IDT CORP
Form 10-K/A
October 30, 2003
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO

SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED JULY 31, 2003, OR**

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

Commission File Number: 0-27898

IDT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**22-3415036**
(State of other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

520 Broad Street

Newark, New Jersey 07102

(Address of principal executive offices, including area code)

(973) 438-1000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:	**Class B common stock, par value $.01 per share Common stock, par value $.01 per share** **(Title of class)**
Securities registered pursuant to Section 12(g) of the Act:	**None**

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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes x No ¨

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing price on January 31, 2003 (the last business day of the Registrant s most recently completed second fiscal quarter) of the Class B common stock of $15.44 and of the common stock of $16.05, as reported on the New York Stock Exchange, was approximately $801 million. Shares held by each officer and director and by each person who owns 5% or more of the outstanding common stock (assuming conversion of the Registrant s Class A common stock) or Class B common stock have been excluded from this computation, in that such persons may be deemed to be affiliates of the Registrant. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

As of October 20, 2003, the Registrant had outstanding 51,248,679 shares of Class B common stock, $.01 par value, 9,816,988 shares of Class A common stock, $.01 par value, and 22,067,468 shares of common stock, $.01 par value. Excluded from these numbers are 6,166,253 shares of Class B common stock and 3,007,392 shares of common stock held by IDT Corporation.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information in the Registrant s definitive Proxy Statement for its 2003 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after July 31, 2003, is incorporated by reference in Part II (Item 5) and Part III (Items 10, 11, 12 and 13) of this Form 10-K.

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EXPLANATORY NOTE

We are filing this Amendment No. 1 on Form 10-K/A to our annual report on Form 10-K (the Annual Report) for the fiscal year ended July 31, 2003 to provide required information on the cover page of the Annual Report and to make certain other corrections to the Annual Report.

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IDT CORPORATION

ANNUAL REPORT ON FORM 10-K/A (Amendment No. 1)

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PART I

As used in this Annual Report, unless the context otherwise requires, the terms the Company, IDT, we, us, and our refer to IDT Corporation, a Delaware corporation, its predecessor, International Discount Telecommunications, Corp., a New York corporation, and its subsidiaries, collectively. All information in this Annual Report gives effect to the 1995 reincorporation of IDT in Delaware. Our fiscal year ends on July 31 of each calendar year. Each reference to a Fiscal Year in this Annual Report refers to the Fiscal Year ending in the calendar year indicated (e.g., Fiscal 2003 refers to the Fiscal Year ended July 31, 2003).

Item 1. *BUSINESS.*

INTRODUCTION

We are a multinational communications company that provides products and services to retail and wholesale customers worldwide. Our primary offerings are prepaid debit and rechargeable calling cards, wholesale telecommunications carrier services and consumer phone services. We also operate several media and entertainment-related businesses, including a digital animation production company, a talk radio syndication network, a talk radio station in the Washington, D.C. metropolitan area and a call center business.

In providing calling card and wholesale carrier services, we utilize our network of more than 220 switches in the United States, Europe and South America, as well as our owned and leased capacity on 26 undersea fiber-optic circuits that operate on more than six different cable systems connecting our U.S. facilities with our international facilities and with third-party facilities in Europe, Latin America and Asia. We utilize other carriers networks in providing consumer phone services.

We have grown throughout our history, and our growth continued in Fiscal 2003. Our revenues grew to $1.8 billion in Fiscal 2003 from $1.6 billion in Fiscal 2002 and $1.2 billion in Fiscal 2001. We derive the majority or our revenues from IDT Telecom, which comprises primarily our calling cards, consumer phone services and wholesale carrier services, which generated revenues of $1.6 billion in Fiscal 2003, $1.4 billion in Fiscal 2002 and $1.2 billion in Fiscal 2001. In Fiscal 2003, minutes of use from our calling card and wholesale carrier services grew to 16.5 billion minutes, an increase from 11.8 billion minutes in Fiscal 2002 and 7.0 billion minutes in Fiscal 2001. Despite continuing pricing pressure in Fiscal 2003, we maintained our gross margins as we reduced many of our expenses as a percentage of revenues.

Despite our significant growth and our cost cutting measures, we have continued to incur operating losses. For Fiscal 2003, our operating loss was $73.6 million, down from an operating loss of $440.3 million in Fiscal 2002 and an operating loss of $432.7 million in Fiscal 2001. In addition, we incurred a net loss in Fiscal 2003 of $17.5 million compared with a net loss of $303.3 million in Fiscal 2002 and net income of $532.4 million in Fiscal 2001.

We have maintained the strength of our balance sheet during our growth and despite our operating losses. As of July 31, 2003, we had more than $1.0 billion in cash, cash equivalents, restricted cash and marketable securities and minimal long-term debt, primarily attributable to capital lease obligations. Our management believes that our strong balance sheet creates numerous business opportunities for us, including:

selling our services to significant customers who take comfort in our solid financial position;

enabling us to make strategic investments and acquisitions at attractive prices; and

expanding our network and the range of services and products that we provide at attractive prices.

Our main offices are located at 520 Broad Street, Newark, New Jersey 07102. Our headquarters telephone number is (973) 438-1000 and our Internet address is www.idt.net.

We make available free of charge through the investor relations page of our Web site our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports, and all beneficial ownership reports on Forms 3, 4 and 5 filed by directors, officers and beneficial owners of more than 10% of our equity as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission. We have adopted codes of business conduct and ethics for all of our employees, including our principal executive officer, principal financial officer and principal accounting officer. Copies of the codes of business conduct and ethics are available on our Web site.

Our Web site and the information contained therein or incorporated therein are not intended to be incorporated into this Annual Report on Form 10-K or our other filings with the SEC.

HISTORY

We were founded in August 1990 and were originally incorporated in New York as International Discount Telecommunications Corp. We were renamed IDT Corporation and reincorporated in Delaware in December 1995.

We entered the telecommunications business in 1990 by introducing our international call reorigination service to capitalize on the opportunity created by the large spread between U.S.-originated and foreign-originated international long distance telephone rates.

We used the calling volume and expertise derived from our call reorigination business to enter the consumer long distance business in late 1993 by reselling long distance services of other carriers to our customers. In 1995, we began reselling access to the favorable telephone rates we received as a result of our calling volume to other long distance carriers.

The initial public offering of our common stock occurred on March 15, 1996. Our common stock was quoted on the Nasdaq National Market until February 26, 2001, when it was listed on the New York Stock Exchange, where it now trades under the symbol IDT.C. On May 31, 2001, we distributed a stock dividend of one share of our Class B common stock for each outstanding share of our common stock, Class A common stock and Class B common stock. On June 1, 2001, our Class B common stock was listed on the New York Stock Exchange and now trades under the symbol IDT.

Through Net2Phone, then our wholly owned subsidiary, we entered the Internet telephony market in August 1996 with our introduction of PC2Phone, the first commercial telephone service to connect calls between personal computers and telephones over the Internet.

We began marketing and selling prepaid calling cards in January 1997.

In August 1999, Net2Phone completed an initial public offering of 6.2 million shares of its common stock, yielding $85.3 million in net proceeds. In December 1999, Net2Phone completed another offering of 3.4 million shares of its common stock. In connection with that offering, we also sold 2.2 million shares of Net2Phone common stock, generating $115.0 million in cash proceeds for us.

In June 2000, we acquired CTM Brochure Display, a brochure distribution company.

In August 2000, we completed the sale of 14.9 million shares of Net2Phone common stock to AT&T, receiving approximately $1.1 billion in cash proceeds.

In October 2001, we created a consortium, NTOP Holdings, LLC, which as of July 31, 2003 held approximately 28.9 million shares of Net2Phone s Class A common stock representing approximately 48% of Net2Phone s outstanding capital stock and approximately 65% of the voting power in Net2Phone. The consortium originally consisted of IDT, AT&T and Liberty Media. On October 29, 2002, AT&T sold its interests in the consortium to IDT and Liberty Media. IDT has the right to appoint the majority of the members of the

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board of managers of the consortium. Accordingly, we are currently deemed to control of NTOP Holdings, and, through it, Net2Phone. Accordingly, we reconsolidated Net2Phone s financial statements with our own as of October 23, 2001.

In November 2001, we organized a new venture, Digital Production Solutions (DPS), an animation company which uses proprietary technology to operate a global animation studio linking animators throughout the world utilizing IDT s telecom infrastructure. This allows DPS to produce high-quality 3-D computer generated animation at a cost comparable to 2-D animation. That same month, we acquired Talk America Radio Network, a syndicator of talk radio programming.

In December 2001, we acquired substantially all of the core domestic telecommunications assets of Winstar Communications, a broadband and telephony service provider to commercial and government customers, which we refer to in this report as Old Winstar. The acquisition was consummated by our subsidiary Winstar Holdings, in a transaction under Section 363 of the United States Bankruptcy Code. We acquired Old Winstar s assets in exchange for (i) $30 million in cash, (ii) $12.5 million of our Class B common stock and (iii) 5% of Winstar Holdings. On April 16, 2002, we purchased from the estate of Old Winstar the 5% of Winstar Holdings that we did not already own for $13.3 million of our Class B common stock. In this report, we use the term IDT Solutions, which represents a Winstar product line and its marketing arm, interchangeably with Winstar.

In January 2002, we sold 4.8% of IDT Telecom to Liberty Media for $30 million in cash.

In July 2002, we acquired WMET, a 1,000 watt AM radio station in the Washington, D.C. metropolitan area. We are currently upgrading the strength of WMET s signal to 50,000 watts.

DEVELOPMENTS IN FISCAL 2003

In September 2002, we more than doubled the size of our domestic telecommunications backbone by acquiring indefeasible rights of use, more commonly known as IRUs (rights to transmission lines, which are more akin to ownership than leases of capacity), and equipment from the bankrupt estate of Star Telecommunications.

In December 2002, we were selected as the exclusive prepaid calling card provider to Walgreens, the nation s largest drugstore chain.

In January 2003, we acquired Global One s prepaid calling card business from France Telecom.

In May 2003, DPS acquired a controlling interest in Film Roman, a leading independent animation company known for its production work on animated television programs including *King of the Hill* and *The Simpsons*.

In June 2003, we sold 5.6% of IDT Media to Liberty Media for $25 million in cash.

In June 2003, we were named exclusive calling card provider for Barnes and Noble College Bookstores.

In July 2003, DPS purchased a minority stake in Vanguard Animation, a producer of computer generated animation feature films, and entered into a joint venture with Vanguard Animation to co-produce and co-own other computer generated animated films, as well as computer generated animation projects for television exhibition or direct-to-video/DVD distribution.

CORPORATE ORGANIZATION

We conduct our business primarily through the following four operating subsidiaries:

IDT Telecom. IDT Telecom operates our principal telecommunications operations and provides both retail and wholesale telecommunications services. Retail services include prepaid debit and rechargeable calling cards, private label calling cards and consumer phone services. Wholesale services consist of carrying the telecommunications traffic of other telecommunications companies, which we refer to as carrier s carrier services. In Fiscal 2003, IDT Telecom generated $1.6 billion of revenues, equaling

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89.3% of our consolidated revenues, and recorded operating income of $63.4 million. Retail services constituted 75.3% of IDT Telecom s revenues, with the remaining 24.7% attributable to wholesale services. We own 95.2% of IDT Telecom s common stock, with Liberty Media holding the remaining 4.8% for which it paid $30 million in cash in January 2002.

Winstar Holdings. Winstar Holdings, our wholly owned subsidiary whose services we also market under the trade name IDT Solutions, is a broadband and telephony service provider to commercial and government customers that offers a cost-effective last mile (the connection between a telecommunications switch and the end user) telecommunications solution through its fixed wireless and fiber infrastructure, including local and long distance phone services, high speed Internet and data communications, wide-area-network, or WAN, solutions, co-location, mobile network infrastructure and web hosting. In Fiscal 2003, Winstar Holdings generated $87.6 million of revenues, equaling 4.8% of our consolidated revenues, and recorded an operating loss of $88.8 million, including an impairment charge of $4.5 million.

Net2Phone. Net2Phone is a leading provider of voice over Internet protocol, or VoIP, telephony products and services. In Fiscal 2003, Net2Phone generated $80.8 million of revenues, equaling 4.4% of our consolidated revenues, and recorded an operating loss of $9.7 million, which included a $58.0 million gain on settlement of litigation, and restructuring, severance and impairment charges of $7.3 million. As of July 31, 2003, our effective equity investment in Net2Phone (through NTOP Holdings) was 21.2%, but, as noted above, we currently have the ability to control Net2Phone through our control of NTOP Holdings. Net2Phone s common stock is publicly traded on the Nasdaq National Market under the symbol NTOP .

IDT Media. IDT Media is a holding company for our media-related holdings, including DPS, Talk America, our WMET radio station, CTM Brochure Display, IDT Contact Services and OTV, a corporate video service. In Fiscal 2003, IDT Media generated $27.6 million of revenues, equaling 1.5% of our consolidated revenues, and recorded an operating loss of $9.1 million. We own 94.4% of IDT Media s common stock, with Liberty Media holding the remaining 5.6% for which it paid $25 million in cash in June 2003. IDT Media owns 90% of Digital Production Solutions, with the remainder being held by its management.

These four operating subsidiaries correspond, respectively, to our four business segments IDT Telecom, IDT Solutions, Internet Telephony and IDT Media as discussed in this Annual Report on Form 10-K under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations. Detailed financial information about each segment may be found under such heading.

IDT TELECOM

Overview

Our subsidiary, IDT Telecom, provides competitively priced retail and wholesale telecommunications services and products, including prepaid debit and rechargeable calling cards, private label calling cards, consumer phone services and wholesale carrier services.

Our telecom division generated revenues of $1.6 billion during Fiscal 2003, a 16.1% increase over the $1.4 billion of revenues generated during Fiscal 2002. Our telecom division s revenues represented 89.3% of our total consolidated revenues in Fiscal 2003, as compared to 89.1% in Fiscal 2002. During Fiscal 2003, our retail telecommunications services and products (prepaid debit and rechargeable calling cards, private label calling cards and consumer phone services) contributed 75.3% of our telecom division s revenues, with the remaining 24.7% attributable to wholesale carrier services. Our telecom division s operating income increased to $63.4 million in Fiscal 2003, from $30.8 million in Fiscal 2002.

We are one of the largest providers of prepaid and rechargeable calling cards in the United States. In Fiscal 2003, we recorded revenues of $1.08 billion from sales of calling cards worldwide, which were primarily

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distributed through Union Telecard Alliance, a joint venture of which we own 51% of the outstanding membership interests. We provided 12.6 billion minutes of phone service to our calling card customers. We also provided consumer phone services to more than 575,000 individual and business customers in the United States as of July 31, 2003. In addition, as of July 31, 2003, we had approximately 350 wholesale carrier customers (i.e., other telecommunications companies that purchase our telecommunications services to terminate their traffic) located primarily in the North America and Europe.

We deliver our telecommunications services over a network consisting of more than 220 switches in the United States, Europe and South America, including eight international gateway switches and one domestic carrier switch. Four of these international gateway switches are located in the United States, two are located in the United Kingdom and the remaining two are located in Peru and in Argentina. An international gateway switch connects networks across international borders and translates voice and signaling protocols between those used in North America, in Europe and in other areas of the world so that the networks can communicate. We also own or lease capacity on 26 undersea fiber-optic circuits that operate on more than six different cable systems. These undersea circuits connect our U.S. facilities with our international facilities and with third-party facilities in Europe, Latin America and Asia. We utilize other carriers networks in providing consumer phone services.

The International Long Distance Market

In the United States, an international long distance telephone call typically originates on the network of the caller s local exchange carrier (most often a Regional Bell Operating Company, commonly referred to as an RBOC such as Verizon or Bell South) and is switched to the network of the caller s long distance provider (such as AT&T, MCI or Sprint). The long distance provider then carries the call to its own international gateway switch or to another carrier (a carrier s carrier such as IDT Telecom). From there, it is carried directly or indirectly to a corresponding gateway switch operated in the destination country by the dominant carrier of that country (typically a state-owned or state-sanctioned foreign post, telephone or telegraph company, commonly referred to as a PTT), and then that country s domestic telephone network routes the call to the party being called. All of this routing and switching of calls is automatically performed in milliseconds based upon a predetermined set of routing criteria.

International long distance providers can generally be categorized by the extent of their ownership and use of switches and transmission facilities. The largest U.S. carriers, AT&T, MCI and Sprint, own the U.S. transmission facilities that they primarily use and tend to utilize other international long distance providers only to reach niche markets where they do not own networks, in order to take advantage of lower prices or to carry their overflow traffic. With deregulation, a significant group of alternative long distance providers emerged. These providers own and operate their own switches but either rely solely on resale agreements with carrier s carriers to terminate traffic or use a combination of resale agreements and leased or owned facilities in order to terminate their traffic.

The international telecommunications industry is undergoing a period of rapid technological and regulatory change that, we believe, continues to offer market opportunities for telecommunications services providers such as IDT. Recent years have witnessed rapid growth in the usage of international telecommunications services (international long distance telephone minutes increased from approximately 93 billion in 1998 to 127 billion in 2002) and a shift towards deregulation in many of the world s major telecommunications markets (including Eastern Europe, Latin America and Asia).

We believe that growth in international long distance telecommunications traffic will continue to be driven by:

the globalization of the world s economies and the worldwide trend toward deregulation of telecommunications;

declining prices arising from increased competition generated by privatization and deregulation;

increased worldwide telephone density in both traditional landline and wireless telephones;

a wider selection of products and services; and

the growth in the transmission of data traffic.

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We believe that growth of voice and data traffic originated outside of the United States will exceed the growth in voice and data traffic originated within the United States due to recent deregulation in many foreign markets and increasing access to telecommunications facilities in emerging foreign markets.

Many participants in the worldwide telecommunications industry have not been able to benefit from the growth in worldwide telecommunications traffic. Rather, the telecommunications industry currently finds itself in a worldwide downturn, which has resulted in a number of companies filing for protection under Chapter 7 or Chapter 11 of the U.S. Bankruptcy Code (including WorldCom, Global Crossing and Williams Communications in the last two years), and a 61.3% decline in the industry s aggregate public market value from 2000 to 2002, according to Deutsche Bank. This has resulted in a dramatic change to the competitive landscape in the international long distance market during the past two to three years.

Commencing in the mid-1990s, spurred primarily by the deregulation of telecommunications services in the United States and abroad, new entrants in the international long distance market cut prices to try to gain market share. With relatively easy access to the public debt and equity markets in the late 1990s, many of these emerging companies were able to survive without generating profits. This access to funding enabled many emerging companies to begin constructing large telecommunications networks in an attempt to compete directly with the industry s largest facilities-based carriers. At the time, these investments were justified by projections of growth in both voice and data traffic which would, in turn, increase demand for bandwidth. It was believed that data demand would be the key driver of demand growth, as the increase in Internet use experienced during the mid and late-1990s was expected to continue unabated. Many believed that a fortuitous cycle for bandwidth demand had been set in motion, where increased demand for bandwidth would lead to an increased supply, which would enable bandwidth-hungry applications such as video-on-demand to become mainstream, which in turn would lead to even more need for bandwidth.

By mid-2000, however, it was becoming apparent that the estimates for future demand for bandwidth were overly optimistic. Demand for data transmission, in particular, was not nearly as robust as had been anticipated by many. The bandwidth-hungry applications that were supposed to drive much of the growth in data demand had not yet materialized. In addition, the oversupply of bandwidth was further exacerbated with the introduction of enhanced compression technologies. With supply significantly outpacing demand, prices for bandwidth plummeted, while pricing for termination of international calls also fell significantly. As a result of these falling prices and lower-than-expected demand, many telecommunications companies fell short of their revenue projections. In addition, many emerging telecommunications companies were subject to large principal and interest payments on their substantial indebtedness. At the same time, raising funds in the public debt and equity markets became more difficult. As a result, many of these new entrants either filed for bankruptcy or otherwise exited the international long distance marketplace.

Beginning in 2001, a second wave of financial difficulties swept the international telecommunications market. Significantly larger and established telecommunications companies encountered cash flow and fundraising difficulties. Companies that had built or purchased large fiber networks with massive capacities, such as WorldCom, Global Crossing and Williams Communications, suffered when both prices and demand for bandwidth decreased.

Because we did not increase our leverage and did not participate in the network overbuild which plagued the industry, we were not affected financially as greatly as other telecommunications companies who over-leveraged themselves and overbuilt their networks. Nevertheless, our revenues (and revenues per minute) were negatively affected as industry pricing dropped significantly, due primarily to the industry oversupply of capacity. We were also affected by the financial difficulties or bankruptcies of some of our customers, primarily in terms of adapting our credit risk management policies, which resulted in lost opportunities for sales to entities where we determined that such additional sales would leave us overexposed to potential non-payment of amounts owed to us.

The industry s malaise has not been limited to emerging international long distance providers and bandwidth companies. In the local calling markets in the United States, which have traditionally been dominated

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by the RBOCs, competitors known as competitive local exchange carriers, or CLECs, have entered the market since the Telecommunications Act of 1996 effectively opened local markets for competition. To this point, however, the CLECs experience has not generally been successful. Whether due to the RBOCs inherent advantages in their local markets, or because of the overbuilding of networks and large debt burdens of some of the CLECs, most competitors in the local markets have failed, with a significant number of the CLECs (including XO Communications, ICG Communications, CTC Communications Group and McLeod USA) filing for bankruptcy protection.

In addition, since 1996, the FCC has allowed the RBOCs to provide long distance telephone service as well as local telephone service if an RBOC can successfully establish that it has opened its local footprint to local telephone competition. For example, Verizon now offers long distance telephone service in all Northeastern U.S. states from Maine to Delaware. The FCC has approved applications for RBOCs to provide long distance service in 47 states and the District of Columbia, having determined that the RBOCs have properly opened their local markets for competition in those states. The FCC is considering applications in one other state and the remaining two states do not contain any RBOC service areas. Although we will compete with the RBOCs for consumer phone service customers, we believe that we can benefit from the RBOCs entrance into the long distance market because the RBOCs, which lack the international networks operated by most existing long distance providers, rely more heavily on carrier s carriers, such as IDT, to arrange for termination of their international telephone traffic. During Fiscal 2004, we will continue to include the RBOCs as a major focus of our wholesale carrier strategy.

Despite the continuing downturn in the telecommunications industry, we continue to believe in the international long distance industry s solid underlying fundamentals. Volumes of both voice and data traffic continue to grow, presenting opportunities for companies like IDT. We do not believe that the current weakness in the global telecommunications industry signals the cessation of the positive long-term factors that have driven the industry s growth. Even during the recent downturn in the telecommunications industry, the volume of worldwide voice and data traffic continued to increase, and we expect that such traffic will continue to increase for the foreseeable future. In fact, while we were also negatively affected by the industry downturn, it has also provided us with opportunities to buy potentially valuable assets and businesses at a fraction of their original cost.

The IDT Approach

Our approach to the constantly changing, deregulating worldwide telecommunications industry has allowed us to survive and grow even as many companies in the telecommunications industry such as Global Crossing, WorldCom and Williams Communications have endured financial difficulties. Our approach can be encapsulated into two overarching concepts:

- our niche strategy; and
- our smart-build approach.

Throughout our history, we have sought to exploit profitable niches within the telecommunications industry. This included establishing ourselves as a low cost provider of services by setting our price points below those offered by the larger, brand-name companies (through our rechargeable calling cards and consumer phone service products), by providing services to under-served segments of the retail markets (our prepaid calling cards) and by providing wholesale telecommunications services to other telecommunications companies (our wholesale carrier services).

Our smart-build approach refers to the incremental approach we take to expand our network we add new facilities only when we determine that such investments are justified by existing or imminent traffic volumes. Under this approach, we usually enter a new market by leasing fiber capacity. As traffic grows, we may install a switch to increase our overall capacity. As traffic increases further, we analyze whether purchasing bandwidth, instead of leasing, would reduce our costs by routing calls over an owned network. If our volume continues to grow, we may deploy additional switching and/or fiber capacity. This approach enables us to focus on our network costs on a per minute basis; only when we believe that we have the traffic volumes to justify the fixed cost involved with a switch or owned bandwidth will we consider such an investment.

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Although our smart-build approach is often difficult to implement, as it depends on reasonably accurate projections of our future traffic volumes and the ability to execute capital projects quickly, we believe that it serves to effectively insulate us from the overbuilding that has plagued the telecommunications industry in recent years. Our generally cautious approach to purchasing capacity is balanced with the need to obtain sufficient capacity to a destination. Insufficient capacity to a termination point could result in higher costs to carry traffic to that destination, resulting in lower margins.

The following represent key elements of our strategy:

Adopt Pricing Strategies Specific to Each Market. We will tailor our pricing strategies for calling cards to meet our goals in each market in which we operate. With respect to markets where we have significant market share, we will focus on improving margins and we will look to maintain our rates. In new target markets, we will aggressively price our calling cards in order to win market share.

Target New Niche Markets. As we have done in the past, we will seek to identify niche markets and products in which we can utilize our existing network to generate incremental revenues and increase our margins. For example, our private label calling cards utilize our existing calling card platform to produce calling card products for corporate and promotional users. These cards tend to have higher rates and margins than our other calling cards, and are marketed to users outside of our traditional customer base, allowing us to expand our market for these products.

Focus on International Opportunities. We will seek to continue to identify international markets with high volumes of traffic, relatively high per-minute rates and favorable prospects for deregulation, and seek to expand our product offerings to retail customers calling into these markets, and to offer to arrange for termination for the RBOCs and other carriers that do not currently possess access to these markets.

Pursue International Agreements. We intend to capitalize on our existing relationships with U.S. and foreign companies in order to expand our customer base. We have traditionally been able to capitalize on our volume of traffic and technological expertise to negotiate favorable termination agreements with international carriers. We will continue to seek new termination relationships with established and emerging carriers to reduce our termination costs for traditional international voice telephony, and we will continue to use our relationship with Net2Phone for additional low cost termination. To date, we have entered into over 100 agreements with carriers that provide for the favorably priced termination of our calls worldwide.

Pursue Strategic Investments and Acquisitions. We will continue to seek opportunities in the distressed marketplace to acquire complementary assets, technologies and lines of business at attractive prices.

IDT Telecom s Telecommunications Services

Our telecom division currently provides our customers with a variety of services, including:

prepaid debit and rechargeable calling cards;

private label calling cards;

consumer phone services; and

wholesale carrier services.

Retail Telecommunications Services

Prepaid Debit and Rechargeable Calling Cards

We sell prepaid debit and rechargeable calling cards providing telephone access to more than 230 countries and territories. We offer rates on our calling cards that we believe are generally well below the rates for international calls offered by most of the major brand-name, facilities-based carriers such as AT&T, MCI and

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Sprint. We sell more than 165 different prepaid calling cards in the United States, and more than 85 different cards abroad, with specific cards featuring favorable rates to specific areas of the world. The cards are sold in several different dollar denominations, most commonly $5 and $10. When a calling card is used to complete a telephone call, its balance is reduced by the then applicable per minute rate to the destination called multiplied by the number of minutes of the call, plus certain additional fees (e.g., payphone fees, toll-free access surcharges and monthly fees). The calling rates and other fees on the card vary on a card-to-card basis and are adjusted periodically. We offer calling cards that provide access to our network by dialing a toll-free number or, in certain metropolitan markets, local area calling cards that only require a local call, thereby allowing customers to avoid the payphone fee and toll-free access surcharges.

Our prepaid calling cards are marketed primarily to the ethnic, immigrant communities in the United States, Europe and Latin America that tend to generate high levels of international traffic. We believe that recent immigrants and members of the ethnic communities tend to be heavy users of international long distance telephone service because of their desire to keep in touch with family members and friends located in their country of origin. Specifically, a large portion of our calling card customers are from the Hispanic community. Therefore, a significant proportion (47% in Fiscal 2003) of our international prepaid calling card minutes are terminated in Latin America. We believe that many customers typically use our prepaid calling cards as their primary means of making long distance telephone calls due to attractive rates, reliable service, the ease of monitoring and budgeting their long distance spending and the appealing variety of prepaid calling cards that we offer to different market segments.

Our prepaid calling card business is particularly strong in the Northeastern United States because of our extensive distribution network and attractive rates to countries that immigrants in the Northeastern United States prefer to call, such as Colombia, Mexico and the Dominican Republic. With the expansions of operations in Arizona, California, Florida, Georgia, Texas and other parts of the United States, our prepaid calling card sales in the Northeastern United States now constitute a smaller percentage of our total prepaid calling card sales in the United States. In Fiscal 2003, prepaid calling card sales in the Northeastern United States were approximately 53% of our total prepaid calling card sales in the United States, as compared to 65% in Fiscal 2002. Supporting our expansion outside of the Northeastern United States, Union Telecard opened offices in California and North Carolina during Fiscal 2003.

The following table lists some of the major prepaid calling cards that we sell in the United States:

Red New York	CC1	Perico Ripiao
Union California	Blue Georgia	UTA Card
PT1 Gold	Diamond Direct	Simply Africa
Green Midwest	Union Phonecard	Union New England
Red Texas	Diamond Georgia	New York Exclusive
Green California	Green Massachusetts	Simply Eastern Europe IL
Union Carolina	California Payless	Carribean Rum
Blue NJ	People s Choice	UME
Green Florida	New York Alliance	Megatel Africa
Union New York	Union Florida	

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In the European market, we market our prepaid calling cards in the United Kingdom, the Netherlands, Spain, Germany, Belgium, France, Italy, Sweden, Switzerland, Denmark, Norway, Portugal, Austria, Greece and Israel, seeking to capitalize on the opportunity presented by the recent surge in immigration from underdeveloped countries around the globe to Europe s developed nations. We sell approximately 85 different prepaid calling cards in Europe, with some of the major cards listed below:

Spain SuperCall	Belgium Unity	German Afrikakarte
UK Unity	Sweden Star	Spanish Salsa
UK Supercalling	NL Asiacard	Belgium Asiaconnect
UK Eastern Europe	NL Afrikakaart	Swiss Africall
UK Africall	NL Unity	France Unity
UK Easy	Denmark Global One	UK Latinocall
UK Eagle	Swiss Global One	UK Asiacall
Spain Platicard	UK Wild	UK Number One
German SuperCalling	UK Orientalk	UK Royal Mail
German Unity	Ireland Unity	Sweden Supercall

We believe that there is a significant untapped market for prepaid calling cards in Latin America, where certain countries serve as regional nexuses, attracting immigrants due to stronger job markets and opportunities. Immigrants from satellite countries share the needs of their U.S. counterparts for low-cost, prepaid calling solutions to maintain contact with relatives and friends in their countries of origin. In Fiscal 2002, we began distributing prepaid calling cards in Latin America by selling calling cards in Argentina. In Fiscal 2003, we generated $2.0 million in revenue selling calling cards in Latin America.

Worldwide, we sold more than 267 million prepaid calling cards, excluding rechargeable calling cards, during Fiscal 2003, a 34.8% increase from the 198 million prepaid calling cards sold in Fiscal 2002. The sale of these calling cards in Fiscal 2003 generated $1,057.5 million in revenue, as compared with $982.4 million in Fiscal 2002, and resulted in the completion of 12.6 billion minutes of phone calls, as compared with 8.8 billion in Fiscal 2002. During Fiscal 2003, sales of prepaid calling cards accounted for 64.5% of our telecom division s total consolidated revenues, as compared to 69.6% in Fiscal 2002. During Fiscal 2003, we sold 84% of our prepaid calling cards in the United States, with the remaining 16% sold abroad.

Our rechargeable calling cards, marketed to business travelers, are distributed primarily through in-flight magazines and permit users to place calls from over 25 countries through international toll-free services. Accounts are automatically recharged with a credit card that the customer provides at the time of initial card activation. In Fiscal 2003, revenues attributable to rechargeable calling cards were $22.5 million, or 1.4% of our telecom division s consolidated revenues.

Combined, our prepaid and rechargeable calling cards accounted for 65.9% of our telecom division s consolidated revenues in Fiscal 2003.

We believe that we possess the following competitive advantages in the calling card industry:

- our extensive network, purchasing power and least-cost-routing system allow us to procure the most cost-effective termination to the required destinations at the quality levels that we require;

our network of switches and transmission facilities, which allows us to keep our costs low as compared to our competitors, whose operations consist solely of selling calling cards;

our debit platform, which is a database that keeps track of the remaining balance on each calling card, enables us to process a large number of cards simultaneously and to provide multilingual and multi-currency cards. When a user makes a telephone call using a calling card, the user calls an access number and is connected to our platform, which notifies the user of the remaining monetary balance on the card. As the caller uses the card, the platform deducts the appropriate amount of value from the card. Our

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debit platform can be scaled to handle a larger number of cards. In addition, functionality can be added to the platform, such as the ability to handle multiple currencies and the ability to communicate in various languages.

our extensive distribution channel, which covers a wide variety of over 350,000 retail outlets worldwide;

the quality and dependability of the telephone service provided by our cards;

our understanding of, and commitment to, the ethnic prepaid calling card market; and

our superior customer service.

Private Label Calling Card Services

We market the following types of private label calling cards:

Customized Retail Calling Cards. These prepaid calling cards are printed with the retailer s name and logo or other specifications determined by the retailer. We market these cards to major national retailers and the cards are primarily sold in high-traffic stores. In December 2002, we became the exclusive prepaid calling card provider to Walgreens, the United States largest retail drugstore chain. We supply Walgreens-branded prepaid calling cards to the drugstore chain s 4,000 stores. Earlier this year, we became the exclusive calling card provider to Barnes & Noble College Bookstores, the country s leading manager of college and university bookstores. On June 30, 2003, we began providing Barnes & Nobles nearly 500 on-campus retail outlets with Barnes & Noble-designed, IDT-branded prepaid calling cards.

IDT-Branded Retail Calling Cards. These prepaid calling cards are printed with the IDT logo and design and are sold to small to medium sized retail chains (supermarkets, drug stores, convenience stores, etc.) for resale to their customers. These cards are activated by the retailer at the point of sale. With our upgraded retail calling card offering, we can provide these retailers an attractive program for capitalizing on the demand for international long distance communications services. Key elements of our offering for retailers include: domestic and ethnic international brands with competitive price points, point-of-purchase materials and marketing support, a merchant services team, detailed reporting and inventory and auto-replenishment services. New York-based Gristede s supermarkets and New Jersey-based Community Distributors Inc. s Drug Fair and Cost Cutters stores were among the first customers to sign up for this new program.

Promotional Calling Cards. These prepaid calling cards are a marketing and branding tool used by consumer goods and other Fortune 1000 companies such as Alaska Airlines, Coca-Cola, Colgate, Goya, Jet Blue and Pizza Hut. Our private label promotional cards can be used for a variety of purposes, including give-aways, incentive building programs, loyalty rewards and special occasions.

Corporate Calling Cards. Many companies are using the benefits of prepaid/postpaid and rechargeable calling cards to control and track their employees long distance telephone charges by giving each employee a calling card and mandating its use for long distance telephone service whenever possible, including during international travel. IDT s corporate calling card customers include both medium sized companies as well as Fortune 1000 and other large international companies who enjoy customized programs (such as a customer s advertising prior to the voice prompt), voice prompt for the value-added service (e.g., speed dialing, news tickers, conference calling) and specialized rates.

Our private label group is developing new potential sources of revenue, including placing third-party advertising on calling card packaging, offering gift calling cards and offering loyalty calling cards. For example, we launched a loyalty calling card for one of our customers that accrues free phone minutes as a reward and can also be recharged at exclusive retail rates, so that loyalty calling card minute awards are added to the retail calling card balance.

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Leveraging the technologies built for our point of sale activation services and our retail distribution channel, we are developing prepaid cards accepted by (a) banking networks (particularly internationally) for ATM withdrawals and (b) retail stores for purchases.

Our private label group was formed in Fiscal 2002, during which it reported revenues of $2.1 million. In Fiscal 2003, it reported revenues of $13.3 million.

Consumer Phone Services

We market long distance phone services directly to consumers and businesses in the 48 U.S. contiguous states, as well as in Washington, D.C.

In August 2003, we launched local/long distance bundled phone service in New York and New Jersey, followed by launches in Pennsylvania and Maryland in September. We plan to offer bundled service in states covering approximately half of our long distance customer base by the end of Fiscal 2004. Our bundled local/long distance service includes unlimited local, regional toll and long distance calling with caller ID, speed dial, call waiting and 3-way calling. In these states, we are offering these services for $39.95 per month, plus applicable taxes and surcharges. We also offer a second bundled plan providing unlimited local service with caller ID and call waiting with IDT long distance included for as low as 5 cents a minute. With either plan attractive international rates can be added on for an additional monthly fee.

Our long-standing five cents per minute long distance service continues to be available in the continental United States with a monthly service fee. For this plan, we bill in six second increments, instead of one minute rounding, which is the practice of some industry participants. As part of our calling plan, customers are offered our calling cards, with no monthly fees or per-call surcharges, featuring a domestic rate of ten cents per minute. Our rates for international calls are also competitive with those charged by the major international long distance carriers.

Consumer phone services accounted for 9.3% of our telecom division s total consolidated revenues in Fiscal 2003. As of July 31, 2003, we had approximately 575,000 active consumer phone service customers. The greatest concentrations are in large urban areas, with the greatest number of customers located in California, Florida, New Jersey and New York.

The competitive landscape for consumer long distance service changed in early calendar year 2003, with the introduction of a variety of bundled local and long distance plans by several competitors, including some of the industry s largest companies. We believe that customer turnover rates for the industry are currently at some of their historically highest levels, as customers switch among the large variety of new plans available to them. Our advertising has continued to attract new customers, albeit at higher costs, and customer churn has risen. We believe that our elevated customer turnover rates have been primarily due to the bundled plan offerings from our major competitors.

In providing local phone service, we will initially rely upon the use of local lines and other network elements leased from the Incumbent Local Exchange Carriers (ILECs, also known as the Regional Bell Operating Companies, or RBOCs). As mandated by the FCC s UNE-P (Unbundled Network Element-Platform) provision, ILECs are required to allow access to their local networks to competitive phone companies. UNE-P has remained the subject of intense lobbying efforts on behalf of the ILECs and others seeking to have the FCC overturn this provision. This past spring the FCC left standing those rules related to UNE-P, but there can be no assurance that the FCC will not amend these rules. We believe that the discussions surrounding UNE-P are far from complete, but we also believe that UNE-P, or some version of it, will remain intact for the foreseeable future, and serve as a viable method for reaching the residential and small business market. If we are incorrect and UNE-P is amended so that we cannot access the local networks on the terms we do today, our consumer phone service offerings may be materially and adversely affected.

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In Fiscal 2002, we entered into an agreement with AT&T to resell AT&T s services and began to migrate our long distance customers from Global Crossing, which was the primary provider of long distance service to our customers. Our resale agreement with AT&T also provides that AT&T will originate calls from our long distance customers and that the types of calls specified (international, specific area codes, etc.) will be routed to their destination on our network. Management believes that the agreement with AT&T gives us the flexibility to select those calls to terminate on our own network at a lower cost to us. Management believes that this flexibility can increase our gross mar