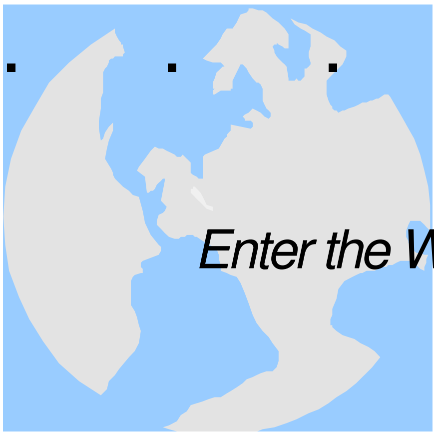
INet Inc.

Annual Report 2005



Enter the World of Excellence in Technology

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Annual Report 2005

Enter the World of Excellence in Technology

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 has been in the business of Information and Communication Technology (ICT) on the Macedonian market since 1991. It is highly recognized in the fields of sales, distribution, rental and services of ICT products and ICT based business solutions. This focused strategy has permitted INet to increase both revenues and profits over the years. The company has established three self-directed business teams: ICT Product Distribution, ICT Support Services and ICT Consulting, in order to grow and develop in these businesses while seeking new opportunities. Our strategy could never succeed if the relationship between INet and our supplier-partners did not embrace and support it. Exclusive agreements with our best partners: IBM, Lenovo, Info Quest, SAP, Red Hat, Trend Micro… guarantee the quality, wide portfolio and professionalism of our company. In 2005, INet opened doors of opportunity by signing agreements with new vendors and by expanding the product portfolio. The year was a significant turning point, as the company charged ahead, and remained focused on improving operations, enhancing efficiency and customer focus.

Today our company is stronger, more agile and better prepared for the future than ever before.

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.

- *Enlarging the product portfolio* – The Company established excellent collaboration relations with several worldwide vendors:

  - ***IBM*** - IBM Business Partner – Distributor
IBM Authorized Service Provider
IBM Authorized Training Provider
IBM PartnerWorld Member
  - ***Info Quest*** - Authorized Distributor and Service Provider

In year 2005, INet has signed agreements with recognized vendors that are well identified at the regional market such as:

- ***SAP*** – SAP Sales and Services Partner
- ***Lenovo*** - Lenovo Business Partner – Distributor
Lenovo Authorized Service Provider
- ***Red Hat*** - Red Hat Advanced Partner
Red Hat Certified Training Partner

- ***Trend Micro*** - Trend Micro Premium Partner

The signed agreements for mutual collaboration provide the company to enlarge its product portfolio, and to define new strategies for growth in order to become recognized on the regional market.

Vision, Mission, Values

Vision
INet to be universally regarded as the best way to deliver technology in Macedonia and in the Balkan region.

Mission
To help our business partners grow and be more profitable, while maximizing value for our shareowners, by:

- Broadening the reach of our business partners, connecting them with new markets, technologies and solutions
- Earning the respect and loyalty of our business partners through superior value and service
- Creating innovative ideas through bright, energetic, customer-focused and talented people

Guiding Principle
INet will achieve results with the highest integrity, with a focus on enhancing the success of our customers, vendors and associates.

Values
We commit to these values to guide our decisions and our behaviors:

- **Teamwork**
  We promote and support a diverse, yet unified, team. We work together to meet our common goals.
- **Respect**
  We honor the rights and beliefs of our fellow associates, our customers, our shareowners, and our community. We treat others with the highest degree of dignity, equality and trust.
- **Accountability**
  We accept our individual and team responsibilities and we meet our commitments. We take responsibility for our performance in all of our decisions and actions.
- **Integrity**
  We employ the highest ethical standards, demonstrating honesty and fairness in every action that we take.
- **Innovation**
  We are creative in delivering value to our fellow associates, customers, shareowners, and community. We anticipate change and capitalize on the many opportunities that arise.

Our Strategic Focus
Our strategic focus witch 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.

Serving Our Communities

Our Purpose

INet's Corporate Giving Program invests volunteer, cash and in-kind support in communities where our associates live and work. These investments are directed to innovative programs to promote education and economic self-sufficiency, to ensure quality of life and improve the health and well-being of citizens.

This program, guided by our corporate values of teamwork, respect, accountability, integrity and innovation, focuses on three areas:

Education

Support is targeted at scholarships, computer science, distribution management and other programs that promote economic self-sufficiency. General operating support will not be considered.

Health and Human Services

Support is targeted at community-based social and health service agencies for specific programs. A significant portion of the support granted in this area will be channeled through INet's investment. General operating support will not be considered.

Arts and Culture

Program support is targeted at performing arts centres and cultural organizations. General operating support and requests to underwrite performances and exhibitions will not be considered.

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, and create demand for our suppliers' products and services, and facilitate customer contact. Our product portfolio is enlarged and improved with the services that the company is offering. The product portfolio combined with IT professional services on the premier level is on of the important steps that we are planning to promote and develop. The IT products and services distribution industry is characterized by intense competition but the business plan that has been developed is that the company should establish B2B contact and collaboration in order to overrun the regional market and promote itself.

We believe that customer information systems and product ordering and delivery systems, including Internet-based systems, are becoming increasingly important in the distribution of technology products and services. Therefore the company promotes the web site with its features and capabilities in order to reduce time and costs that the employees are spending and in order the sale to become more effective. Customers can access the company's' IT system through Internet on the web site www.inet.com.mk, and also there is possibility for our partners in Macedonia and abroad to access our partner web site partner.inet.com.mk.

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

In addition we present table for customers, orders and average orders per year, starting from year 2002 until 2005.

	2003	2004	2005
Number of customers per year	728	565	493
Number of orders per year	1620	2137	2168
Average value of order per year in EUR	571	775	828

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 2002 until 2005.

	2003	2004	2005
IBM	35,84	53,00	40,65
Lenovo			20,31
Info Quest	32,56	10,46	12,96
Others	37,52	28,62	21,11

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.

EU Projects
In order to become familiar with the EU standards, legislative and to be closer to the European community from the managerial perspective, INet has expanded the involvement in the EU projects supported by the governmental institutions and various EU initiatives. The company gain management skills, soft skills, sales skills and strategies of the human resources development which resulted in improved segments and areas identified as company weakness.

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.

Community Relations

Global Compact – Communication on Progress

"In order to advance universal environmental and social principles to foster a more sustainable and inclusive world economy INet Inc. has engaged in the Global Compact and ten universal principles in the areas of human rights, labor standards, the environment and anticorruption. Many Global Compact participants have changed their practices, codes of conduct and engaged in new ways with stakeholders as they have sought to implement the principles." - Toni Petreski, President & Chief Executive Officer of INet Inc.

"The key drivers of INet Inc. are above all of ethical character; improvement of the reputation of the company through increased employee satisfaction with their jobs, improved and closer relationship business partner and clients in all aspects of business relationship."

Our first report will help to establish the status of our entities sustainable development performance and identify areas for improvement. It is in our self – interest to work towards alleviation of many of the world's most pressing dilemmas. We recognized that many of these problems can be addressed only through multi – stakeholders cooperation.

Until now we set changes to business operations so that the principles become part of strategy, culture and day-to-day operations. The aim is to promote the activities in the area of Corporate Social Responsibility and to provoke an even greater inclusion in the promotion and support of these activities among the wider community.

The informations are initial reports and are a first attempt in publishing public information on social responsible activities in practice. They will continuously be updated in accordance with the progress achieved.

Over the coming months, we will devote considerable effort to be actively involved in the project pertaining to the Skopje ZOO.

Description of activities

Two new tools support this process. In order to raise awareness on Information and communication technology in all spheres of influence we decided to take activities like IT equipment donations. The initiatives which we apply are to engage in environmentally friendly activities with positive impact on our society, change in internal processes with a view to lending support to such activities.
Our first donation came as a result of principles that refer to the areas of Human Rights. We have donated to Association of disabled persons trough BOOZ Allen Hamilton. The employees presented the idea to the Executive Board in November 2004, and the donation activities take place in December 2004.

Second donation followed our first action. We have donated IT equipment to Alliance of Humanitarian associations of citizens – April 2005.

Also, the ten principles of Global Compact are present in each business decision, each business process, specially in the area of Human Resources Management.

Principles	Sphere of action			
	Human Rights	Labor standards	Environment	Anticorruption
1. Businesses should support and respect the protection of internationally proclaimed human rights within their sphere of influence	√			
2. Businesses should make sure they are not complicit in human rights abuses	√			
3. Freedom of Association and Collective Bargaining		√		
4. Businesses should uphold the elimination of all forms of forced and compulsory labour				
5. Businesses should uphold the effective abolition of child labour				
6. Businesses should uphold the elimination of discrimination in respect of employment and occupation		√		
7. Businesses should support a precautionary approach to environmental challenges			√	
8. Businesses should undertake initiatives to promote greater environmental responsibility				
9. Businesses should encourage the development and diffusion of environmentally friendly technologies			√	
10. Businesses should work against corruption in all its forms, including extortion and bribery				√

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 2003, 2004 and 2005 represent the fiscal years of INet as a 52- or 53-week period ending on December 31.

Fiscal Year Euro (€)	***2003***	***2004***	***2005***
Selected Operating Info (1 EUR = Den. as of 31.12)	***61.2931***	***61.3100***	***61.1779***
Net Sales	924.777	1.656.357	1.795.851
Gross profit	240.232	385.351	344.057
Income before income taxes	5.091	6.410	53.389
Net income	418	3.415	45.297
Common Shares Outstanding	13.844	13.844	13.844
Earnings per share	-	0.25	3,27
Selected Balance Sheet Info			
Cash and cash equivalents	54.657	83.338	83.501
Total assets	377.611	381.935	385.083
Total Debt	-	-	-
Total liabilities	289.942	290.876	248.489
Stockholder’s equity	87.669	91.058	136.594

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

Percentage of Net Sales	***2003***	***2004***	***2005***
Net Sales	100.0%	100.0%	100%
Cost of goods sold	74.02	76.74	80.85
Gross profit	25.98	23.26	19.15
Operating expenses: - S&M expenses - R&D expenses - G&A expenses	37.63	15.43	8.55
Other (income) expense	2.98	2.11	0.92
Net income before taxes	0.55	0.39	2.97
Taxes	0.51	0.18	0.45
Net income	0.05	0.21	2.52

As the result of the improved domestic market conditions, net sales grew to €1.79 million in 2005 from €1.66 million in 2004.

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.

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 previous 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.

Net income in 2005 is on high level and turn out to be as the result of the increased revenue and reducing the cost in the company according to the detailed reports and analysis that have been established during the year.

The corporate 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:

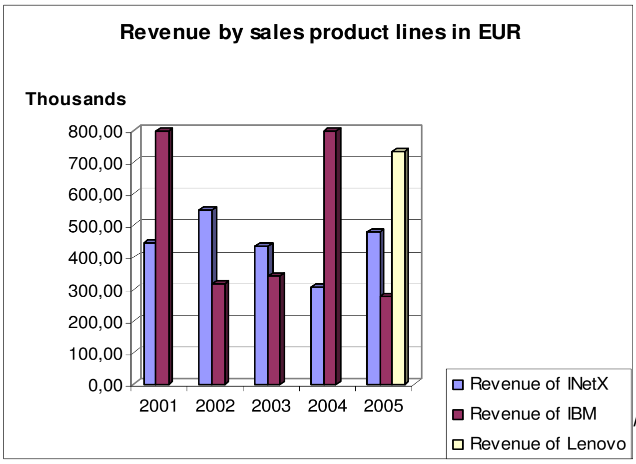
  - Representation & Distribution of ICT products (IBM, Lenovo, SAP, Red Hat products etc.)
  - INetX PC Integration Center – based on Info-Quest distribution products
  - INet Financial Services – flexible financing options to help consumer market and qualified customers keep costs down and PCs current.

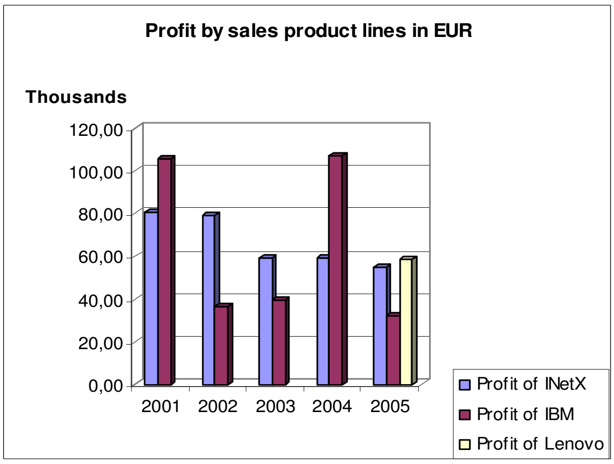
In 2005 IBM has engaged in an alliance with Lenovo. IBM's multi-year agreement with Lenovo is broad-based and now Lenovo has the leading position in the fastest growing market in the world. The acquisition of IBM's PC business makes them the third largest PC supplier in the world.

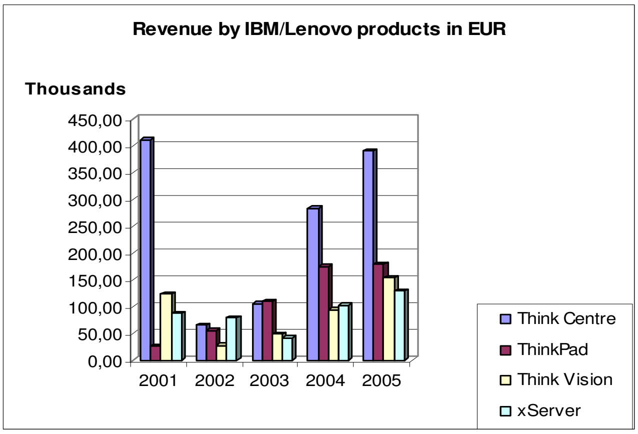
- *INet Customer Support Department:*

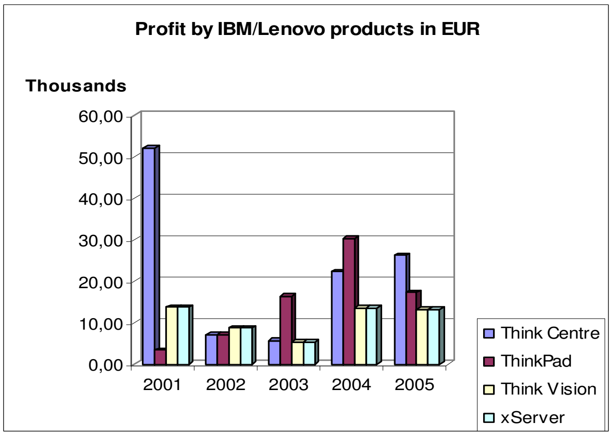
  - Red Hat Certified Training Center
  - Trend Micro AntiVirus Prroducts & Solutions
  - INet Service Level Agreements – long-term contracts for comprehensive setup, network structure optimisation & security, system upgrades & migrations, help desk support and maintenance.
  - INet Support Services – 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:

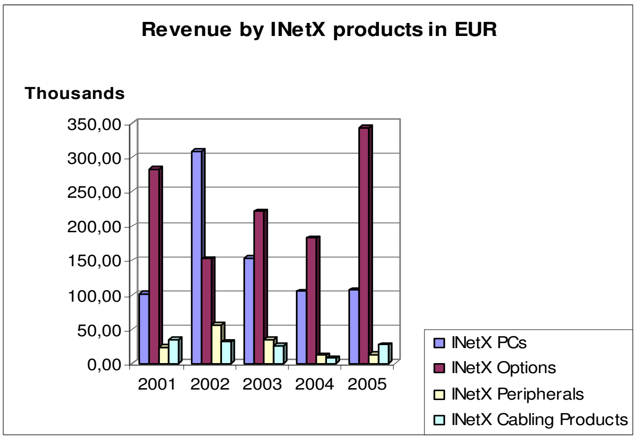
  - Consulting Services – SAP implementation and consulting, ICT strategy developments, ICT business assessment, BPR, IBM & Lotus based e-Business & e-Government solutions
  - Education Services – IBM Training Courses, Red Hat Training

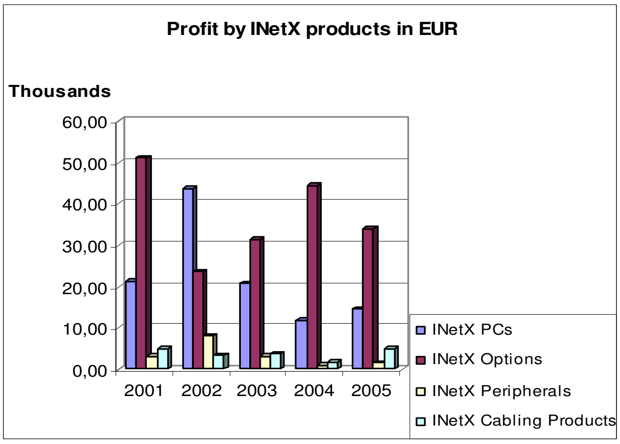





Revenue by IBM/Lenovo products in EUR
Thousands
450,00
400,00
350,00
300,00
250,00
200,00
150,00
100,00
50,00
0,00
2001
2002
2003
2004
2005
Think Centre
ThinkPad
Think Vision
xServer


Profit by IBM/Lenovo products in EUR
Thousands
60,00
50,00
40,00
30,00
20,00
10,00
0,00
2001
2002
2003
2004
2005
Think Centre
ThinkPad
Think Vision
xServer


Revenue by INetX products in EUR
Thousands
350,00
300,00
250,00
200,00
150,00
100,00
50,00
0,00
2001
2002
2003
2004
2005
INetX PCs
INetX Options
INetX Peripherals
INetX Cabling Products


Profit by INetX products in EUR
Thousands
60,00
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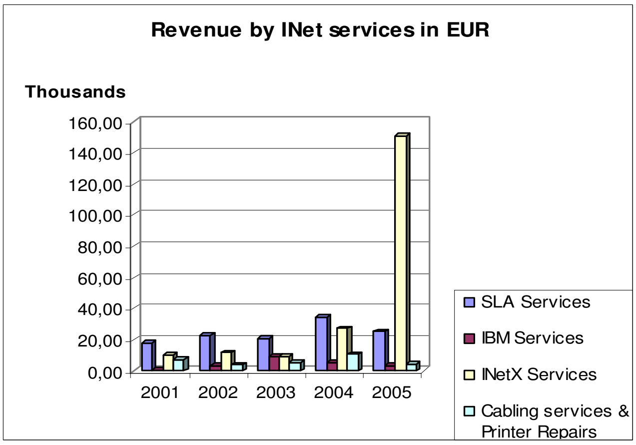
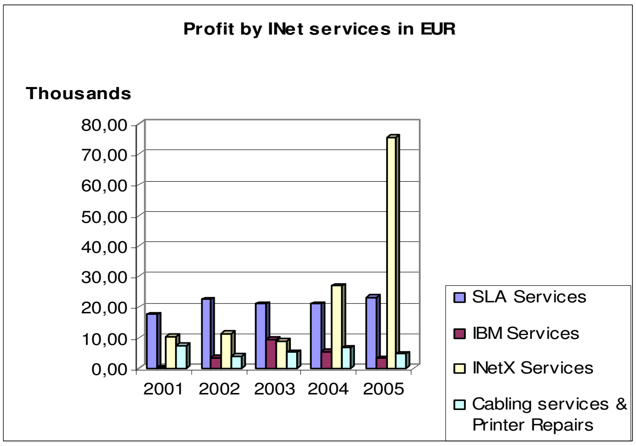
INetX Peripherals
INetX Cabling Products


Revenue by INet services in EUR
Thousands
160,00
140,00
120,00
100,00
80,00
60,00
40,00
20,00
0,00
2001
2002
2003
2004
2005
SLA Services
IBM Services
INetX Services
Cabling services & Printer Repairs


Profit by INet services in EUR
Thousands
80,00
70,00
60,00
50,00
40,00
30,00
20,00
10,00
0,00
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2004
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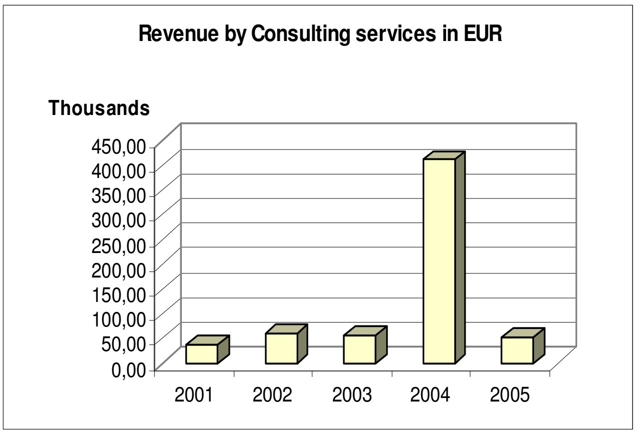
IBM Services
INetX Services
Cabling services & Printer Repairs


Revenue by Consulting services in EUR
Thousands
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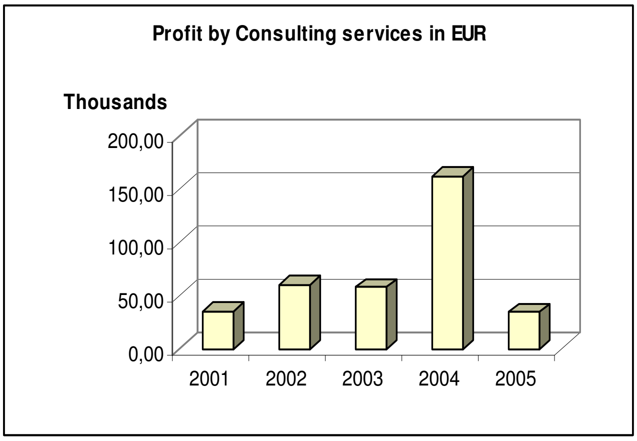
2005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Thousands
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0,00
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2003
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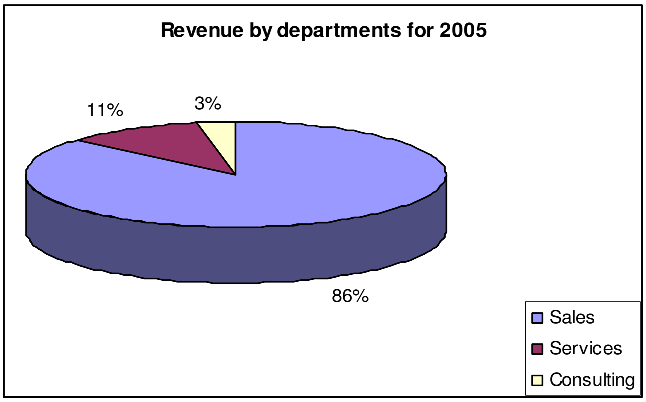
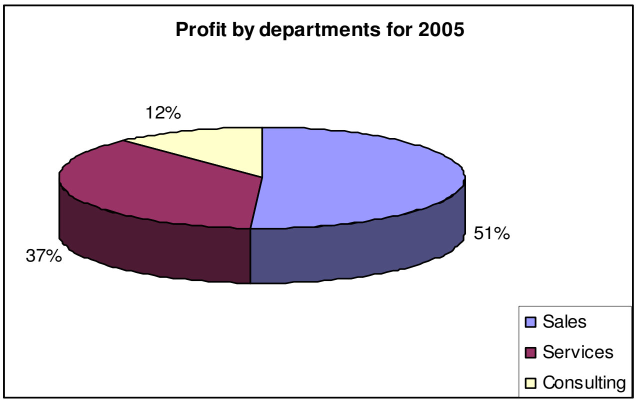
2005


Revenue by departments for 2005
11%
3%
86%
Sales
Services
Consulting


Profit by departments for 2005
12%
37%
51%
Sales
Services
Consulting

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

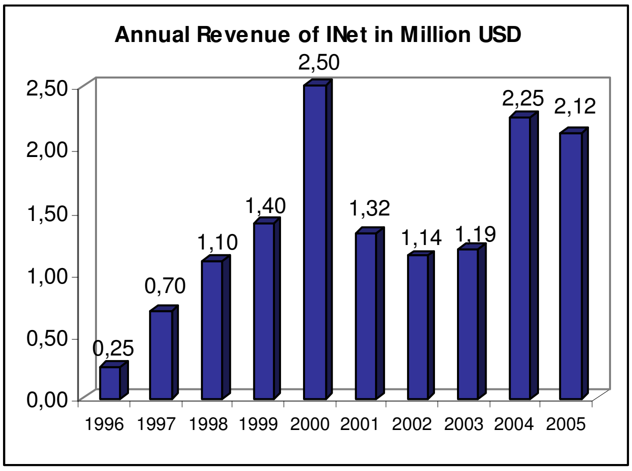
Sales

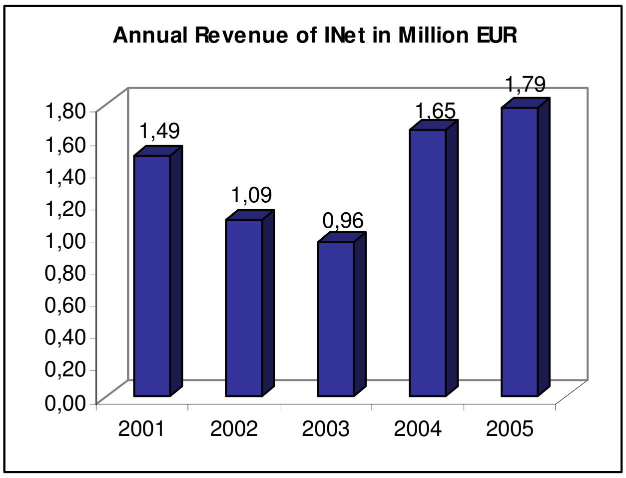
INet is one of the leading distributors of IT products and services on the domestic and neighbouring markets. We offer range of IT products and services and help generate demand and create efficiencies for our customers and suppliers. The company generated annual sales growth from expansion existing operations, addition of new vendors and product categories, new customers, increased sales to the existing customer base, reducing the costs etc. The company's net sales grew to €1.79 million in 2005 from €1.66 million in 2004.

The increase in net sales was primarily attributable to big demand for technology products in the public sector and projects that were on a national level. In addition, during 2005, the demand for information technology products and services was becoming stronger and bigger and the addition of new customers (government, public organizations, primary and secondary schools), increased sales to the existing customer base, and expansion of the company's product and service offerings.

INet managed to increase the revenue in year 2005 at very high level with only 14 employees and low operating expenses.

If we analyze the period of existing and working of one decade of INet, we can see the chart witch gives significant growth in annual revenue. The chart in US dollars gives an impression that the revenue has decreased in 2005, but the main reason is the fluctuations of the dollar during these years.





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, Lenovo) 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 asses 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 asses 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 ad deferred tax liabilities involves evaluations and judgments of uncertainties in the interpretation of complex tax regulations by various taxing authorities.

- *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 2005 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€ thousands in 2005.

Capital resources

Starting from 2003 and until the end of the 2005 the company had 6 Loan Agreements with Crimson Capital provided for working capital and investments. They resulted with financial growth trend with intention to continue in next year.

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 13.01.2005 to 15.06.2005 (Project 4) – 100.000,00 USD for Investments and Working capital;
- From 05.07.2005 to 25.11.2005 (Project 5) – 100.000,00 USD for Investments and Working capital;
- From 28.11.2005 to *30.05.2006* (Project 6) – 120.000,00 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 SUPLEMENTARY DATA

BALANCE SHEET

ASSETS	***Amount in EUR***	
	2004	***2005***
A. The requests for the inscribed, but not paid capital	**0**	**0**
B. Fixed assets	**61.156**	**82.525**
Non- material assets	615	616
Material assets	45.373	66.707
Financial investments	15.169	15.202
C. Current assets	**320.779**	**302.559**
Inventories - stocks	93.666	150.878
Accounts receivable - debtors	143.775	68.180
Marketable securities – short – term investments	0	0
Cash and cash equivalents	83.338	83.501
D. Prepaid expenses	0	0
E. Assets	**381.935**	**385.084**
LIABILITIES AND STOCKHOLDERS' EQUITY		
A. Capital and reserves	**91.058**	**136.552**
Capital –shareholder's capital	69.034	69.183
Paid – in capital	0	0
Revaluation reserve	8.725	8.744
Mandatory reserve	9.249	16.063
Accumulated profit	1.149	4.059
Transferred loss (-)	0	0
The profit for the financial year	2.902	38.503
VIII. The loss for the financial year	0	0
B. Long term reservation for risks and expenses	**0**	**0**
C. Long and short – term liabilities	**290.876**	**248.490**
D. Delayed payment of expenses and revenues in total period	**0**	**42**
E. Liabilities and stockholders' equity	**381.935**	**385.084**

INCOME STATEMENT

REVENUES	***Amount in EUR***	
	2004	***2005***
Sales revenue	1.656.016	1.795.851
Other incomes	34.923	16.482
Extraordinary incomes	341	340
Total	1.691.279	1.812.673
EXPENSES		
Operating expenses	1.627.763	1.732.258
Cost of good sold	1.338.403	1.524.602
The expenses for the employees	35.780	48.283
Net salaries	19.874	27.333
Salary expense	15.907	20.950
Depreciation	16.265	18.290
Other expenses	57.108	27.026
Extraordinary expenses	0	0
Total	1.684.871	1.759.284
FINANCIAL RESULT		
Net profits before taxes	6.410	53.389
Net losses before taxes	0	0
Taxes	2.994	8.092
Net profits after taxes	3.415	45.297
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.

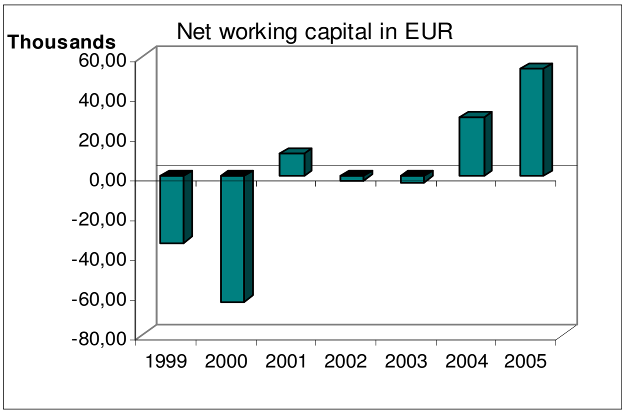
Percentage comparison is also done on the balance sheet to see how each item relates to the total assets. To calculate the balance sheet percentages, the individual accounts, including the liability and equity accounts, are divided by the total assets figure. In such a case the company's performance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

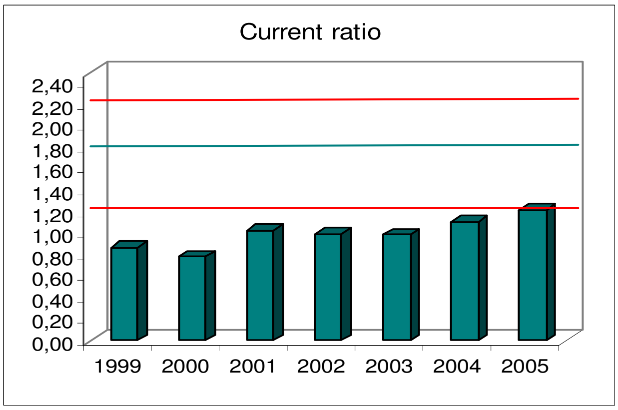
The horizontal comparison and common-size statements (vertical analysis) are explained above in this Report in the part "Management discussion and analysis". The management will use the common-size statements in the future to analyze the operating and financing characteristics of the company with other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

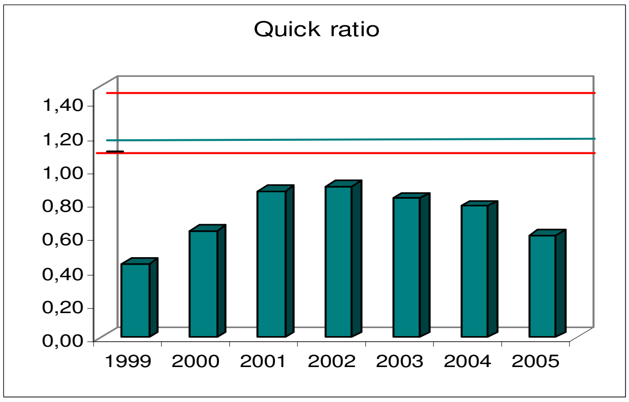
INet is using the ratio analyses which are reports for the solvency of the company, to compare the financial results in the previous years or with other companies in the industry, and to point out areas needing further investigation. Industry averages can be used only as a broad guideline to compare the company's performance.

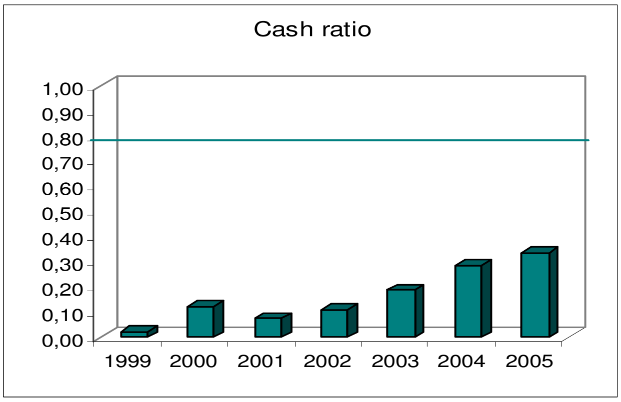
The company is using Dun & Bradstreet "Industry Norms and Key Business Ratios" industry norms for comparison. According to the reports that INet is preparing on yearly, monthly and daily base, there are ratios who gives clear picture for the INet's solvency and any ratio is maintained at a specific value 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.









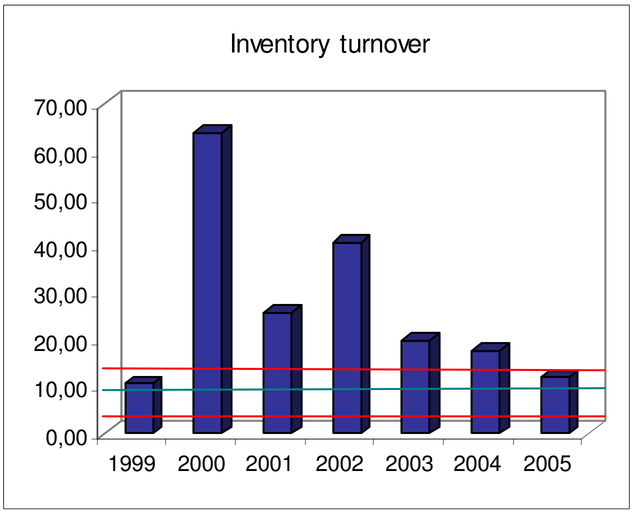
Net working capital is more a measure of cash flow than a ratio. Over the period that has be analysed, we see that net working capital few years was negative but, compared to year 2005 there is significant result with intention for reasonable growth and stable trend according to the company growth policy.

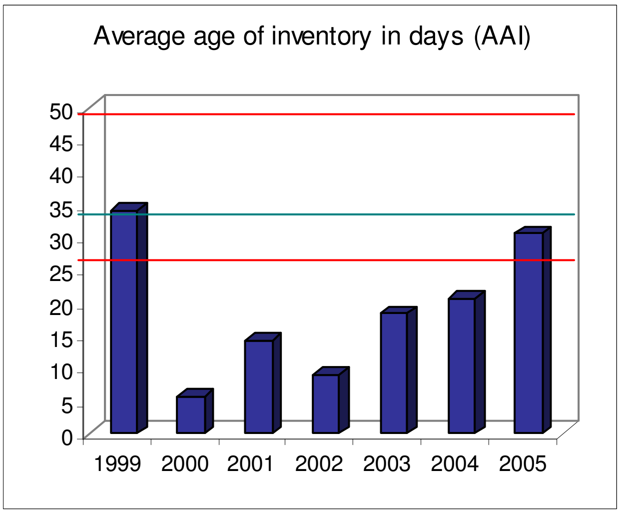
The current ratio (CUR) method is a model for measuring the liquidity and it is an indicator of a company's ability to pay short - term obligations. In 1999, 2000, 2002 and 2003 this indicator was less than 1.0. The growing started 2004 and in year 2005 the current ratio is 1.22.

Quick (Acid – Test) Ratio (QUR) as an indicator of the extent to witch the company can pay current liabilities without to rely on the sale of inventory, decreased in 2005.

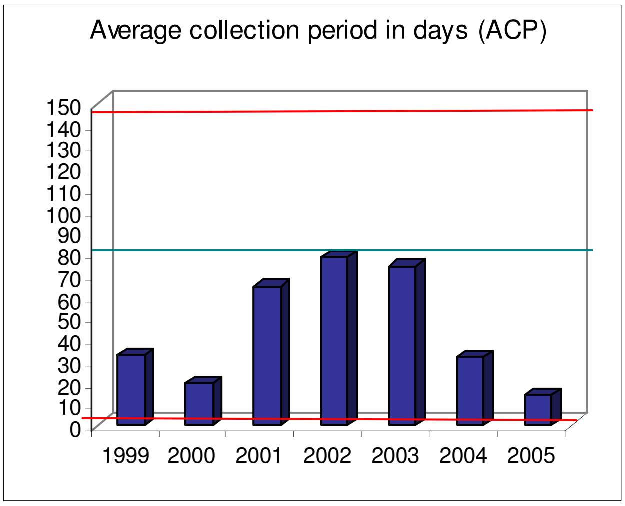
Cash ratio measures the ability quickly to liquidate the assets and cover short - term liabilities. As the result of continual growing of INet and its profitable working, the indicator increased from 0.29 in 2004 to 0.34 in 2005.

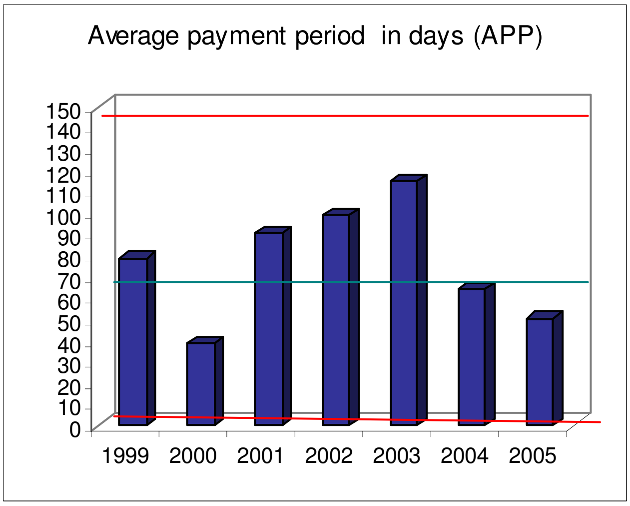
Activity ratios - measures the speed with which accounts are converted into sales or cash. This ratio indicates that INet is in a good shape. The industry averages have been reached.





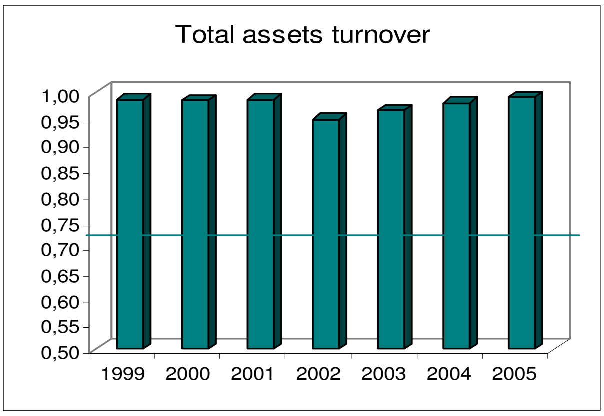
Inventory turnover - is in the frame of industry average. Also Average age of inventory increased from 21 to 30 days on 2005. Still the activity ratios are stable and in the predefined industry limits and reflect good relative inventory levels of the company.

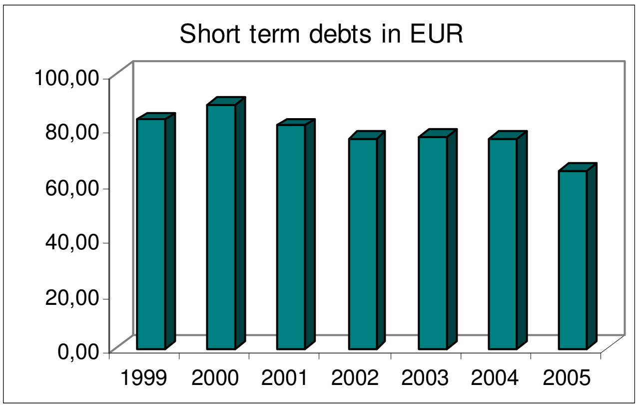


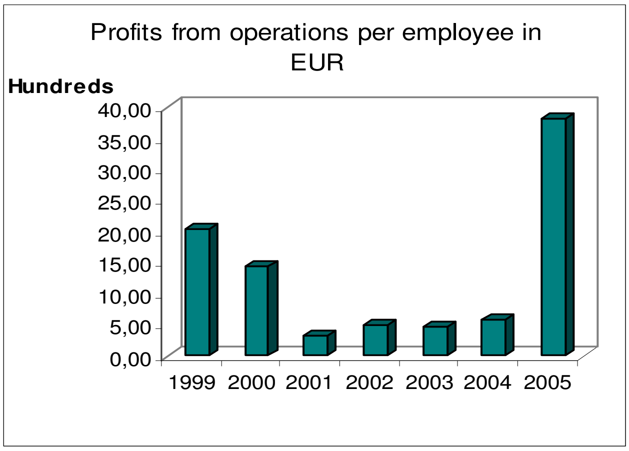


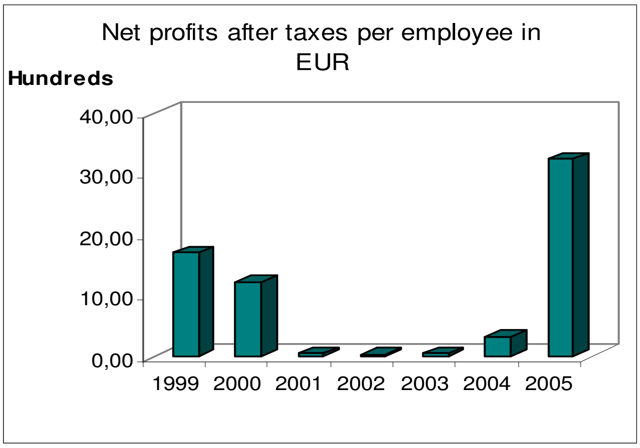
Average collection (ACP) decreased from 32 to 14 days in 2005 and Average payment (APP) period decreased in 2005 from 64 to 51 days, witch means that INet is collecting the account receivable for shorter time, and also is able to pay its bills in shorter time then previous years witch reflect good success of company's credit and collection policies. Although overall liquidity appears good, some attention should be given to accounts receivable and accounts payable, 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 1999 to 2005. 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 in 2005.

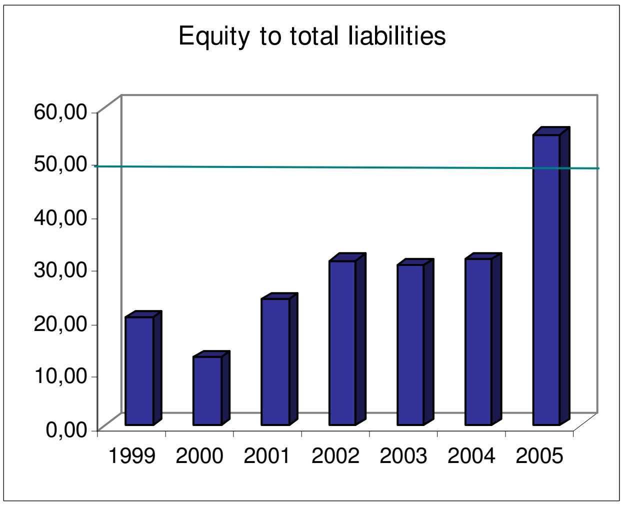


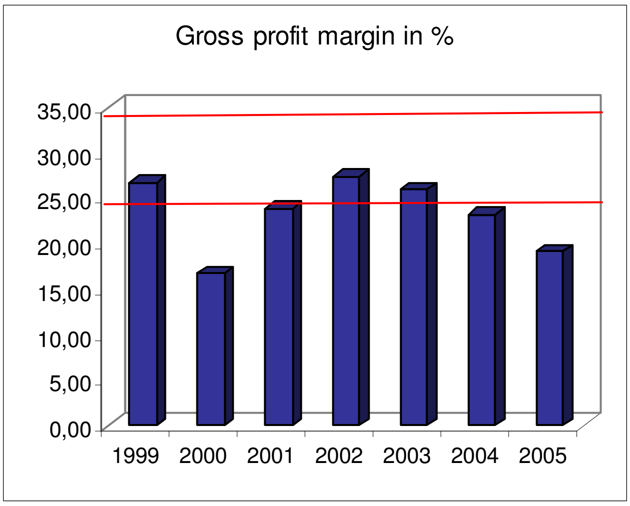






Financial leverage – is the magnification of risk and return of its debt in relation to total assets. The higher the financial leverage the more the company is considered risky. As for most ratios, an acceptable level is determined by its comparison to ratios of companies in the same industry and industry 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. Annual gross profit for 2006 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, IT education and consulting.

Note 2 Significant Accounting Policies

Fiscal year

INet financial statements are prepared for the calendar year, as a company fiscal year. All references 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.