
			12.00%	-
Short-term borrowings	493,668	487,576	24.00	%
			12.00%	-
Capital lease obligations	69,058	83,457	17.00	%

Total	\$14,438,910	\$14,130,578
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Debt with Principal Lender

As of February 28, 2011 and November 30, 2010, we owed our principal lender \$13,876,184 and \$13,559,545, respectively. All of such debt became due by its terms on September 30, 2010. We have not made payments of principal or interest when due, and we are in default of our agreements with our principal lender. In connection with this debt, in prior years, we had issued warrants to our lender. During the year ended November 30, 2010, the warrants were cancelled by the lender. In connection with the financings, we agreed, so long as 25% of the principal amount of the financings is outstanding, to certain restrictive covenants, including, among others, that we will not declare or pay any dividends; issue any preferred stock that is subject to mandatory redemption prior to the one year anniversary of the maturity date, as defined in the agreement; redeem any of our preferred stock or other equity interests; dissolve, liquidate or merge with any other party unless, in the case of a merger, we are the surviving entity; materially alter or change the scope of our business; incur any indebtedness except as defined in the agreement; or assume, guarantee, endorse or otherwise become directly or contingently liable in connection with any other party's obligations. To secure the payment of all obligations to the lender, we entered into a master security agreement that assigns and grants to the lender a continuing security interest and first lien on all of our assets and the assets of our subsidiaries.

Short-Term Borrowings and Capital Lease Obligations

We are in default on substantially all of our capital lease obligations and we have recorded such obligations as current obligations. Short-term borrowings include demand notes from our chief executive officer of \$473,141, at annual interest rates ranging from 12% and 24% and convertible debentures outstanding of \$20,527, at annual interest rates ranging from 6% to 12%.

The convertible debentures consist of a \$50,000 convertible debenture that we issued in exchange for a \$50,000 cash payment, and three debentures, which we issued in the aggregate total of \$93,170, in exchange for a reduction in notes and trade payables that totaled \$93,170. Conversion features allow the holders to convert into shares of our common stock at a discount to the trading price of our common stock, ranging from 10% to 50%. We can pre-pay any portion of the debentures at any time at a 15% to 25% premium to the principal amount that is retired. From December 1, 2010 to April 15, 2011 we issued a total of 5,358,606 shares of our common stock for debt conversions to pay approximately \$92,000 in debt. We determined that the conversion option should be classified as a derivative liability as the number of shares issuable pursuant to the conversion option is undeterminable. The derivative liability was calculated using the Black Scholes method over the expected terms of the convertible debentures, with a risk free rate of .14% and volatility of 327%. At February 28, 2011, the aggregate derivative liability for the convertible debentures was adjusted to a marked to market value of \$61,374, using the Black Scholes method.

Note 11-Income Taxes

At November 30, 2010, we had net operating loss carryforwards for federal income tax purposes of approximately \$34,000,000 that expire in the years 2011 through 2030. We have provided an allowance for the full value of the related deferred tax asset since it is more likely than not that none of such benefit will be realized. Utilization of the net operating losses may be subject to annual limitation provided by Section 382 of the Internal Revenue Code and similar State provisions.

Note 12 – Related Party Transactions

In connection with use of software development costs, we paid fees to a third-party intellectual property development firm (the “Consultant”) for the three-month periods ended February 28, 2011 and 2010 of \$48,000 and \$63,000, respectively. One of our officers has performed work for the Consultant, including the function of distributing such funds to appropriate vendors. Our officer received fees from the Consultant of \$15,000 during the three-month period ended February 28 2010. The fees for services performed by the Consultant were deemed to be operating costs.

At February 28, 2011, we owed our chief executive officer was approximately \$690,000 for loans he provided to the Company, unpaid salary and unpaid business expenses. Our chief executive officer also participated in private placements to purchase 1,250,000 shares of common stock and warrants to purchase 2,500,000 shares of common stock at a price of \$0.10 per share, for a total cost of \$125,000 during the period of January 2011 to March 2011. In addition, on April 14, 2011, our chief executive officer sold three demand notes that we issued to him, totaling \$50,000, to a third-party investor for a price of \$50,000. The third-party investor also received conversion rights to convert the debt into our common stock at a 45% discount to its trading price. Our chief executive officer lent us the \$50,000 he received from the third-party investor and we issued him a \$50,000 demand note, with interest payable at 24% per annum.

Note 13 – Equity

During the first quarter of fiscal 2011, we issued stock and warrants to purchase stock in conjunction with a private placement of securities. In December 2010, we issued 200,000 shares of common stock and a warrant to purchase 400,000 shares of common stock at a price of \$0.10 per share, to an employee for an aggregate purchase price of \$20,000. In January 2011, we issued 350,000 shares of common stock and a warrant to purchase 700,000 shares of common stock at a price of \$0.10 per share, to our chief executive officer for an aggregate purchase price of \$35,000. In March 2011, we issued 900,000 shares of common stock and a warrant to purchase 1,800,000 shares of common stock at a price of \$0.10 per share, to our chief executive officer for an aggregate purchase price of \$90,000.

In December 2010, we issued 75,000 shares of common stock, at a price of \$0.10 per share, in conjunction with the exercise of stock options granted under our equity incentive plans.

From December 1, 2010 to April 15, 2011 we issued 6,982,980 shares of our common stock to settle notes and trade payables totaling approximately \$112,000.

Note 14 – Fair Value

The Fair Value Measurements Topic of the FASB Accounting Standards Codification establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the company has the ability to access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability.

Under the Fair Value Measurements Topic of the FASB Accounting Standards Codification, we base fair value on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy. Fair value measurements for assets and liabilities where there exists limited or no observable market data and, therefore, are based primarily upon management's own estimates, are often calculated based on current pricing policy, the economic and competitive environment, the characteristics of the asset or liability and other such factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows that could significantly affect the results of current or future value.

Derivative Liability

The table below presents the amounts of liabilities measured at fair value on a recurring basis as of February 28, 2011 and November 30, 2010.

The fair value of the derivatives that are traded in less active over-the counter markets are generally measured using pricing models with market observable inputs such as interest rates and equity index levels. These measurements are classified as Level 2 within the fair value of hierarchy.

	Total	(Level 1)	(Level 2)	(Level 3)
February 28, 2011				
Derivative liability	\$61,374	-	\$61,374	-
November 30, 2010				
Derivative liability	\$70,519	-	\$70,519	-

Item 2. Management's Analysis and Discussion of Financial Condition and Results of Operations