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## **BUSINESS**

The following discussion includes forward looking statements, including but not limited to, management's expectations of competition; revenues, margin, expenses and other operating results or ratios; operating efficiencies; economic conditions; cost savings; liquidity; capital requirements; exchange rate fluctuations and rate of return.

### **Introduction**

INet Inc. sells, rents and services personal computers and PC-based business solutions. INet is the only authorized IBM PC distributor for Macedonia and part of Serbia and Montenegro (Kosovo). The company has developed a genuine PC repair and maintenance service that is the most recognized IBM Authorized Service Provider in the region. Also has initiated a successful rental business with computer-based equipment, including laptops, LCD projectors and printers. INet is ISO9000:2000 certified for the production of hardware, the design of ICT systems and other relevant services provided.

### **Industry**

IT products and services distribution industry generally consists of two types of business: traditional distribution business and fee-based supply chain services business. Within the traditional distribution model, the distributor buys and sells products and/or services to resellers who, in turn, typically sell directly to end-users, or other resellers. Hardware manufacturers and other publishers, which we collectively call suppliers or vendors, sell directly to distributors, resellers and end-users. As demand for supply chain services grows, distributors will seek new opportunities to provide services within and outside of the IT sector to complement their traditional distribution business. Fee-based supply chain services include the supply chain components that ensure the flow of goods from origin to consumption.

The traditional IT distribution industry continues to change as a result of a number of factors. As margins have narrowed on hardware products due to commoditization trends as technology evolves along its life cycle, suppliers and resellers have transitioned from a more product-focused to a more solution-oriented business model. Suppliers have also reduced the number of distribution partners and believe that suppliers continue to embrace two-tier distributors and are able to deliver products to market in a low cost manner. Resellers in the traditional distribution model continue to depend on distributors for a number of services, including product availability, marketing, credit, technical support, and inventory management. As resellers adjust their business models from selling products to selling solutions, they rely on distributors to help them combine products with services to complete the solutions they offer to their customers. As resellers require more solution-oriented offerings, distributors respond with enhanced value-added solutions and services customized to the needs of their specific customer base. A variety of reseller categories exist, including value-added resellers ("VARs"), corporate resellers, systems integrators, direct marketers, independent dealers, PC assemblers, and consumer electronics ("CE") retailers. Different types of resellers are defined and distinguished by the end-user market they serve, such as large corporate accounts, mid-market, small-to-medium sized businesses ("SMBs"), or home users, and by the level of value they add to the basic products they sell.

Many of our reseller customers are heavily dependent on distribution partners with the necessary systems, capital, inventory availability, and distribution facilities in place to provide fulfillment and other services.

## Company Strengths

The following strengths enable us to further enhance our leadership position in the IT sector:

- **Leading Market Reach** - We believe that we are one of the leaders in the IT sector in this region offering large products and services in the IT industry. Our scale allows us to purchase products in large quantities and avail ourselves of purchase opportunities from a broad range of suppliers and provide competitive pricing for our reseller customers. Our reseller customers can derive purchasing efficiencies and reduce their investment in inventory while simultaneously enhancing end-user service levels by establishing a supply relationship with us. This relationship ensures resellers meet their product inventory needs through a single point of contact rather than purchasing product directly from multiple suppliers. We believe that we also provide suppliers with access to a broad customer base that few can reach directly in a more cost-effective manner.
- **Strong Working Capital and Financial Position** - We have consistently demonstrated strong working capital management in both positive and difficult economic conditions. In particular, we have maintained a strong focus on optimizing our investment in inventory, while minimizing the deployment of debt. We are reducing our inventory days as result of our focused and sustainable initiatives towards reducing excess and obsolete goods, better buying strategies, and a cultural orientation towards return on invested capital. Furthermore, we continue to manage our accounts receivable through collections, credit limit setting, customer terms and process efficiencies to minimize our working capital requirements. Our business process improvement programs have also resulted in improving profitability, providing us with a solid foundation for growth. Based on the strength of our balance sheet and improving profit trends, we also believe that we are well positioned to support our growth initiatives in our core business and/or invest in incremental profitable growth opportunities.
- **Superior Execution and Vital Link in the Supply Chain.** - We are committed to increasing our value to our customers and suppliers as a vital link in the IT distribution and technology supply chain. Through our understanding and fulfillment of the needs of our reseller and supplier partners, we provide our customers with the tools they need to increase the efficiency of their operations, enabling them to minimize inventory levels, improve customer delivery, and enhance profitability. Critical to our superior execution is our ability to provide quick and efficient order fulfillment along with consistent, accurate and on-time delivery to our customers. We provide business information to our customers, suppliers, and end-users by leveraging our information systems. We give resellers, and in some cases their customers, real-time access to our product inventory data.

## Our Strategic Focus

Our strategic focus with support and enhance our position in the IT sector is to drive profitable growth by growing and optimizing our core business and expanding at the market.

## **Achieve Sustainable Profitable Growth**

- *We continually improve our operations* - by enhancing our capabilities while reducing costs to provide an efficient flow of products and services through the IT value chain. By optimizing delivery methodologies, we deliver faster, while reducing costs. We are also enhancing our revenues through the development of tools and capabilities to identify new growth opportunities. By streamlining our catalog to include the products most desired by our customers, we optimize inventory management, focus on higher margin opportunities, and develop merchandising and pricing strategies that produce enhanced business results.
- *We benefit from a growth perspective by targeting market segments that provide growth opportunities for customers and vendors* - We look for opportunities to invest in high-growth and profitable geographic markets. We will continually evaluate developing markets for expansion where IT demand supports a local presence. Therefore INet developed its business in Kosovo (Serbia and Montenegro), and filled the absence in the IT sector in that region.
- *We provide supply chain solutions* - tailored to each region to clients who are focused on increasing supply chain efficiencies, lowering overhead costs, and maximizing profits. We help our supply chain clients deliver products to key customers and new markets on a fee-for-service basis.

## **Optimal Productivity**

- *Our focus on driving efficiencies and achieving the best-in-class financial metrics has enabled us to improve our operating margins* - We employ a disciplined and focused approach when we review our operations and develop initiatives designed to streamline business processes and further increase our operating efficiency.
- *By maximizing economies of scale and leveraging our best-in-class logistics services* - we are prepared to address the changing needs of resellers and suppliers, providing a broad array of distribution and supply chain management solutions, services and programs.
- *We are continuously looking for ways to take cost out of our business* - INet is taking significant actions to improve the financial position. We are always focused on finding new ways to more cost-effectively respond to market demands.

## **Sales and Marketing**

We employ sales representatives who assist our clients with product and solution specifications, system configuration, new product/service introductions, pricing, and availability. Our product management and marketing groups also promote our sales growth, create demand for our suppliers'

products and services, and facilitate customer contact. For example, our marketing programs are tailored to meet specific supplier and reseller customer needs. These needs are met through a wide offering of services by our marketing department including advertising, direct mail campaigns, market research, on-line marketing, retail programs, sales promotions, training, solutions marketing, and other events.

*Selling Arrangements* - We offer various credit terms to qualifying customers, as well as prepay, credit card, and cash on delivery terms. We also offer various alternative financing solutions to our clients based on their creditworthiness and, in some cases, the creditworthiness of their end-users, to assist our resellers and their end-users in acquiring products.

**Products**

We distribute and market hundreds IT products with our clients require and our revenue mix by product category has remained relatively stable over the past several years, although it may slightly fluctuate between and within different operating times.

INet currently offers the following products:

- IBM PC Products – ThinkCentre, ThinkPad, xServer, Data Storage, Microperipherals, Monitors, Accessories
- INetX PC Products – ISO certified assembly line
- Non-IBM PC Products - Quest PCs, Data Storage, Microperipherals, Monitors, Accessories
- Software Packages – SAP, IBM/Lotus, Microsoft and Oracle
- Peripherals – Hewlett Packard printers and scanners, Epson matrix printers, Lexmark printers
- Cabling (Networking) Systems – LinkSys and Nexans.

In addition we present table for customers, orders and average orders per year, starting from year 2001 until 2004.

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
<b>Number of customers per year</b>	<b>534</b>	<b>215</b>	<b>728</b>	<b>565</b>
<b>Number of orders per year</b>	<b>1735</b>	<b>1879</b>	<b>2445</b>	<b>137</b>
<b>Average value of order per year in EUR</b>	<b>848</b>	<b>552</b>	<b>423</b>	<b>775</b>

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## Suppliers

Our suppliers generally warrant the products we distribute and allow returns of defective products, including those returned to us by our customers. We have written distribution agreements with many of our suppliers; however, these agreements usually provide for nonexclusive distribution rights and often include territorial restrictions. The agreements are also generally short term, subject to periodic renewal, and often contain provisions permitting termination by either party without cause upon relatively short notice. A supplier who elects to terminate a distribution agreement generally will repurchase its products carried in the distributor's inventory. Our biggest suppliers are presented in the table in percentage starting from 2001 until 2004.

	2001	2002	2003	2004	Total (2001-2004)
<b>IBM</b>	56,27	33,01	35,84	53,00	47,63
<b>Info Quest</b>	26,27	35,63	32,56	10,46	24,42
<b>Pakom Company</b>	1,06	4,94	2,04		1,75
<b>Flamingo Computers</b>	1,00	5,20	9,70	2,54	4,00
<b>Cabtel</b>		3,10	2,13		
<b>SRC</b>				17,80	6,02
<b>Login Systems</b>				2,67	
<b>Others</b>	15,40	18,12	17,73	13,53	16,18

## Competition

We operate in a highly competitive environment on our domestic market and internationally. The IT products and services distribution industry is characterized by intense competition, based primarily on:

- ability to tailor specific solutions to customer needs;
- availability of technical and product information;
- credit terms and availability;
- effectiveness of sales and marketing programs;
- price;
- products and services availability;
- quality and breadth of product lines and services;
- delivery service.

We believe we compete favorably with respect to each of these factors. We compete with a variety of national and regional distributors. The evolving direct-sales relationships between suppliers, resellers, and end-users continue to introduce change into our competitive landscape. We are constantly seeking to expand our business into areas closely related to our core IT products and services distribution business.

As we enter new business areas, including value-added services, we may encounter increased competition from current competitors and/or from new competitors, some of which may be our current customers.

### **Cautionary Statements for Purposes of the Safe Harbour Provisions**

The matters in this Report that are forward-looking statements are based on current management expectations that involve certain risks, including without limitation: intense competition; foreign exchange rate fluctuations; failure to attract new sources; failure in timely fashion to remain competitive; the potential for continued restrictive vendor terms and conditions; changes in tax rules and regulations; impact from downturn economic conditions, governmental controls and political or economic instability on domestic market; the potential decline as well as seasonal variations in demands for the company's products and services; product supply shortages; rapid product improvement and technological change; risk of credit loss; continued pricing and margin pressures; dependency on independent shipping companies.

INet has instituted and continues to institute changes to its strategies, operations and processes to address these risk factors to mitigate their impact on the company's results of operations and financial condition. However, no assurance can be given that the company will be successful in these efforts.

**SELECTED FINANCIAL DATA**

The following table presents selected financial data of INet Inc. ("INet" or the "company"). The information set forth should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the historical financial statements. References below to 2002, 2003 and 2004 represent the fiscal years of INet as a 52- or 53-week period ending on December 31.

<b>Fiscal Year Euro (€)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
<b>Selected Operating Info (1EUR = Den. As of 31.12)</b>	<b>61.0707</b>	<b>61.2931</b>	<b>61.3100</b>
Net Sales	1.038.736	918.494	1.656.357
Gross profit	284.819	240.232	385.351
Income before income taxes	4.808	5.091	6.410
Net income	250	418	3.415
Common Shares Outstanding	13.844	13.844	13.844
Earnings per share	-	-	0.25
<b>Selected Balance Sheet Info</b>			
Cash and cash equivalents	31.213	54.657	83.338
Total assets	368.639	377.611	381.935
Total Debt	-	-	-
Total liabilities	281.071	289.942	290.876
Stockholder's equity	87.568	87.669	91.058

The following table sets the percentage of total net sales company's represented thereby, for each of the fiscal years indicate:

<b>Percentage of Net Sales</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Net Sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	73.25	83.32	76.10	72.58	74.02	76.74
Gross profit	26.75	16.68	23.90	27.42	25.98	23.26
Operating expenses: S&M expenses R&D expenses G&A expenses	20.57	14.21	20.51	26.75	37.63	15.43
Other (income) expense	3,33	1.61	3.04	5.36	2.98	2.11
Net profits before taxes	2.85	0.87	0.32	0.46	0.55	0.39
Taxes	0.48	0.13	0.28	0.44	0.51	0.18
Net income	2.37	0.74	0.05	2.76	2.22	0.04

As the result of the restructuring plan that INet developed net sales grew to €1.66 million in 2004 from €0.92 million in 2003,

Gross margin is relatively stable with intention to grow in the future as the result of the modifying pricing policies and term and conditions for our customers. As we may experience negative sales growth of changing these terms, INet must remain in the stable limit, terms and conditions.

Total operating expenses decreased to 15.43% in 2004 from 37.63% in 2003.

Other (income) expense consisted primarily of interest, foreign currency exchange losses, and fees associated with the company's accounts receivable facilities. The table is showing tendencies during the 6 years. This tendency was as the result of improved working capital management, and an increase in the utilization of the company's accounts receivable facilities, partially offset by an increase in interest rates for the same period.

The company's effective tax rate remained consistent at 15%.

## Revenue and Profit by Departments in EUR

The following pie charts present our data about revenue and profit by the three departments of INet:

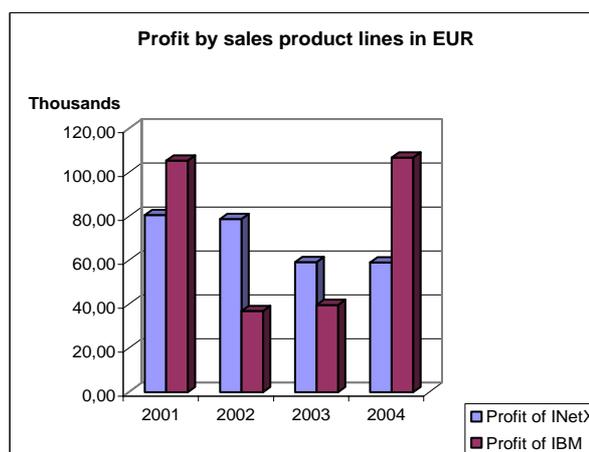
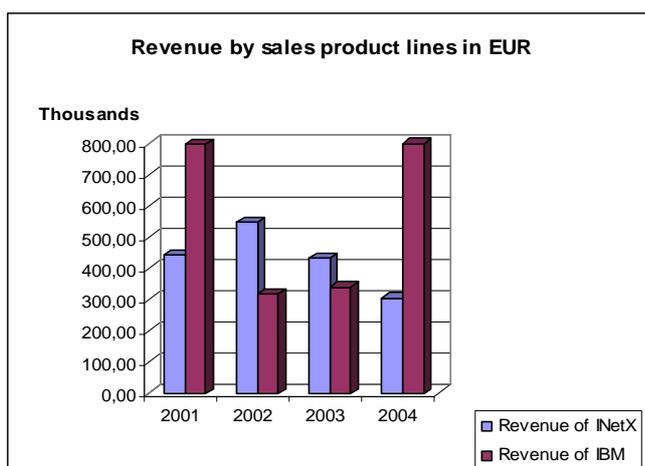
- **INet Sales Department** – to service small and medium size corporations as well as the retail market through an extensive network of dealers:
  - Representation & Distribution of ICT products (IBM, Info-Quest, SAP, Red Hat etc.)
  - INetX PC Integration Center – based on Info-Quest distribution products
  - INet Financial Services – flexible financing options to help consumer market and qualified customers keep costs down and PCs current.

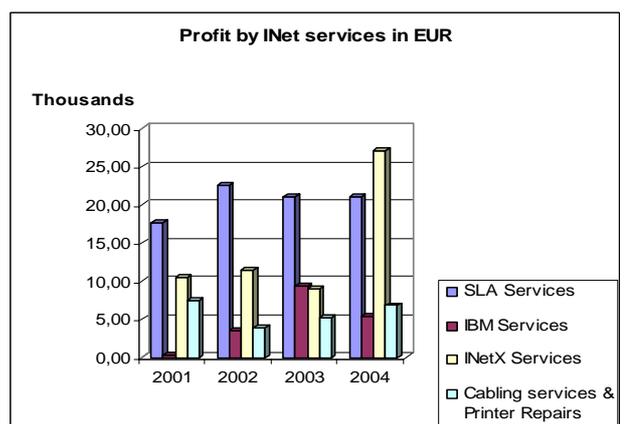
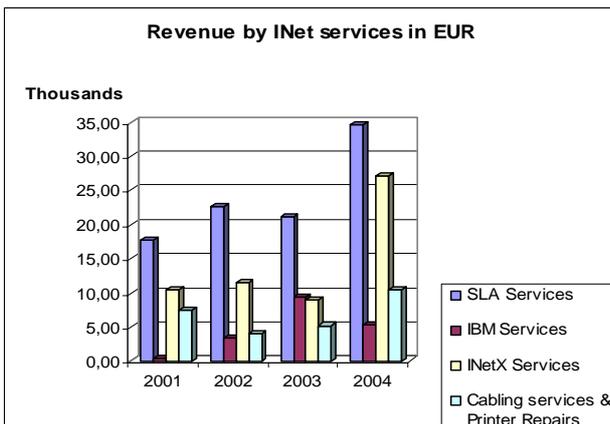
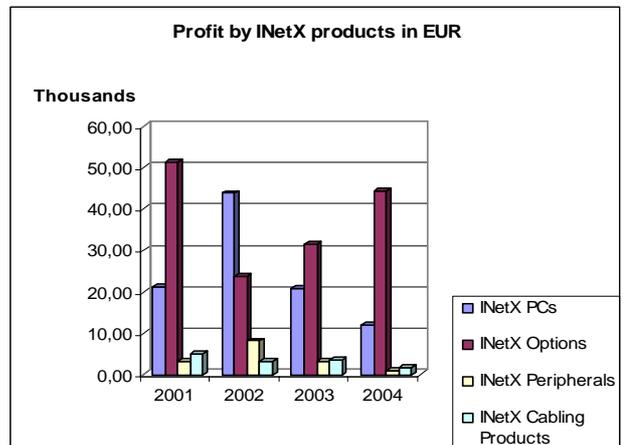
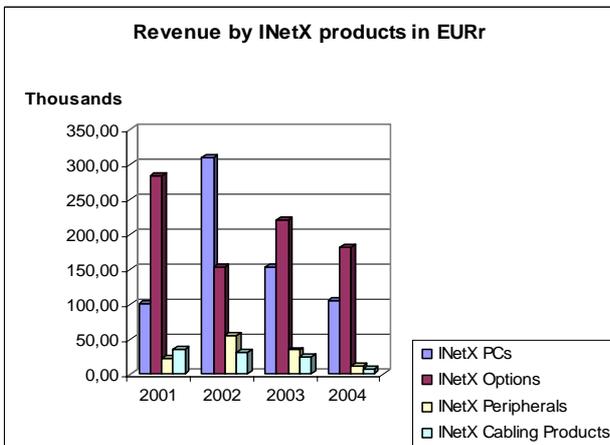
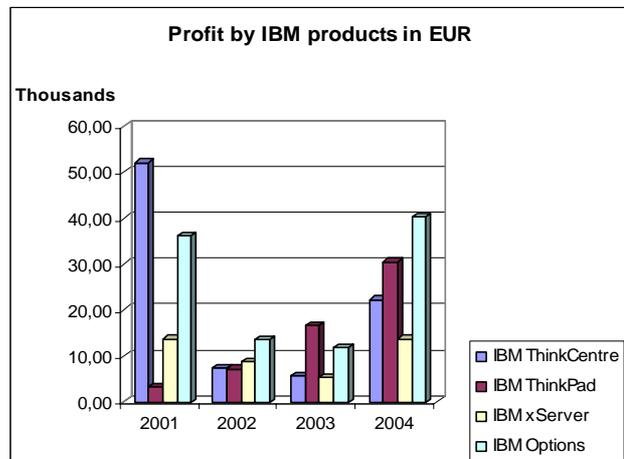
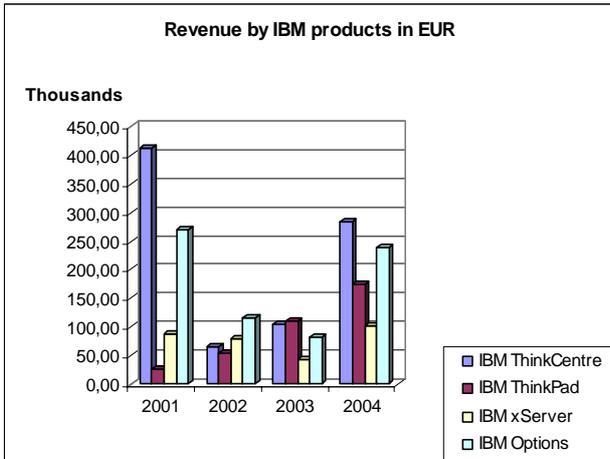
- **INet Customer Support Department:**

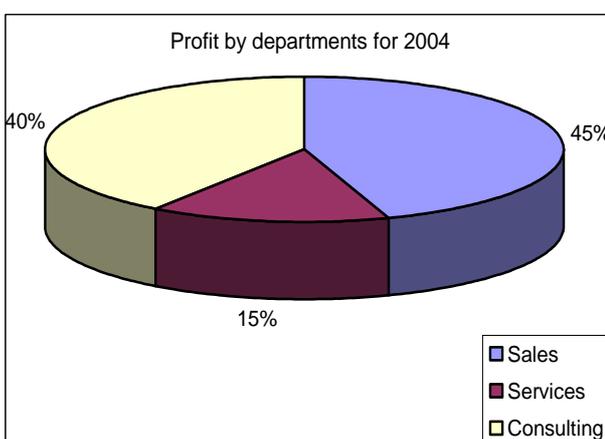
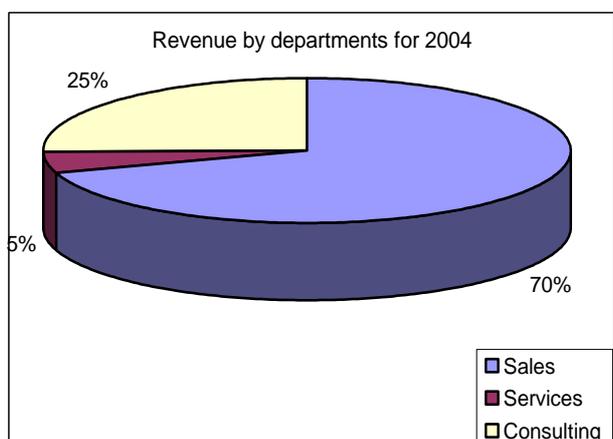
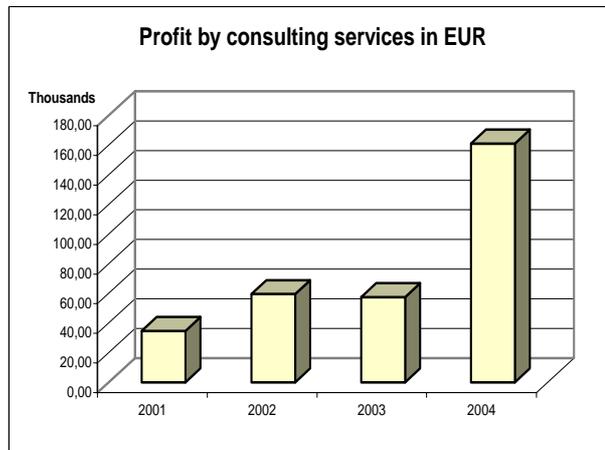
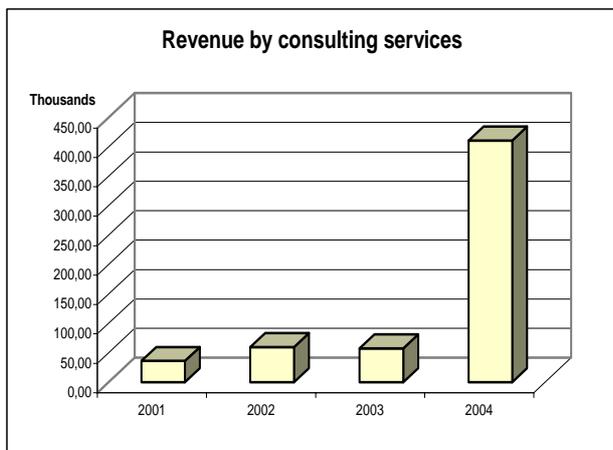
- INet Service Level Agreements – long-term contracts for comprehensive setup, network structure optimisation & security, system upgrades & migrations, help desk support and maintenance.
- INet Support Services – for comprehensive setup, help desk support and maintenance:
  - INet SLA Help Desk Support
  - INet Product Installation Services
  - INet Product Maintenance Services
  - INet Cabling & Wireless Solutions Services - offering the best cabling and wireless infrastructure

- **INet Consulting and Education Department** – in order to service corporations of all sizes for a fast implementation of ICT solutions:

- Consulting Services – SAP implementation, ICT strategy developments, ICT business assessment, BPR, IBM & Lotus based e-Business & e-Government solutions
- Education Services – IBM Training Courses







**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION**

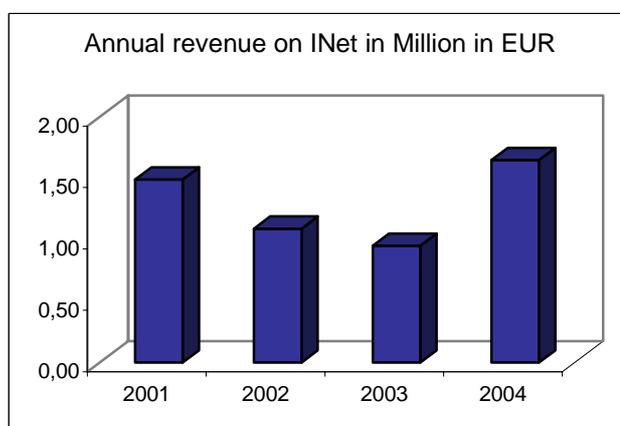
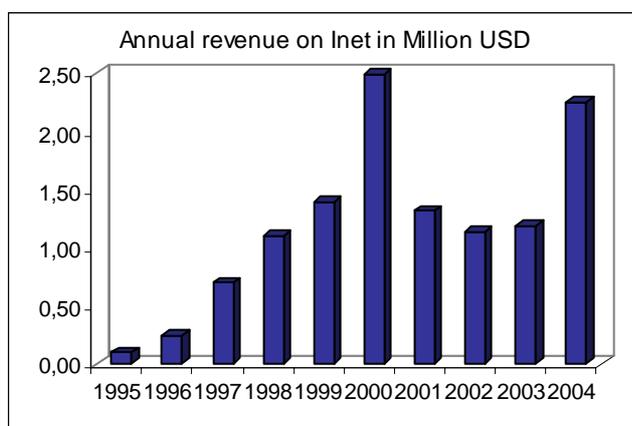
**Sales**

INet is one of the leading distributors of PC products and service on the domestic market. We offer range of IT products and services and help generate demand and create efficiencies for our customers and suppliers. We generated annual sales growth from expansion existing operations, addition of new product categories and new customers, increased sales to the existing customer base etc. The company's net sales grew to €1.66 million in 2004 from €0.92 million in 2003. The increase in net sales was primarily attributable to big demand for technology products in the public sector. In addition, during 2004, the demand for information technology products and services was becoming stronger and bigger and the addition of new customers (government, public organizations), increased sales to the existing customer base, and expansion of the company's product and service offerings.

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If we analyze the period of existing and working of one decade of INet, we can see the chart witch gives significant results in annual revenue, first in US dollars and then the chart in euros for 4 years.

In year 2000 the company achieved annual revenue witch is significant and is as the result of the efforts from 28 employees, but also INet managed to increase the revenue in year 2004 at very high level with only 12 employees and low operating expenses. Company's business was seriously affected by the 2001 hostilities in Macedonia, which resulted in sales dropping from € 2.5 mil. in 2000 to € 1.5 mil in 2001, € 1.1 mil in 2002 and € 1.0 mil in 2003. After implementing a comprehensive restructuring plan, INet's 2004 revenues total about € 1.65 million, and gross profit is about € 0.255 million. Annual gross profit for 2005 is projected to be at least 16 percent higher, i.e. € 0.295 million, with a gross margin of 19.2 percent, while keeping operational expenses at the same or lower level as in year 2004.



### Gross Margin

The IT distribution industry in which we operate is characterized by narrow gross profit as a percentage of net sales ("gross margin") and narrow income from operations as a percentage of net sales ("operating margin"). The margins have been negatively impacted by intense price competition, as well as changes in vendor terms and conditions, including, but not limited to, significant reductions in vendor rebates and incentives, tighter restrictions on our ability to return inventory to vendors, and reduced time periods qualifying for price protection. To mitigate and reduce these factors, we have implemented, and continue to refine, changes to our pricing strategies, inventory management processes, and vendor program processes. In addition, we continuously monitor and change, as appropriate, certain of the terms and conditions offered to our customers to reflect those being set by our vendors.

### Critical Accounting Policies and Estimates

The discussions and analyses of our financial condition and results of operation were based on our financial statements, which have been prepared in conformity with International Accounting Standards and with reference of SEC. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of

any contingent assets and liabilities at the financial statement date, and reported amounts of revenue and expenses during the reporting period. On an ongoing basis, we review and evaluate our estimates and assumptions, including those that relate to accounts receivable, vendor programs, inventories, goodwill, intangible assets and other long-lived assets, income taxes, and contingencies and litigations.

Our estimates are based on our historical experience and a variety of other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making our judgment about the carrying values of assets and liabilities that are not readily available from other sources. Actual result could differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies are affected by our judgment, estimates and/or assumptions used in the preparation of our financial statements.

- **Account Receivable** – Having receivables means that the company has made the sale but has yet to collect the money from the purchaser. We provide allowances for doubtful accounts on our accounts receivable, including retained interest in securitized receivables, for estimated losses resulting from the inability of our customers to make required payments. Changes in the financial condition of our customers or other unanticipated events, which may affect their ability to make payments, could result in charges for additional allowances exceeding our expectations. If the financial condition of our customers were to deteriorate, which may result in the impairment of their ability to make payments, additional allowances may be required. Our estimates are influenced by the following considerations: the small number of customers, the fact that one customer accounts for 50% or more of our net sales, the non-standard credit evaluation of our customer's financial condition, our credit non-insurance coverage and non-collateral requirements from our customers in certain circumstances.
- **Vendor Programs** – We receive funds from vendors (IBM) for price protection, product rebates, marketing and training, and promotion programs which are generally recorded, net of direct costs, as adjustments to product costs, revenue, or selling, general and administrative expenses according to the nature of the program. Some of these programs may extend over one or more quarterly reporting periods. We accrue rebates or other vendor incentives as earned based on sales of qualifying products or as services are provided in accordance with the terms of the related program. Actual rebates may vary based on volume or other sales achievement levels, which could result in an increase or reduction in the estimated amounts previously accrued. We also provide reserves for receivables on vendor programs for estimated losses resulting from vendors' inability to pay, or rejections of claims by vendors.
- **Inventories** – Our inventory levels are based on our projections of future demand and market conditions. Any sudden decline in demand and/or rapid product improvements and technological changes could cause us to have excess and/or obsolete inventories. On an ongoing basis, we review for estimated excess or obsolete inventories and write down our inventories to their estimated net realizable value based upon our forecasts of future demand and market conditions. If actual market conditions are less favorable than our forecasts, additional inventory reserves may be required. Our estimates are influenced by the following considerations: sudden decline in demand due to economic downturn, rapid product improvements and technological changes, our ability to return to vendors a certain percentage of our purchases, and protection from loss in value of inventory under our vendor agreements.

- **Goodwill, Intangible Assets and Other Long-Lived Assets** – We assess potential impairment of goodwill, intangible assets and other long-lived assets when there is evidence that recent events or changes in circumstances have made recovery of an asset's carrying value unlikely. When the sum of the expected, undiscounted future net cash flows is less than the carrying value of an asset, an impairment loss will be recognized. The amount of an impairment loss would be recognized as the excess of the asset's carrying value over its fair value. Factors we consider important, which may cause impairment include: significant changes in the manner of use of the acquired asset, negative industry or economic trends, and significant underperformance relative to historical or projected future operating results. In accordance with the International Accounting Standards, we will not amortize goodwill or indefinite-lived intangible assets and these assets will be reviewed for impairment at least annually.
- **Income Taxes** – As part of the process of preparing our financial statements, we have to estimate our income taxes in each of the taxing jurisdictions in which we operate. This process involves estimating our actual current tax expense together with assessing any temporary differences resulting from the different treatment of certain items, such as the timing for recognizing revenues and expenses, for tax and accounting purposes. We are required to assess the likelihood that our deferred tax assets, which include net operating loss carry forwards and temporary differences that are expected to be deductible in future years, will be recoverable from future taxable income or other tax planning strategies. If recovery is not likely, we have to provide a valuation allowance based on our estimates of future taxable income in the various taxing jurisdictions, and the amount of deferred taxes that are ultimately realizable. The provision for current and deferred tax liabilities involves evaluations and judgments of uncertainties in the interpretation of complex tax regulations by various taxing authorities. In situations involving tax related uncertainties, such as gains on sales of common stock of banks (Radobank) or other companies, we provide for deferred tax liabilities unless we consider it probable that additional taxes will not be due. Actual results could differ from our estimates.
- **Contingencies and Litigations** – There might be various claims, lawsuits and pending actions against us incident to our operations. If a loss arising from these actions is probable and can be reasonably estimated, we record the amount of the loss, or the minimum estimated liability when the loss is estimated using a range within which no point is more probable than another. Based on current available information, we believe that the ultimate resolution of these actions will not have a material adverse effect on our financial statements. As additional information becomes available, we assess any potential liability related to these actions and may need to revise our estimates. Future revisions of our estimates could materially impact the results of our operations and financial position.

### Quarterly Data, Seasonality

INet's quarterly operating results have fluctuated significantly in the past and will likely continue to do so in the future as a result of: seasonal variations in the demand for the products and services such as lower demand during the summer months and pre-holiday stocking in the retail channel; competitive conditions in our industry, which may impact the prices charged and terms and conditions

imposed by our suppliers and/or competitors and the prices or terms and conditions we offer our customers, which in turn may negatively impact our revenues and/or gross margins; currency fluctuations; variation in the amount of provisions for excess and obsolete inventory, vendor sponsored programs, and doubtful accounts resulting from technological changes or other changes in the market or e whole; changes in the level of operating expenses; the introduction by suppliers of new hardware and software products and services which may result in the obsolescence of existing products and/or affect the mix of products sold or overall demand; the loss or consolidation of a significant supplier or customer; product supply constraints; interest rate fluctuations; currency fluctuations; and general economic conditions.

## **Liquidity and Capital Resources**

### *Cash flows*

We have enhanced its growth and cash needs largely through income from operations, short-term borrowings, credit and other facilities, collecting of accounts receivable, and trade and supplier credit.

In 2003-2004 one of the company's objectives has been to improve the utilization of working capital and put assets to work through increasing inventory turns and steady management of vendor payables and customer receivables. INet will continue to strive for further improvements in working capital management and debt reduction for the foreseeable future.

Our cash and cash equivalents totalled 83.34 € thousands in 2004 from 54.66 € thousands in 2003.

### *Capital resources*

INet has additional lines of short-term credit with Crimson Capital, which provide for borrowings aggregating. Starting from year 2003 and until the end of the year 2004 the company has 4 Loan Agreements with Crimson Capital for working capital and investments. They resulted with financial growth trend with intention to continue in 2005.

#### *Crimson Capital – Loan Agreements*

- From 07.11.2003 to 16.01.2004, (Pilot project 1) - 45.700,00 USD for Working capital;
- From 27.01.2004 to 20.12.2004, (Project 2 and 3) – 2 x 100.000,00 USD for Working capital;
- From 30.12.2004 to 15.06.2005 (Project 4) – 100.000,00 USD for Investments and Working capital.

INet believes that existing cash resources and cash provided by operating activities, supplemented as necessary with funds available under credit arrangements will provide sufficient resources to meet its present and future working capital and cash requirements.

### *Market risk*

We are exposed to the impact of the foreign currency fluctuations and interest rate changes. In the normal course of business, INet is unable to employ established policies and procedures to manage its exposure to fluctuations in the value of the foreign currencies and interest rates using a variety of financial instruments. It is the our policy to utilize financial instruments in a future to reduce risks, but not to enter into foreign currency or interest rate transactions for speculative purposes.

In addition to product sales and costs, the company has foreign currency risk related to debt that is denominated in local currency. The company's foreign currency risk management objective is to protect its earnings and cash flows resulting from sales, purchases and other transactions from the adverse impact of exchange rate movements.

Our foreign currency risk management objective is to protect our earnings and cash flows resulting from sales, purchases and other transactions from the adverse impact of exchange rate movements. Foreign exchange risk is managed by using forward contracts to offset exchange risk associated with receivables and payables.

We are exposed to changes in interest rates primarily as a result of our short-term debt used to maintain liquidity and finance inventory, capital expenditures and business expansion. The company's interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flows and to lower its overall borrowing costs.

### *Market risk management*

Foreign exchange and interest rate risk should be monitored in a future using a variety of techniques including a review of market value, sensitivity analysis and Value-at-Risk techniques ("VAR"). The VAR model determines the maximum potential loss in the fair value of foreign exchange rate sensitive financial instruments assuming a one-day holding period. The VAR model estimates should be made assuming normal market conditions and 95% confidence level.

The VAR model is a risk analysis tool and does not purport to represent actual losses in fair value that will be incurred by the company, nor does it consider the potential effect of favorable changes in market rates. It also does not represent the maximum possible loss that may occur. Actual future gains and losses will likely differ from those estimated because of changes or differences in market rates and interrelationships, timing and other factors.

### *Euro conversion*

Beginning in January 1, 2002, the company has implemented plans to address the issues raised by the euro currency conversion. The company's Built-to-Run ERP computer information systems and ISO-9000:2000 business processes and equipment generally accommodate multiple currencies and euro-denominated transactions.

**FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**
**BALANCE SHEET**

<b>ASSETS</b>	<b>Amount in EUR</b>	
	<b>2003</b>	<b>2004</b>
<b>A. The requests for the inscribed, but not paid capital</b>	<b>0</b>	<b>0</b>
<b>B. Fixed assets</b>	<b>90.758</b>	<b>61.156</b>
Intangible assets	37.112	615
Net fixed assets – property, plant and equipment	32.616	45.373
Long – term investments	21.029	15.169
<b>C. Current assets</b>	<b>286.853</b>	<b>320.779</b>
Inventories - stocks	46.343	93.666
Accounts receivable - debtors	185.853	143.775
Marketable securities – short – term investments	0	0
Cash and cash equivalents	54.657	83.338
<b>D. Prepaid expenses</b>	<b>0</b>	<b>0</b>
<b>E. Assets</b>	<b>377.611</b>	<b>381.935</b>

**LIABILITIES AND STOCKHOLDERS' EQUITY**

<b>A. Capital and reserves</b>	<b>87.669</b>	<b>91.058</b>
Common stock	69.053	69.034
Paid – in capital	0	0
Retained earnings	8.727	8.725
Reserves	8.739	9.249
Accumulated profit	793	1.149
Transferred loss (-)	0	0
The profit for the financial year	356	2.902
VIII. The loss for the financial year	0	0
<b>B. Long term reservation for risks and expenses</b>	<b>0</b>	<b>0</b>
<b>C. Long and short – term liabilities</b>	<b>289.942</b>	<b>290.876</b>
<b>D. Delayed payment of expenses and revenues in total period</b>	<b>0</b>	<b>0</b>
<b>E. Liabilities and stockholders' equity</b>	<b>377.611</b>	<b>381.935</b>

**INCOME STATEMENT**

<b>REVENUES</b>	<b>Amount in EUR</b>	
	<b>2003</b>	<b>2004</b>
Sales revenue	918.494	1.656.016
Other incomes	27.513	34.923
Extraordinary incomes	6.283	341
<b>Total</b>	<b>952.290</b>	<b>1.691.279</b>
<b>EXPENSES</b>		
Operating expenses	922.344	1.627.763
Cost of good sold	739.649	1.338.403
The expenses for the employees	32.998	35.780
Net salaries	18.453	19.874
Salary expense	14.545	15.907
Depreciation	19.350	16.265
Other expenses	24.855	57.108
Extraordinary expenses	0	0
<b>Total</b>	<b>947.199</b>	<b>1.684.871</b>
<b>FINANCIAL RESULT</b>		
Net profits before taxes	5.091	6.410
Net losses before taxes	0	0
Taxes	4.673	2.994
Net profits after taxes	418	3.415
Net losses after taxes	0	0

## **FINANCIAL STATEMENTS ANALYSIS**

The company is using the following two analysis standards of comparison of the financial measures over a period of time:

- Percentage Analysis - Horizontal and Vertical Analysis of the past performance measurements of the company ;
- Comprehensive Ratio Analysis - Evaluating Liquidity, Profitability, Long-term Solvency, Cash Flow Adequacy, Market Strength ;

### **Percentage Analysis**

#### *Horizontal and Vertical Analysis – Comparative Statements*

Percentage analysis of the income statement focuses in the gross profit, expenses, and net income related to the gross sales. As sales grow or decline over the years, the expenses also grow or decline, which makes a direct euro-to-euro comparison impractical. However, the expenses remain relatively stable as a percentage of sales.

Percentage comparison is also done on the balance sheet to see how each item relates to the total assets. To calculate the balance sheet percentages, the individual accounts, including the liability and equity accounts, are divided by the total assets figure. In such a case the company's performance are compared to the historical performance and to the PC industry averages.

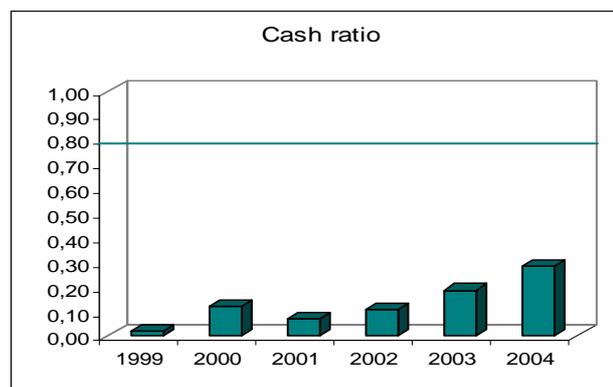
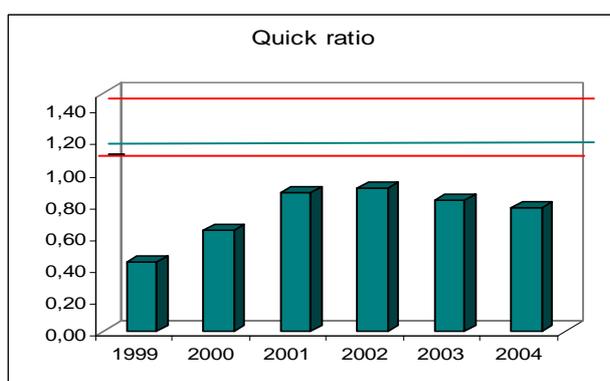
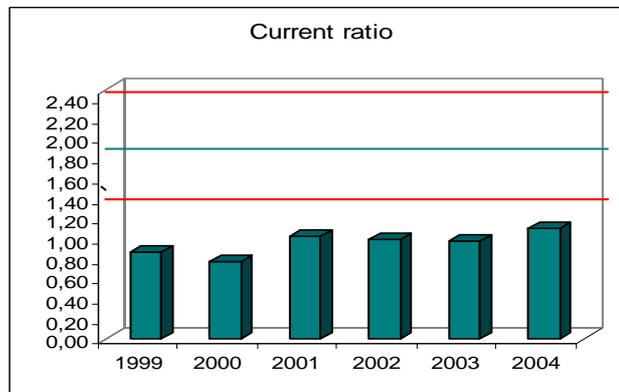
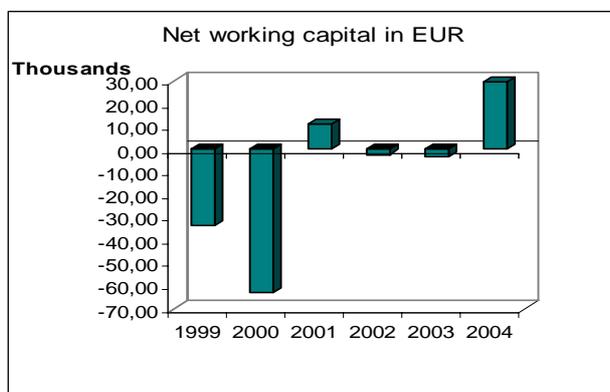
The horizontal comparison and common-size statements (vertical analysis) are explained above in this Report in the part "Management discussion and analysis". The management will use the common-size statements in the future to analyze the operating and financing characteristics of the company with other companies of same or different size in the same PC industry.

INet is using the ratio analysis which are reports for the solvency of the company, to compare the financial results in the previous years or with other companies in the industry, and to point out areas needing further investigation.

Industry averages can be obtained from Dun & Bradstreet, Standard & Poor, Moody, and Robert Morris Associates, among others. These averages can be used only as a broad guideline to compare the company's performance.

The company is using Dun & Bradstreet "Industry Norms and Key Business Ratios" industry norms for comparison. According to the reports that INet is preparing on yearly, monthly and daily base, there are ratios which give a clear picture for the INet's solvency and any ratio is maintained at a specific value as part of a financing agreement and is calculated and monitored on a timely basis. Ratio Analysis enables to spot trends in a business and to compare its performance and condition with the average in the industry. To do this we compare our ratios with the industry averages and watching, especially for any unfavourable trends that may be starting. Ratio analysis may provide the all-important early warning indications that allow solving the business problems before business is destroyed by them.

**Indicators of liquidity** - are measured by the ability of the company to satisfy its short term liabilities as they come due. It refers to the company's overall financial position.



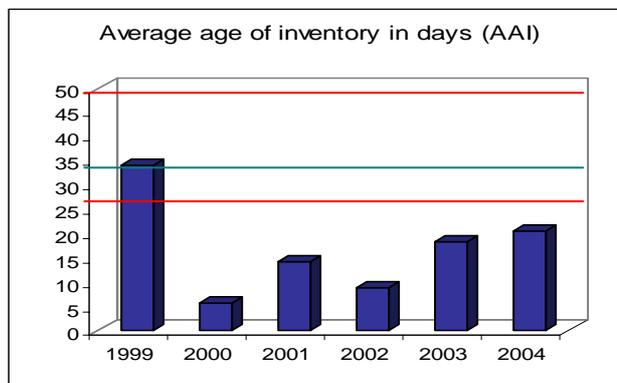
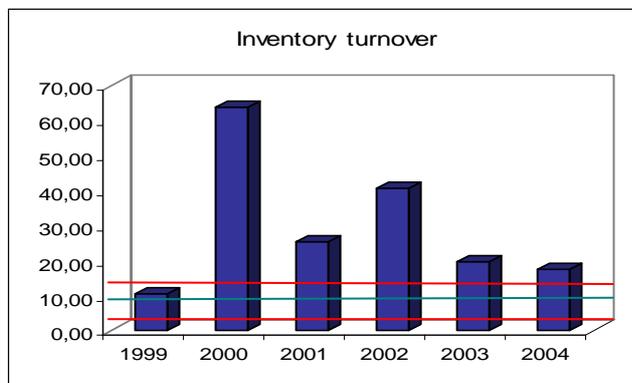
*Net working capital* is more a measure of cash flow than a ratio. Over the six year period that has been analysed, we see that net working capital few years was negative but, compared to 2003, in year 2004 there is significant result with intention for reasonably growing and stable trend.

*The current ratio (CUR) method* is a model for measuring the liquidity and it is an indicator of a company's ability to pay short - term obligations. In 1999, 2000, 2002 and 2003 this indicator was less than 1.0. This indicator is still not in the frame of the industry average but from 0.99 in 2003 the current ratio increased to 1.1 in 2004.

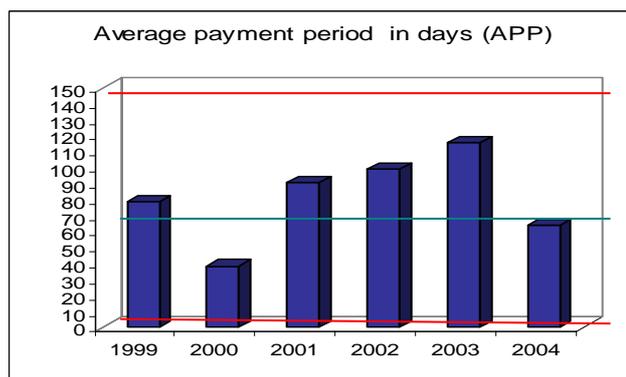
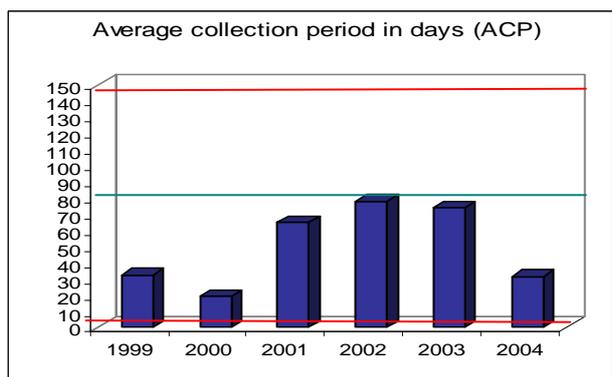
*Quick (Acid - Test) Ratio (QUR)* as an indicator of the extent to which the company can pay current liabilities without to rely on the sale of inventory, decreased from 0.83 to 0.78 in 2004.

The last is the *Cash ratio* who measures the ability for quickly to liquidate the assets and cover short - term liabilities. As the result of continual growing of INet and its profitable working, the indicator increased from 0.19 in 2003 to 0.29 in 2004.

**Activity ratios** - measures the speed with which accounts are converted into sales or cash. This ratio indicates that INet is in a good shape. Industry averages have been reached.

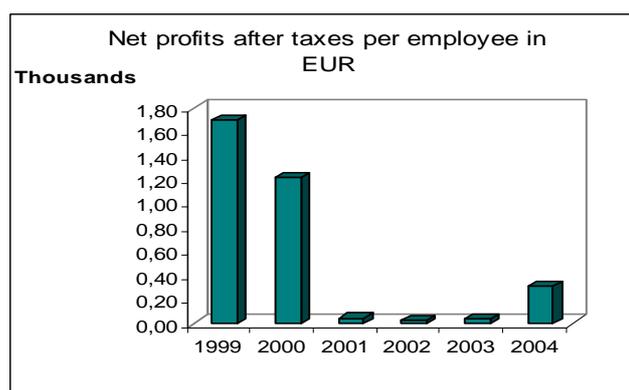
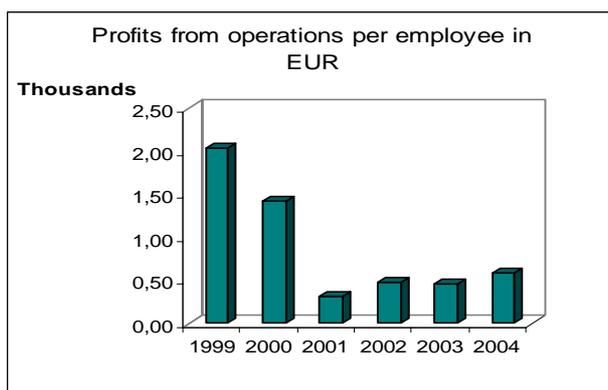
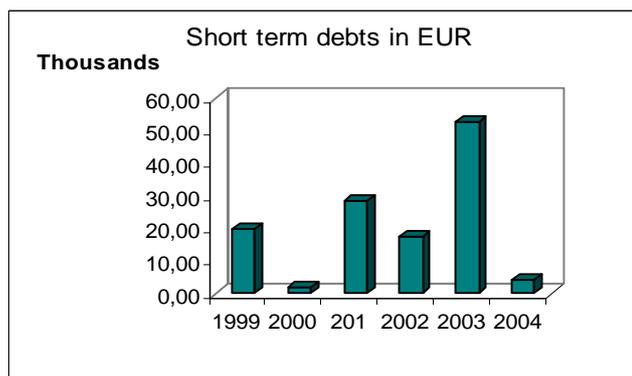
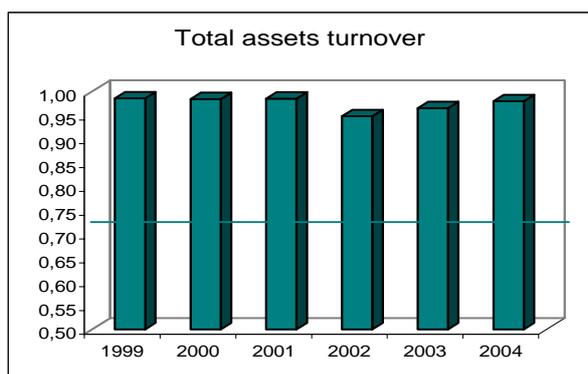


*Inventory turnover* - is in the frame of industry average. Also *Average age of inventory* had increasing from 18 to 20 days on 2004. Still the activity ratios are stable and in the predefined industry limits and reflect good relative inventory levels of the company.

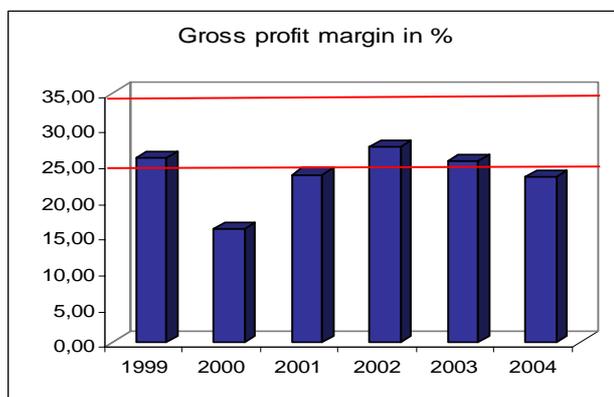
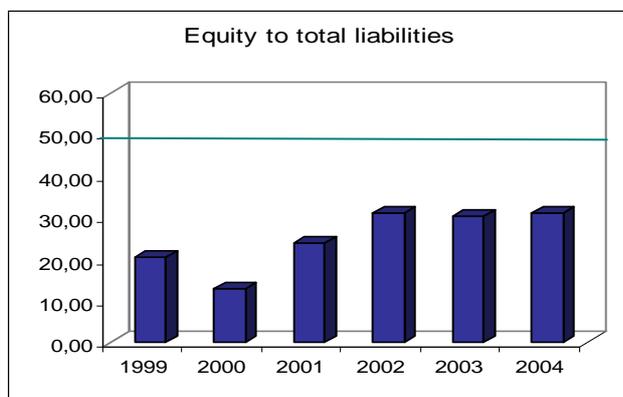


*Average collection (ACP)* decreased from 74 to 32 days in 2004 and *Average payment (APP) period* decreased in 2004 from 112 to 63 days, which means that INet is collecting the account receivable for shorter time, and also is able to pay its bills in shorter time than previous years which reflect good success of company's credit and collection policies. Although overall liquidity appears good, some attention should be given to accounts receivables and accounts payables, even they are in the industry frame and are satisfactory. Still is in the best interest of the company to collect and pay in very short time and to have complete influence on the entire cash flow and outflow process.

**Indicators of productivity, efficiency and operating** - in addition there are *Total asset turnover*, *Short term debts* and also data about *Profits from operations* and *Net profits after taxes per employee* from year 1999 to year 2004. Total assets turnover indicate that INet has efficiency witch is on approximate constantly high level. The company's operations have been financially efficient. Also short term debts have decreased from 0.53€ in 2003 to 0.4€ in 2004.



**Financial leverage** – is the magnification of risk and return of its debt in relation to total assets. The higher the financial leverage the more the company is considered risky. As for most ratios, an acceptable level is determined by its comparison to ratios of companies in the same industry and industry averages.



The gross profit margin ratio tells us the profit a business makes on its cost of sales, or cost of goods sold. It is a very simple idea and it tells us how much gross profit per 1€ of turnover our business is earning. The gross profit total is about € 0.23 million. Annual gross profit for 2005 is projected to be at least 16% higher with a gross margin of 19,20%, while keeping the operation expenses at the same level. The gross margin is not an exact estimate of the company's pricing strategy but it does give a good indication of financial health. Without an adequate gross margin, a company will be unable to pay its operating and other expenses and build for the future. The margin decline during these years was caused by intense price competition in the local market. We expect these competitive price pressures and restrictive vendor terms and conditions to continue in the foreseeable future. We have implemented and continue to refine changes to our pricing strategies, inventory management processes, and administration of vendor subsidized programs.

## NOTES TO FINANCIAL STATEMENTS

### Note 1 Organization and Basis of Presentation

INet Inc. (the “company” or “INet”) is a privately owned entrepreneurial-based company involved in sales, rental and services of personal computers and PC based business solutions. INet is the only authorized IBM PC distributor for Macedonia and part of Serbia and Montenegro (Kosovo). The company has developed a genuine PC repair and maintenance service that is the most recognized IBM Authorized Service Provider in the region. The company also has initiated a successful rental business with computer-based equipment, including laptops, LCD projectors and printers. INet is following ISO9000:2000 for the production of hardware, the design of ICT systems and other relevant services provided.

### Note 2 Significant Accounting Policies

#### Fiscal year

INet financial statements are prepared for the calendar year, January 1 to December 31, as a company fiscal year. All references herein to “2004”, “2003”, and “2002” represent the 52-week fiscal year ended December 31.

#### Use of Estimates

The financial statements have been made in accordance with the requirements of the regulation generally accepted in the RoM, as well as the usual accounting practice. The domestic accounting regulation differs in some aspects from the International Accounting Standards.

Preparation of financial statements in conformity with International Accounting Standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the financial statement date, and reported amounts of revenue and expenses during the reporting period.

These accounting policies are used consequently from year to year during a longer period of time.

INet classification rules are: INet has developed Accounts and Chart of Accounts for its own needs, with seven digits in the account numbers and hundreds of accounts in the chart of accounts.

#### Revenue and Expenses Recognition

INet generally recognizes sales and revenues on hardware and software products sales at the time of shipment to the customer. Service revenues are not recognized over the contractual period but upon delivery of the services, i.e. as the services are provided and performed.

The expenses are assigned to the accounting period in which they are used to produce revenue.

Revenues and expenses are shown in the following categories:

- Sales – Cost of Goods Sold = Gross Profit
- Gross Profit – Operating Expenses = Income from Operations
- Income from Operations + Interest Income – Interest Expense – Taxes = Net Income After Taxes

## **Vendor Programs**

Funds received from vendors for price protection, product rebates, marketing or training programs are recorded net of direct costs as adjustments to: cost of goods sold; selling, general and administrative expenses; or revenue according to the nature of the program.

## **Warranties**

INet's suppliers generally warrant the products distributed by the company and allow returns of defective products, including those that have been returned to the company by its customers. The company does not independently warrant the products it distributes. However, INet does warrant the following: (1) its services with regard to products that it configures for its customers, and (2) products that it builds to order from components purchased from other sources. Provision for estimated warranty costs is recorded at the time of sale and periodically adjusted to reflect actual experience.

## **Foreign Currency Translation (current rate) and Remeasurement**

All foreign-currency-denominated liabilities are converted into local currency values using the exchange rate prevailing at the fiscal year ending date (the current rate).

## **Cost value of financial instruments**

The carrying amounts of cash, accounts receivable, accounts payable and other accrued expenses approximate cost value because of the short maturity of these items. The carrying amounts of outstanding debt issued pursuant to bank credit agreements approximate cost value.

## **Cash**

The company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

The cash and cash equivalents consist of cash on hand, bank balances and foreign exchange accounts. INet does not have any limitation regarding free disposal with the cash.

## **Inventories**

INet is pricing inventory at cost under the *perpetual merchandise inventory system* according to the first-in, first-out (FIFO) method, as more effective for providing information about quantities and ensuring optimal customer service.

## **Property and Equipment**

Property and equipment are recorded at cost and depreciated using the straight-line method over the useful lives estimated according to the domestic officially announced depreciation rate. The calculation is made for each asset separately (not on group of assets).

## **Long-Lived Assets**

INet assesses potential impairments to its long-lived and intangible assets when there is evidence that events or changes in circumstances have made recovery of the asset's carrying value unlikely. An impairment loss would be recognized when the sum of the expected, undiscounted future net cash flows is less than the carrying amount of the asset. The amount of the impairment loss would be recognized as the excess of the asset's carrying value over the fair value.

## **Investments in Available-for-Sale Securities**

The company classifies its existing marketable equity securities as available-for-sale. INet valuation rules are: All of the company's securities, i.e. short- and long-term investments, are classified as available-for sale and reported at book value, with unrealized gains and losses reported in assets.

## **Derivative Financial Instruments**

The company operates on the domestic market and is not in the position to reduce its exposure to fluctuations in interest rates and foreign exchange rates by creating offsetting positions through the use of derivative financial instruments.

## **Note 3 Income Taxes**

According to the domestic legislation, the company is paying 15% income taxes.

## **Note 4 Segment Information**

INet operates predominantly in a single industry segment as distributor of information technology products and services. The company's reportable measure of segment profits is income from operations. The accounting policies of the segments are those described in the summary of significant accounting policies. Geographic area in which the company operates include mainly the domestic market but also has developed its business in Kosovo (Serbia and Montenegro).

## **Note 5 Common Stock**

The Shareholders Equity of the company is stated at the accounting value. The equity of INet is 100% private. The reserves are founded through distribution of the profit according to the domestic regulations.