QUEPASA CORP
Form 424B1
November 10, 2005
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**Filed Pursuant to Rule 424(b)(1)**

**Registration No. 333-128078**

## 3,093,628 shares of common stock

# QUEPASA CORPORATION

Our selling stockholders are offering an aggregate of 3,093,628 shares of our common stock for sale comprised of 1,699,388 shares of common stock and 1,394,240 shares underlying common stock purchase warrants. None of the selling stockholders are our officers, directors or 10% or greater stockholders. The shares of common stock will be offered from time to time in open market transactions at prevailing market prices. We will not receive any proceeds from the sale of the common stock offered by the selling stockholders.

Our common stock trades on the Over-the-Counter Electronic Bulletin Board under the symbol QPSA. On November 8, 2005, the closing price of the common stock was $2.75 per share.

Investing in our common stock involves substantial risks. See Risk Factors beginning on page 4.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

**The date of this prospectus is November 10, 2005.**

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## ABOUT THIS PROSPECTUS

You should rely only on the information contained in this prospectus as we have not authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where such an offer or sale is not permitted.

## SUMMARY

This summary highlights material information regarding our company and the offering contained in this prospectus. You should read the entire prospectus carefully, including the financial information and related notes, before making an investment decision.

### Business

Since 1998, we have operated a bilingual, Spanish and English, Internet portal and online community primarily aimed at the United States Hispanic market, and have spent over $50 million developing our brand. Our quepasa.com Web site provides users with information and content centered on the Spanish language and offers performance based marketing capabilities in addition to traditional portal services including e-mail and news in Spanish and English. The quepasa.com Web site is operated and managed by our wholly-owned Sonora, Mexico-based subsidiary, Quepasa.com de Mexico, S.A. de C.V.

Our performance based marketing capabilities include paid search solutions which are designed to enable Internet users to locate information, merchants, services and products. We offer paid search services through our Web site as well as through the Web sites of distribution partners. Partner versions of our search services are generally offered on a private-label basis. We believe we are among the first technology companies to develop, deploy and promote performance based online marketing solutions for the Spanish language market.

We are also developing information retrieval and management software technology products, which we intend to provide to a diverse clientele within the information technology sector emphasizing publishers of interactive, online content offerings, certain specialized online communities, online virtual product exchanges and online advertisers that target Spanish speaking users.

### History

We were incorporated in Nevada in June 1997 as an online media company and completed our initial public offering in June 1999 raising approximately $55 million from the sale of 4,600,000 shares of our common stock at $12.00 per share. In August 2003, we changed our name from quepasa.com, Inc. to Quepasa Corporation. In August 2003, we reversed split our common stock on the basis of one share for each 20 shares outstanding. Our offices are located at 410 North 44th Street, Suite 450, Phoenix, Arizona 85008, and our telephone number is (602) 716-0100. All references to share amounts throughout this prospectus reflect our reverse stock split. Our Web site at www.quepasa.com is not part of this prospectus.

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**The Offering**

| | |
|---|---|
| Common stock offered by the selling stockholders: | 1,699,388 shares of common stock and 1,394,240 shares of common stock underlying warrants |
| Common stock outstanding: | 7,453,688 shares of common stock as of the date hereof. |
| Electronic Bulletin Board Symbol | QPSA |

**Description of Selling Stockholders**

Through this prospectus, we are registering the resale of 1,699,388 shares of common stock and 1,394,240 shares of common stock underlying common stock purchase warrants. We issued the common stock and 994,240 warrants in a September 2004 and a December 2004 private placement to a group of non-affiliated accredited investors. 400,000 warrants are being re-registered as a part of this prospectus.

**Forward-Looking Statements**

This prospectus includes forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about us which are discussed in the Risk Factors section below as well as throughout this prospectus. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this prospectus might not occur.

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## SUMMARY FINANCIAL DATA

The following summary financial data should be read in conjunction with our audited financial statements and related notes included elsewhere in this prospectus.

**Statement of Operations Data:**

| | Years Ended | | Six Months Ended | |
|---|---|---|---|---|
| | December 31, 2004 | December 31, 2003 | June 30, 2005 (unaudited) | June 30, 2004 (unaudited) |
| Revenue | $ 465,481 | $ 5,774 | $ 285,810 | $ 127,803 |
| Net loss | $ (3,217,249) | $ (2,870,345) | $ (1,563,434) | $ (1,775,503) |
| Net loss per share | $ (0.70) | $ (1.25) | $ (0.22) | $ (0.43) |
| Weighted average number of shares of common stock outstanding | 4,612,198 | 2,294,592 | 7,084,349 | 4,138,818 |

**Balance Sheet Data:**

| | December 31, 2004 | June 30, 2005 (unaudited) |
|---|---|---|
| Total assets | $ 3,353,549 | $ 2,313,994 |
| Total liabilities | $ 798,130 | $ 596,939 |
| Working capital | $ 2,323,113 | $ 1,500,575 |
| Stockholders equity | $ 2,555,419 | $ 1,717,055 |
| Book value per share | $ 0.37 | $ 0.23 |

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## RISK FACTORS

The shares of common stock offered by this prospectus involve a high degree of risk and represent a highly speculative investment. You should not purchase these shares if you cannot afford the loss of your entire investment. In addition to the other information contained in this prospectus, you should carefully consider the following risk factors in evaluating our company, our business prospects and an investment in our shares of common stock.

### Risks Related To Our Business

**We Have Incurred Ongoing Operating Losses and Cannot Assure We Will be Profitable in the Future. Continued Losses Could Limit Our Operations.**

For the years ended December 31, 2003 and 2004, we incurred losses of $2,870,345, $3,217,249, respectively, and for the six months ended June 30, 2005, we incurred a loss of $1,563,434. We cannot assure that we will be profitable in the future and continued losses could cause us to limit our operations in order to preserve working capital.

**We Are Generating Limited Revenue and Expect Future Losses, Which Could Cause Us to Limit Our Operations.**

Our revenue for the year ended December 31, 2004 and the six months ended June 30, 2005 was $465,481 and $285,810, respectively. We are not currently generating sufficient revenue to reach profitability nor can there be any assurance that we will generate sufficient revenue in the foreseeable future and expect to continue to report losses in the near future. The losses could cause us to limit our operations in order to preserve working capital.

**We May Face Liability for Information Content and Commerce-Related Activities, Which Could Reduce Our Net Worth and Working Capital and Increase Our Operating Losses.**

Because materials may be downloaded by the services that we operate or facilitate and the materials may be subsequently distributed to others, we could face claims for errors, defamation, negligence or copyright or trademark infringement based on the nature and content of such materials, which could adversely affect our financial condition. Even to the extent that claims made against us do not result in liability, we may incur substantial costs in investigating and defending such claims.

Although we carry general liability insurance, our insurance may not cover all potential claims to which we are exposed or may not be adequate to indemnify us for all liabilities that may be imposed. Any imposition of liability that is not covered by insurance or is in excess of insurance coverage would reduce our net worth and working capital and increase our operating losses.

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**Regulations Imposed on the Operation of Our quepasa.com Web Site in Mexico Could be Costly and Time Consuming.**

We are subject to regulations imposed by the government of Mexico in connection with the operation of our quepasa.com Web site from Sonora, Mexico. These regulations are expensive and time consuming with which to comply, and future regulations could be even more costly to us.

**There Can be no Assurance that Our Information Retrieval Services Will Generate Revenue, the Absence of Which May Require Us to Limit Our Operations.**

We have completed the core development of our information retrieval services but have not generated significant revenue to date from such services. Revenue from our information retrieval and management software technology is expected to result primarily from the number of end-user data retrieval requests processed by our software. Any future agreements with customers will not require them to direct end-users to our retrieval services. Accordingly, revenue from such services is highly dependent upon the willingness of customers to use the retrieval and related services we provide, the ability of our customers to attract end-users to their online services, the volume of end-user inquiries that are processed by our retrieval software, and the ability of customers to generate revenue from traffic through their Web site retrieval request pages. Our future customers, if any, may also use competing query and directory services to operate in combination with our services, which will reduce the number of queries available for us to service and may erode revenue growth opportunities. In order for us to generate revenue from our information retrieval and software business, we will need to attract customers, develop and deliver new retrieval services, products and features to future customers and establish strategic relationships with our customers. In the absence of doing so, we may be required to limit our operations.

**The Information Retrieval Services Business is a New and Untested Business Model for Us Which May Not be Profitable, Thereby Reducing Our Working Capital and Limiting Our Operations.**

The information retrieval services business is based on a new and untested business model. Our failure to complete the development and to market our services successfully could increase our losses, reduce our working capital and limit our operations.

**Competition in the Operation of Our Web Site and in the Provision of Our Information Retrieval Services Could Cause Us to Reduce Our Prices or Increase Our Marketing Costs.**

Our quepasa.com Web site competes with a number of other Spanish speaking Web sites, including Web sites offered by large multinational Internet companies such as Yahoo. Moreover, we compete with a number of companies that provide information retrieval services, most of which have operated retrieval services in the market for a longer period, are better known, have greater financial resources, have established marketing relationships with leading online services and advertisers and have secured greater presence in distribution channels. The level of competition could cause us to reduce our prices or increase our marketing costs, either of which would reduce our profitability or increase our losses.

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**The Provision of Internet Information Retrieval Services Subjects Us to Risks that Could Result in Cancellation of Customer Contracts or Interruptions of Services to Our Customers.**

We are required to provide information retrieval services in accordance with certain specifications as to the functionality and performance of the information retrieval results, the size of the Internet database maintained, the frequency of refreshing the retrieval query database, reliability of the service and retrieval response speeds. Our failure to perform in accordance with these specifications could result in the cancellation of customer contracts. We expect we will be required to expand the capacity of our existing Tempe, Arizona data center or add additional data center space to adequately provide service. These activities require highly specialized personnel and involve many difficult installation, tuning and optimization tasks, and will require us to expend substantial financial and management resources. We could experience difficulties and delays in expanding and stabilizing the cluster of workstations in our existing data center. As a result, there can be no assurance that we will be able to expand our infrastructure to meet any increased customer demand on a timely basis. We house our data centers at hosting facilities operated by independent third parties who take certain precautions to protect our equipment against damage from fire, earthquakes, floods, power and telecommunications failures, sabotage, intentional acts of vandalism and similar events. Despite such precautions, the occurrence of a natural disaster, terrorist activities or other unanticipated problems at our current and future data centers could result in interruptions in the search services provided by us. Such interruptions could result in reductions in, or terminations of, service provided to our customers, which, in turn, would reduce our revenue.

**If We are Unable to Protect Our Intellectual Property Rights, We May be Unable to Compete with Competitors Developing Similar Technologies.**

Our success and ability to compete are often dependent upon internally developed software technology which we are developing in connection with the quepasa.com Web site and our search retrieval services. While we rely on copyright, trade secret and trademark law to protect our technology, we believe that factors such as the technological and creative skills of our personnel, new product developments, frequent product enhancements and reliable product maintenance are more essential to establishing a technology leadership position. There can be no assurance that others will not develop technologies that are similar or superior to our technology. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our technology, making it more difficult for us to compete.

**The Loss of the Services of Our Executive Officers and Senior Management Would Disrupt Our Operations and Interfere with Our Ability to Compete.**

We depend upon the continued contributions of our executive officers and senior management. We have employment agreements with these individuals, but we do not carry key person life insurance on any of their lives, except Mr. Peterson s. The loss of services of any of these individuals could disrupt our operations and interfere with our ability to compete with others.

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**If We Need and are Unable to Raise Additional Capital, We May be Unable to Maintain Our Operations.**

We may need to raise additional funds in the future through debt or equity financing in order to remain in business or to expand our operations. If additional funds are raised through the issuance of equity securities, the percentage ownership of our then current stockholders will be reduced, and such equity securities may have rights, preferences or privileges senior to those of the holders of our common stock. There can be no assurance that additional financing will be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, we may be unable to maintain our operations.

**Risks Related to the Offering**

**Shares of Our Common Stock Which are Eligible for Immediate Sale by Our Selling Stockholders May Decrease the Price of Our Common Stock.**

We have 7,453,688 shares of common stock outstanding, all of which are free-trading or are saleable under Rule 144, except for the 1,699,388 shares of common stock which have been registered under this prospectus and are freely tradeable. All of such shares are subject to immediate sale by our stockholders. We are also registering 1,394,240 shares of common stock which may be resold publicly upon exercise of warrants. If the holders sell substantial amounts of our common stock, then the market price of our common stock could decrease.

**Our Common Stock Price Could be Highly Volatile, Increasing the Market Risk Associated With Purchasing Our Common Stock.**

Our common stock trades on the Electronic Bulletin Board upon which there is a greater chance of market price volatility compared to a national exchange or quotation system. This volatility may be caused by a variety of factors, including:

- The lack of readily available price quotations;
- The absence of consistent administrative supervision of bid and ask quotations;
- Lower trading volume; and
- Market conditions.

In a volatile market, you may experience wide fluctuations in the market price of our securities. These fluctuations may have an extremely negative effect on the market price of our securities and may prevent you from obtaining a market price equal to your purchase price when you attempt to sell our securities in the open market. In these situations, you may be required to either sell our securities at a market price which is lower than your purchase price, or to hold our securities for a longer period of time than you planned.

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**Because Our Common Stock is Classified as Penny Stock, Trading is Limited, and Our Stock Price Could Decline.**

Because our common stock falls under the definition of penny stock, trading in our common stock may continue to be limited because broker-dealers are required to provide their customers with disclosure documents prior to allowing them to participate in transactions involving our common stock. These disclosure requirements are burdensome to broker-dealers and may discourage them from allowing their customers to participate in transactions involving our common stock.

Penny stocks are equity securities with a market price below $5.00 per share other than a security that is registered on a national exchange; included for quotation on the Nasdaq system; or whose issuer has net tangible assets of more than $2,000,000 and has been in continuous operation for greater than three years. Issuers who have been in operation for less than three years must have net tangible assets of at least $5,000,000.

Rules promulgated by the Securities and Exchange Commission under Section 15(g) of the Exchange Act require broker-dealers engaging in transactions in penny stocks, to first provide to their customers a series of disclosures and documents, including:

- A standardized risk disclosure document identifying the risks inherent in investment in penny stocks;
- All compensation received by the broker-dealer in connection with the transaction;
- Current quotation prices and other relevant market data; and
- Monthly account statements reflecting the fair market value of the securities. In addition, these rules require that a broker-dealer obtain financial and other information from a customer, determine that transactions in penny stocks are suitable for such customer and deliver a written statement to such customer setting forth the basis for this determination.

In addition, under the Exchange Act and its regulations, any person engaged in a distribution of shares of our common stock offered by this prospectus may not simultaneously engage in market making activities with respect to the common stock during the applicable cooling off periods prior to the commencement of this distribution.

**Our Preferred Stock and Staggered Terms for Our Board of Directors Will Make a Third-Party Acquisition of Our Company More Difficult.**

Our articles of incorporation authorize our board of directors to issue up to 5,000,000 shares of preferred stock having such rights as may be designated by our board of directors, without stockholder approval. We also have staggered terms assigned to our board members such that only approximately one-third of our directors are elected in any one year. The issuance of preferred stock, and the provisions for a staggered board of directors, could inhibit a change in our control by making it more difficult to acquire a majority of our voting stock or change our board of directors.

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**We Do Not Anticipate Paying Dividends on Our Common Stock.**

We have not paid any cash dividends on our common stock since our inception and we do not anticipate paying cash dividends in the foreseeable future. Any dividends which we may pay in the future will be at the discretion of our board of directors and will depend on our future earnings, any applicable regulatory considerations, our financial requirements and other similarly unpredictable factors. For the foreseeable future, we anticipate that we will retain any earnings which we may generate from our operations to finance and develop our growth.

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## CAPITALIZATION

The following table sets forth our capitalization as of June 30, 2005.

| | |
|---|---|
| Long-term liabilities | $ 24,812 |
| Common stock, $.001 par value, 50,000,000 shares authorized, 7,322,739 shares outstanding | $ 7,323 |
| Preferred stock, no par value, 5,000,000 shares authorized, 0 shares issued and outstanding | $ 0 |
| Additional paid-in-capital | $ 114,805,680 |
| Accumulated deficit | $ (113,092,674) |
| Foreign currency translation adjustment | $ (3,274) |
| Total stockholders equity | $ 1,717,055 |
| Total capitalization | $ 2,313,994 |

## MARKET PRICE OF OUR COMMON STOCK

As of December 31, 2004, there were approximately 5,000 record holders of our common stock. Our common stock traded on the Nasdaq National Market under the symbol PASA from June 24, 1999 until January 18, 2001. Subsequently, our common stock traded first on the Electronic Bulletin Board and then on the Pink Sheets, also under the symbol PASA. On August 26, 2003, our common stock symbol was changed to the QPSA, and our common stock was again listed for trading on the Electronic Bulletin Board.

The following table sets forth the high and low closing prices of our common stock for the calendar years indicated below.

| | Stock Price | |
|---|---|---|
| | **High** | **Low** |
| **2005** | | |
| Second Quarter | $ 2.25 | $ 1.07 |
| First Quarter | $ 3.96 | $ 1.94 |
| **2004** | | |
| First Quarter | $ 3.05 | $ 1.00 |
| Second Quarter | $ 2.65 | $ 1.30 |
| Third Quarter | $ 3.07 | $ 0.95 |
| Fourth Quarter | $ 4.57 | $ 2.75 |
| **2003** | | |
| First Quarter | $ 0.60 | $ 0.20 |
| Second Quarter | $ 0.60 | $ 0.20 |
| Third Quarter | $ 1.80 | $ 0.65 |
| Fourth Quarter | $ 1.85 | $ 0.78 |

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**SELECTED FINANCIAL DATA**

The selected financial data set forth below should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations which follows, and our audited financial statements and related notes included elsewhere in this prospectus. Historical results are not necessarily indicative of the results to be expected in the future.

**Statement of Operations Data:**

| | Years Ended | | Six Months Ended | |
|---|---|---|---|---|
| | December 31, 2004 | December 31, 2003 | June 30, 2005 (unaudited) | June 30, 2004 (unaudited) |
| Revenue | $ 465,481 | $ 5,774 | $ 285,810 | $ 127,803 |
| Net loss | $ (3,217,249) | $ (2,870,345) | $ (1,563,434) | $ (1,775,503) |
| Net loss per share | $ (0.70) | $ (1.25) | $ (0.22) | $ (0.43) |
| Weighted average number of shares of common stock outstanding | 4,612,198 | 2,294,592 | 7,084,349 | 4,138,818 |

**Balance Sheet Data:**

| | December 31, 2004 | June 30, 2005 (unaudited) |
|---|---|---|
| Total assets | $ 3,353,549 | $ 2,313,994 |
| Total liabilities | $ 798,130 | $ 596,939 |
| Working capital | $ 2,323,113 | $ 1,500,575 |
| Stockholders equity | $ 2,555,419 | $ 1,717,055 |
| Book value per share | $ 0.37 | $ 0.23 |

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**MANAGEMENT S DISCUSSION AND ANALYSIS OF**

**FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion of our financial condition and results of operations for the years ended December 31, 2004 and 2003 should be read in conjunction with our consolidated financial statements, the notes related thereto, and the other financial data included elsewhere in this prospectus.

**Company Overview**

We operate a Spanish/English language Internet Portal with proprietary search engine technology targeting the U.S. Hispanic and Latin American markets. We are focused on providing users unique search engine capabilities while providing advertisers with a high return on their investment. Our strategy currently includes the following initiatives to generate sales and profit growth:

Market Share Expansion We seek to expand market share by investing in new equipment and technology.

New Business Model We intend to concentrate on performance-based marketing activities to attract advertisers.

Focus on U.S. Hispanic Market We believe we can use our brand to tap into the significant Hispanic consumer population.

Our revenue is primarily generated from pay-for-performance search advertisements and banner advertisements. We recognize revenue related to banner advertisements ratably over the contract period. Pay-for-performance search revenue is recognized in the period in which the click-throughs occur. Click-throughs are defined as the number of times an Internet user clicks on an advertisement or search result. Pay-for-performance revenue is recognized when there is evidence that the qualifying transactions have occurred at a set price.

Customers generally make advance deposits, which are recorded as deferred revenue, for pay-for-performance services which are recorded as revenue when an Internet user clicks on a sponsored advertisement. Most advertisers utilize self-service tools to open and manage accounts online including tracking, price management and measurement features.

During 2004, we obtained gross proceeds of $4.8 million from the combination of our equity financing agreements signed in January, August and November 2004 and funds received directly from accredited investors apart from these financing agreements. We believe that our current cash balances, cash generated from our operations, and our financing activities are sufficient to finance our current level of operations through the next twelve months.

Our operating expenses mainly consist of search services, sales and marketing, product and content development, general and administrative expenses and depreciation and amortization.

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**Critical Accounting Policies**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make a number of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Such estimates and assumptions affect the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate our estimates and assumptions based upon historical experience and various other factors and circumstances. We believe that our estimates and assumptions are reasonable in the circumstances; however, actual results may differ from these estimates under different future conditions.

Management believes that the estimates and assumptions that are most important to the portrayal of our financial condition and results of operations, in that they require management s most difficult subjective or complex judgments, form the basis for the accounting policies deemed to be most critical to us. These critical accounting policies relate to revenue recognition including the ultimate collectibility of receivables, valuation and useful lives of long-lived assets, valuation of equity transactions such as the fair value assigned to common stock and warrants, and litigation. Revenue recognition resulting from sales of paid search advertising placement is discussed in Note 1 to our consolidated financial statements. We believe our estimates and assumptions related to these critical accounting policies are appropriate under the circumstances; however, should future events or occurrences result in unanticipated consequences, there could be a material adverse impact on future financial condition and results of operations.

**Introduction to Results of Operations**

*Net Revenue*

In late 2003, our new business model based on pay-for-performance began to generate revenue for us, and in all of 2004 the majority of our revenue has been generated under this model. Our ability to generate significant revenue in the future is contingent upon the completion and enhancements to our information retrieval software, management infrastructure and the direct marketing of the product to potential customers. During 2003 and 2004, our revenue was primarily generated from two principal sources: revenue earned from pay-for-performance insertion of results from our search engine based on proprietary technologies and the sale of banner advertising on our Web site.

*Pay-for-Performance Revenue.* Pay-for-performance revenue, or paid search results, is generated when an Internet user searches for a keyword and clicks on an advertisers listing. Pay-for-performance revenue is recognized in the period in which the click-throughs occur. Click-throughs are defined as the number of times a user clicks on an advertisement or search result. Pay-for-performance revenue is recognized when there is evidence that the qualifying transactions have occurred at a set price.

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*Banner Advertising Revenue.* Banner revenue is generated when an advertiser purchases a banner placement within our quepasa.com Web site. We recognize revenue related to banner advertisements ratably over the contract period.

*Operating Expenses*

Our principal operating expenses consisted of:

- search services expenses;
- product and content development expenses;
- sales and marketing expenses; and
- general and administrative expenses.

*Search Services Expenses.* Our search services expenses consist of payments made to our affiliates and partners that have integrated our pay-for-performance search services into their sites. There are generally two economic structures of the affiliate and partner agreements: fixed payments based on a minimum amount of traffic delivered and variable payments based on the amount of searches or paid clicks associated with affiliate or partner traffic. We expense search services costs under two methods; fixed payments are expensed pro-rata over the term of the agreement and agreements based on a percentage of revenue are expensed based on the underlying revenue multiplied by the agreed upon rate.

*Product and Content Development Expenses.* Product and content development expenses consist of personnel costs associated with the development, testing and upgrading of our Web site and systems, purchases of content and specific technology, particularly our search engine software, and telecommunications links access charges. We continued to reduce the products and content we provide as we reduce our operating expenses and conserve cash.

*Sales and Marketing Expenses.* Our sales and marketing expenses consist primarily of salaries and expenses of marketing and sales personnel, and other marketing-related expenses including our mass media-based branding and advertising. In 2003, we began to reinvest in marketing and sales efforts as we move forward with our new business model.

*General and Administrative Expenses.* General and administrative expenses consist primarily of costs related to corporate personnel, occupancy costs, general operating costs and corporate professional fee expenses, such as legal and accounting fees. As we move forward with our new business model, we will be increasing certain general operating expenses and anticipate a decrease in certain expenses, specifically, professional fees related to costs associated with business advisory services and financial consulting services.

*Depreciation and Amortization Expenses.* Our depreciation and amortization expenses have consisted primarily of depreciation related to our proprietary software and amortization of a bridge loan. As of December 31, 2004, substantially all of the depreciation related to the

proprietary software has been expensed. We expect the depreciation and amortization expense in 2005 to be substantially less than 2004.

*Other Income (Expense).* Other income (expense) consists primarily of interest earned, net of interest expense. We have invested our cash in money market funds, corporate bonds and interest bearing checking and saving accounts, including cash and cash equivalents, which are subject to minimal credit and market risk. Interest income will increase over time as proceeds are received from the sale of common and / or preferred stock and the anticipated return to positive cash flow generation later in 2005.

**Results of Operations**

**Six months ended June 30, 2005 compared to the six months ended June 30, 2004**

For the six months ended June 30, 2005 the net loss attributable to common stockholders was $1.6 million compared to a net loss of $1.8 million for the six months ended June 30, 2004. The decreased loss was attributable, in part, to the increased revenue we generated and to a decrease in depreciation and amortization expense. These decreases in expenses were partially offset by an increase in search services costs associated with the new business model as well as the increase in resources associated with the management of our Quepasa.com website by our Mexican subsidiary, Quepasa.com de Mexico, and the development of our proprietary Internet information search and retrieval software.

**Three months ended June 30, 2005 compared to the three months ended June 30, 2004**

For the three months ended June 30, 2005 the net loss attributable to common stockholders was $956 thousand compared to a net loss of $1.1 million for the three months ended June 30, 2004. The decreased loss was attributable, in part, to the increased revenue we generated and to a decrease in depreciation and amortization expense. These decreases in expenses were partially offset by an increase in search services costs associated with the new business model as well as the increase in resources associated with the management of our Quepasa.com website by our Mexican subsidiary, Quepasa.com de Mexico, and the development of our proprietary Internet information search and retrieval software.

***Revenues***

For the three months ended June 30, 2005, the Company generated revenues of $160 thousand compared to $104 thousand in revenue for the three months ended June 30, 2004. For the six months ended June 30, 2005, revenues were $286 thousand compared to $128 thousand in revenue for the six months ended June 30, 2004. In order to generate significant revenue under the new model, we must continue to enhance the development and marketing of our proprietary search and retrieval software. For the six months ended June 30, 2005, our revenue was primarily generated from three principal sources: revenue earned from pay-for-performance results from our search engine based on proprietary technologies or our advertiser directory listings and the sale of advertising on our web site.

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*Pay-for-Performance Revenue*. Pay-for-performance search advertisements are recognized in the period in which the click-throughs occur. Click-throughs are defined as the number of times a user clicks on an advertisement or search result. Pay-for-performance revenue is recognized when there is evidence that the qualifying transactions have occurred. During the three months ended June 30, 2005 and 2004, pay-for-performance revenue accounted for 98% and 99% of total revenue, respectively. For the six months ended June 30, 2005 and 2004, pay-for-performance revenue accounted for 99% and 83% of total revenue, respectively.

*Banner Advertising Revenue.* The Company recognizes revenue related to banner advertisements ratably over the contract period. During the three months ended June 30, 2005 and 2004, banner advertising revenue accounted for 0% and 1% of total revenue, respectively. For the six months ended June 30, 2005 and 2004, banner advertising revenue accounted for 0% and 17% of total revenue, respectively. Payments received from advertisers prior to displaying their advertisements on our website are recorded as deferred revenue, as are all payments received from advertisers for performance based marketing initiatives.

***Operating Expenses***

Our principal operating expenses are, or have been: Search Services, Sales and Marketing, Product and Content Development, General and Administrative, and Depreciation and Amortization expenses. Operating expenses for the three months ended June 30, 2005 were $1.1 million, a decrease from $1.2 million for the three months ended June 30, 2004. The decreased expenses are principally attributable to the decrease in sales and marketing expenses to $58 thousand for the three months ended June 30, 2005, from $140 thousand for the three months ended June 30, 2004, and a decrease in depreciation and amortization expense to $27 thousand for the three months ended June 30, 2005, from $114 thousand for the three months ended June 30, 2004. These decreases were offset by the increase in search services expenses to $122 thousand for the three months ended June 30, 2005, from $51 thousand for the three months ended June 30, 2004 and the increase in general and administrative expenses to $865 thousand for the three months ended June 30, 2005, from $798 thousand for the three months ended June 30, 2004.

For the six months ended June 30, 2005, operating expenses were $1.9 million, an increase from $1.8 million for the six months ended June 30, 2004. The increased expenses are principally attributable to the increase in search services expenses to $227 thousand for the six months ended June 30, 2005, from $55 thousand for the six months ended June 30, 2004 and the increase in general and administrative expenses to $1.4 million for the six months ended June 30, 2005, from $1.2 million for the six months ended June 30, 2004. These increases were offset by the decrease in sales and marketing expenses to $147 thousand for the six months ended June 30, 2005, from $240 thousand for the six months ended June 30, 2004 and a decrease in depreciation and amortization expense to $52 thousand for the six months ended June 30, 2005, from $210 thousand for the six months ended June 30, 2004.

*Search Services Expenses.* Our search services expenses increased to $122 thousand in the three months ended June 30, 2005, from $51 thousand in the three months ended June 30, 2004. For the six months ended June 30, 2005, search services increased to $227 thousand from $55 thousand for the six months ended June 30, 2004. These increases are attributable to an increase in our search partner expenses corresponding to our increased search distribution partner associations. The new search partner agreements have contributed to the increases in revenue for the six months ended June 30, 2005.

*Sales and Marketing Expenses.* Our Sales and marketing expense decreased to $58 thousand in the three months ended June 30, 2005, from $140 thousand for the three months ended June 30, 2004. For the six months ended June 30, 2005, sales and marketing expenses decreased to $147 thousand from $240 thousand for the six months ended June 30, 2004. These changes are mainly attributable to reductions in our sales and marketing workforce.

*Product and Content Development Expenses.* Our product and content development expenses decreased to $32 thousand in the three months ended June 30, 2005, from $67 thousand in the three months ended June 30, 2004. For the six months ended June 30, 2005, product and content development expenses decreased to $74 thousand from $101 thousand for the six months ended June 30, 2004. This decrease is attributable to changes in our development staff. Quepasa.com de Mexico provides significantly all of our design, translation services, and website management and development services for the Company.

*General and Administrative Expenses.* Our general and administrative expenses increased to $865 thousand in the three months ended June 30, 2005, from $798 thousand in the three months ended June 30, 2004. This increase is principally attributable to the increases in advertising expense to $79 thousand for the three months ended June 30, 2005, from $3 thousand for the three months ended June 30, 2004, rent expense increased to $35 thousand for the three months ended June 30, 2005, from $28 thousand for the three months ended June 30, 2004 and general and administrative salaries increased to $297 thousand for the three months ended June 30, 2005, from $149 for the three months ended June 30, 2004, offset by a decrease in professional fees, to $391 thousand for the three months ended June 30, 2005 from $408 thousand for the three months ended June 30, 2004. For the six months ended June 30, 2005, general and administrative expenses increased to $1.4 million in the six months ended June 30, 2005 from $1.2 million in the six months ended June 30, 2004. This increase is principally attributable to the increase in advertising expense to $117 thousand for the six months ended June 30, 2005 from $6 thousand for the six months ended June 30, 2004, an increase in rent expense to $73 thousand for the six months ended June 30, 2005 from $51 thousand for the six months ended June 30, 2004 and general and administrative salaries increased to $447 thousand for the six months ended June 30, 2005 from $258 thousand for the six months ended June 30, 2004, offset by a decrease in professional fees to $490 thousand for the six months ended June 30, 2005 from $535 thousand for the six months ended June 30, 2004.

*Depreciation and Amortization Expense.* Our depreciation and amortization expense decreased to $27 thousand in the three months ended June 30, 2005 from $114 thousand for the three months ended June 30, 2004. For the six months ended June 30, 2005, depreciation and amortization expenses decreased to $52 thousand from $210 thousand in the six months ended June 30, 2004. This decrease is attributable to the decrease in depreciation associated with our proprietary software which was fully depreciated at December 31, 2004, and the decrease in amortization expense associated with a bridge loan.

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*Other Income (Expense)*. Other income (expense), which primarily consists of interest income offset by interest expense, was $2 thousand in the three months ended June 30, 2005, an increase from the ($53) thousand in the three months ended June 30, 2004. For the six months ended June 30, 2005, interest income (expense) increased to $1 thousand from ($71) thousand in the six months ended June 30, 2004. The decreased expense is mainly attributable to the decrease of $64 thousand in amortization of discount on bridge loans and $12 thousand in accrued interest on the bridge loans.

*2004 Compared to 2003*

Our results of operations for the years ended December 31, 2004 and 2003 were characterized by expenses that significantly exceeded revenues during the periods. We reported a net loss of $3.2 million for the year ended December 31, 2004, compared to a net loss of $2.9 million for the year ended December 31, 2003. During the year ended December 31, 2004, we focused on building our new business model including the management of our quepasa.com Web site by our Mexican subsidiary, quepasa.com de Mexico, and the advancement of our Internet information search and retrieval software. As a result of generating more revenue during the year ended 2004, we incurred increased costs associated with that revenue. At December 31, 2004, we had 46 employees compared to 35 employees in 2003. During 2003, we concentrated our efforts on initiating the new business model including integrating the search technology we acquired through our acquisition of Vayala Corporation.

*Net Revenue*

*Pay-for-Performance Revenue.* Pay-for-performance search advertisements are recognized in the period in which the click-throughs occur. Click-throughs are defined as the number of times a user clicks on an advertisement or search result. Pay-for-performance revenue is recognized when there is evidence that the qualifying transactions have occurred. During the years ended December 31, 2004 and 2003, pay-for-performance revenue accounted for 95% and 82% of total revenue, respectively.

*Banner Advertising Revenue.* We recognize revenue related to banner advertisements ratably over the contract period. For years ended December 31, 2004 and 2003, banner advertising revenue accounted for approximately 5% and 18% of total revenue, respectively. Payments received from advertisers prior to displaying their advertisements on our Web site are recorded as deferred revenue, as are all payments received from advertisers for performance based marketing initiatives.

We generated $465 thousand of revenue related to our new business model in 2004 and in 2003 we generated $6 thousand in revenue related to our new business model. In order to generate significant revenue under the new model, we must continue to enhance the development and marketing of our search and retrieval software. In 2004, our revenue was primarily generated from paid search results. Increases in our advertiser base and number of search partner affiliates were the primary factors in our increase in revenue. In 2003, two advertisers represented 100% of our banner revenue and 44% of total revenue.

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*Operating Expenses*

*Search Services Expenses.* Our search services expenses increased to $330 thousand during the year ended December 31, 2004, from $19 thousand during the year ended December 31, 2003. These changes are attributable to an increase in our search partner expenses related to our search distribution partner agreements, and correspond to the increases in revenue for the applicable periods.

*Sales and Marketing Expenses.* Our sales and marketing expenses increased to $427 thousand during the year ended December 31, 2004 from $105 thousand for year ended December 31, 2003. The increase is mainly attributable to an increase in our sales and marketing workforce.

*Product and Content Development Expenses.* Our product and content development expenses increased to $158 thousand during the year ended December 31, 2004 from $89 thousand during the year ended December 31, 2003. This increase is attributable to increasing our technology and development staff. Quepasa.com de Mexico provides significantly all of our design, translation services, and Web site management and development services.

*General and Administrative Expenses.* Our general and administrative expenses decreased to $2.3 million during the year ended December 31, 2004 from $2.4 million during the year ended December 31, 2003. This decrease is attributable to the reduction in stock based compensation to $124 thousand for the year ended December 31, 2004, from $871 thousand, consisting of $763 thousand in stock grants and $108 thousand in stock options granted for the year ended December 31, 2003. Partially offsetting these decreases is the increase in professional fees to $801 thousand, comprised mostly of business advisory services of $381 thousand and legal and accounting fees of $244 thousand for the year ended December 31, 2004, from $257 thousand in professional fees for the year ended December 31, 2003. General and administrative salaries increased to $614 thousand from $433 thousand for the years ended December 31, 2004 and 2003, respectively, due to additional staffing requirements. Additionally, all payroll related taxes are recorded as general and administrative expense.

*Depreciation and Amortization Expense.* Our depreciation and amortization expense increased to $370 thousand during the year ended December 31, 2004 from $271 thousand during the year ended December 31, 2003. These increases are attributable to the increase in basis in the proprietary software during the third quarter of 2003 and also to amortization of loan fees in connection with the acquisition of the bridge loans.

*Other Income (Expense).* Other income (expense) which primarily consists of interest income offset by interest expense. Other income (expense) for the year ended December 31, 2004 was ($71) thousand for the year ended December 31, 2004 and $16 thousand for the year ended December 31, 2003. The increased expense is mainly attributable to what ultimately amounted to $64 thousand in amortization of discounts on bridge loans and $12 thousand in accrued interest on the bridge loans.

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**Liquidity and Capital Resources**

We have substantial capital resource requirements relative to our revenue generation, but limited sources of liquidity and capital resources. We have generated significant net losses and negative cash flows from our inception and anticipate that we will experience continued net losses and negative cash flows for the next few quarters.

At June 30, 2005, we had $2.0 million in cash and cash equivalents compared to $3.1 million at December 31, 2004.

Net cash used in operating activities was $1.4 million for the six months ended June 30, 2005 as compared to $779 thousand for the six months ended June 30, 2004. For the six months ended June 30, 2005, net cash used by operations consisted of a net loss of $1.6 million offset by non-cash expenses of $52 thousand in depreciation and amortization and $247 thousand in stock granted for professional services. Net cash used by operations for the six months ended June 30, 2004 consisted of the net loss of $1.8 million, which was offset by non-cash expenses of $210 thousand in depreciation and amortization plus $256 thousand in warrants issued for professional services, $119 thousand in stock issued for professional services, $64 thousand in amortization of discount on notes payable, $44 thousand in stock issued for the extension of a private placement agreement and $26 thousand in stock option compensation expense.

Net cash used in investing activities was $30 thousand for the six months ended June 30, 2005 as compared to net cash used by investing activities of $53 thousand for the six months ended June 30, 2004. The primary use of cash was for investments in capital equipment.

Net cash provided by financing activities was $431 thousand for the six months ended June 30, 2005 as compared to $1.8 million for the six months ended June 30, 2004. In the six months ended June 30, 2005, we received $435 thousand, net of commissions, from the issuance of common stock. In the six months ended June 30, 2004, we received $1.1 million, net of commissions, from the issuance of common stock, $532 thousand, net of commissions, from the issuance of preferred stock and $225 thousand from the issuance of notes payable.

**Impact of Recently Issued Accounting Standards**

In December 2004, the Financial Accounting Standards Board ( FASB ) issued a revision of Statement of Financial Accounting Standards No. 123, Share-Based Payment ( SFAS123R ). This statement revises FASB Statement No. 123, Accounting for Stock-Based Compensation and requires companies to recognize the cost of employee stock options and other awards of stock-based compensation based on the fair value of the award as of the grant date. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. This statement supersedes Accounting Principles Board ( APB ) Opinion No. 25, which allowed companies to compute compensation cost for each employee stock option granted as the amount by which the quoted market price of the common stock on the date of grant exceeds the amount the employee must pay to acquire the stock.

We currently account for our stock option and stock-based compensation plans using the intrinsic-value method under APB Opinion No. 25. SFAS123R is effective as of the beginning of

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the first interim or annual period that begins after June 15, 2005. As a result of the implementation of SFAS123R, we may incur significant stock-based compensation expenses. For a discussion of the pro forma effect on our earnings for the three-year period ended December 31, 2004, had compensation cost for our stock-based compensation plans been recognized based on fair values as of the dates of grant, see Stock-Based Compensation in Note 1 of Notes to the Consolidated Financial Statements.

In December 2004 the FASB issued SFAS No. 153 Exchange of Non-monetary Assets An Amendment of APB Opinion No. 29. SFAS No. 153 amends APB Opinion No. 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. SFAS No. 153 is to be applied prospectively for non-monetary exchanges occurring in fiscal periods beginning after June 15, 2005. Our adoption of SFAS No. 153 is not expected to have a material impact on our financial position or results of operations.

**System Issues**

We depend on the delivery of information over the Internet, a medium that depends on information contained primarily in electronic format, in databases and computer systems maintained by third parties and us. A disruption of third-party systems or our systems interacting with these third party systems could prevent us from delivering services in a timely manner, which could have a material adverse affect our business and results of operations.

**Quantitative and Qualitative Disclosures about Market Risk**

Market risk generally represents the risk that losses may occur in the values of financial instruments as a result of movements in interest rates, foreign currency exchange rates and commodity prices.

Interest Rate Risk From time to time we temporarily invest our excess cash and restricted cash in interest-bearing securities issued by high-quality issuers. Our management monitors risk exposure to monies invested in securities in its financial institutions. Due to the short time the investments are outstanding and their general liquidity, these instruments are classified as cash equivalents in the consolidated balance sheet and do not represent a material interest rate risk to us. As of December 31, 2004, a 10 basis point change in interest rates would have an immaterial effect to our consolidated financial statements.

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## BUSINESS

### Introduction

Our quepasa.com bilingual Web site and online community provide users with information and content centered on the Spanish language and offer performance based marketing capabilities in addition to traditional portal services including e-mail and news in Spanish and English. The quepasa.com Web site is operated and managed by our wholly-owned Sonora, Mexico-based subsidiary, Quepasa.com de Mexico, S.A. de C.V.

### Performance Based Marketing

Our performance based marketing capabilities include paid search solutions which are designed to enable Internet users to locate information, merchants, services and products. We offer paid search services through our Web site as well as through the Web sites of distribution partners. Partner versions of our search services are generally offered on a private-label basis. We believe we are among the first technology companies to develop, deploy and promote performance based online marketing solutions for the Spanish language market.

We are also developing information retrieval and management software technology products, which we intend to provide to a diverse clientele within the information technology sector emphasizing publishers of interactive, online content offerings, certain specialized online communities, online virtual product exchanges and online advertisers that target Spanish speaking users.

Although businesses have many online advertising options, we believe that only limited opportunities are available to effectively reach the rapidly growing Hispanic online population. We believe that the traditional advertising agency approach to Hispanic marketing is too slow and costly to effectively reach this population in light of rapidly evolving online marketing trends. To address this need, we are developing proprietary information retrieval and management software technology products, along with performance based marketing capabilities, all of which we intend to provide to a diverse clientele within the information technology sector emphasizing publishers of interactive, online content offerings, certain specialized online communities, online virtual product exchanges and online advertisers that target Spanish speaking and bilingual users. We believe we are among the first technology companies to develop, deploy and promote cost effective, performance based online marketing solutions for the Spanish language market.

Our performance-based advertising services are provided to online advertisers, including pay-per-click services. Through our pay-per-click services, advertisers create keyword listings that describe their product or service, which are then marketed to millions of consumers and businesses primarily through search engine results. In many instances, our staff proactively manages the translation of these advertising campaigns from English to Spanish, as well as the intricacies and ongoing maintenance of these highly bilingual campaigns. We believe we are the only search engine marketer to currently provide bilingual search and campaign management solutions with a specific focus on the Hispanic Internet user.

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We deliver search results from our own proprietary technology, as well as the aggregation of results from leading search engines on a contractual basis. We offer search services through our own Web site, as well as through the Web sites of distribution partners. The majority of our revenue growth in 2004 was generated through the addition of such new partnerships.

Additionally, we continually evaluate opportunities to evolve existing technologies and business models, and we regularly review possible acquisitions and strategic relationships.

**quepasa.com Web site**

We have invested over $50 million in the development and promotion of the quepasa.com Web site, including (i) retaining the services of Gloria Estefan for the year 2000 to be our Web site and corporate spokeswoman, and (ii) developing and maintaining marketing relationships through the year 2000 with two major computer manufacturers. Partly as a result of our promotion, in 2000 the quepasa.com Web site was one of the most recognized online brand names to the Hispanic population. We have reactivated the Web site, after temporarily shutting it down in 2001 and 2002, because we continue to believe in the power of the Quepasa brand and the relevance of the statistical information set forth below.

*Hispanic population growth and concentration.*

According to the U.S. Census Bureau and published sources, the Hispanic population:

- Was estimated to be 37.4 million or 13.3% of the total U.S. population in 2002, an increase of approximately 60% from 22.4 million or 9% of the total U.S. population in 1990;
- Is expected to account for 39% of the total U.S. population growth between 2000 and 2010 and is expected to grow to 43.7 million or 15% of the total U.S. population by 2010; and
- Is relatively young, with almost 86% of U.S. Hispanics under 49, compared to less than 74% of non-Hispanics, and with a median age of 26, compared to 33 for the rest of the population.

We believe the relative youth of the Hispanic population will furnish growth opportunities for products and services that appeal to a younger market, such as that found on the Internet. In addition, 70% of all U.S. Hispanics live in 12 metropolitan areas, which makes U.S. Hispanics an attractive demographic group for advertisers, enabling them to deliver messages cost effectively to a highly targeted audience.

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*Hispanics on the Internet*

Hispanics, according to eMarketer, represented 7.6 percent of all U.S. Internet users in 2004, totaling over 13.3 million Hispanic Internet users in the United States. The United States is the fifth largest Spanish-speaking country in the world.

Nearly half of all Hispanic adults access the Internet on a regular basis, according to The Media Audit, a report which tracks national surveys. Also, 51 percent of Hispanics who consult the Internet frequently report household income of $50,000 or more, compared to only 44.9 percent are users who report household income of $50,000 or more.

*Increasing Hispanic purchasing power.*

Total U.S. Hispanic purchasing power:

Hispanic purchasing power has surged to nearly $700 billion and is projected to reach as much as $1 trillion by 2010, according to estimates by HispanTelligence(R), based on analysis of U.S. Bureau of Economic Analysis figures.

HispanTelligence(R) estimates current Hispanic purchasing power is 8.5% of total U.S. purchasing power, but will reach 11% by 2010, when taking into account factors such as the narrowing Hispanic vs. overall U.S. income gap and the increase in the number of Hispanic households with earned income.

*Continuing use of the Spanish-language by U.S. Hispanics.*

According to published sources, approximately 90% of U.S. Hispanic adults speak Spanish at home. Moreover, U.S. Hispanics are expected to continue to speak Spanish because:

Approximately two-thirds of U.S. Hispanic adults were born outside the U.S.;

Hispanic immigration into the U.S. is continuing;

Hispanics generally seek to preserve their cultural identity; and

Population concentration encourages communication in Spanish.

*Increasing adaptation of performance-based advertising and search marketing*

Record advertising revenue. Online advertising sales totaled $2.7 billion in the fourth quarter of 2004, the highest revenue quarter reported to date, according to the Interactive Advertising Bureau ( IAB ) and PricewaterhouseCoopers. That was an increase of 24% over the fourth quarter of 2003. The Internet Ad Revenue Report also estimates that revenue for the full-year 2004 totaled just under $9.6 billion a 32% increase over full-year 2003 ($7.3 billion)

Growth of performance-based advertising and search marketing. *U.S. Bancorp Piper Jafray* estimates that the global market for performance-based advertising and search marketing, such as pay-per click listings and paid inclusion, will grow at a compounded annual growth rate of 38% from approximately $1.4 billion in 2002 to approximately $7 billion in 2007.

Large number of small businesses operating online. According to *International Data Corporation (IDC),* by the end of 2007, 77% of the 8.5 million small businesses in the United States (defined as firms with fewer than 100 employees that are not based at home) will have Web sites, compared to 62% of the 8 million small businesses in 2003.

Growth of electronic commerce. *Forrester Research* forecasts that electronic commerce activity in the United States, fueled by a steady stream of new online shoppers and new product category sales, will grow at a compounded annual growth rate of 19% over the next five years to nearly $230 billion in 2008 (representing 10% of total retail sales in the United States).

**The quepasa.com Community**

Our strategy has been to establish our quepasa.com Web site as a bilingual, Spanish and English, Internet portal and online community, offering our content and search solutions to Hispanic Internet users primarily in the U.S. In November 1998, we launched the quepasa.com Web site which allows individuals to quickly access content and features which appeal to Hispanic Internet users. Although our content is directed toward Spanish-speaking users, to better serve the U.S. Hispanic population, quepasa.com is also offered in English.

**Retrieval Capacity and Performance Based Marketing Capabilities**

We offer performance based marketing capabilities and intend to offer Internet search and retrieval capacities. By offering performance based marketing capabilities, we believe we can attract advertisers to the Web sites of our search and retrieval customers while generating additional revenue for ourselves from the performance based marketing advertisers. Using performance based marketing software which we have developed, when queried, our search engine will display a selection of Web sites related to that query. Our advertisers will be able to determine where in our search results their Web site link will appear for any given query through our proprietary ranking algorithms. These proprietary ranking algorithms will evaluate all relevant information and determine advertiser ranking in our index. Users will be able to access our search results on our Web site and on the Web sites or our search and retrieval partners.

In order to generate significant revenue, we must continue to evolve our information retrieval and management software infrastructure and then direct our marketing to customers who provide information retrieval capabilities to their end-users.

We believe that the private label segment of the information retrieval market, which is still in the beginning of its anticipated growth curve, offers a model, which provides for continued revenue growth and profitability.

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We believe that our search and retrieval software can be differentiated from existing information retrieval and management software offered by others for the following reasons:

- Our software is capable of managing an indexed database of up to 500 million documents, which we believe represents more display page depth than most of the existing Spanish language data retrieval and management software companies;

- In addition to indexing for frequency and for the page locations of keywords, we will count links, integrate other relevancy metrics and use proprietary software we are currently developing to analyze sentence structure on indexed content. If and when developed, we believe that this software will allow our retrieval results to be more robust and relevant than those of our competitors;

- The architecture of our aggregation technology is dynamic, which allows us to constantly search for and index new data simultaneously, unlike many competitive services, which generally have at least a two-week update cycle. Combined with our software, which provides access to the indexed data, we believe that our retrieval capabilities are more flexible than those of our competitors. This flexibility allows our retrieval software to refresh current information more often while enabling the software which controls our retrieval criteria to be modified more quickly and inexpensively;

- We intend to use distributed processing, which will allow us to aggregate the processing power of third-party computers in order to add indexing capability and memory for our retrieval and management software technologies. Using distributed processing will reduce costs by reducing the amount of equipment we will be required to purchase in order to provide these capabilities; and

- We believe that our retrieval response time will be faster than that of most of our competitors and that our product suite is capable of maintaining a dynamic index of larger scale than that of our competitors.

In order to generate significant revenue, we must continue to enhance and make our information retrieval and management software infrastructure more robust and direct our marketing to customers who provide information retrieval capabilities to their end-users.

We believe that the private label segment of the information retrieval market, which is still in the beginning of its anticipated growth curve, offers a model, which provides for continued revenue growth and profitability. The emergence of companies such as Teoma, Wisenut and other new retrieval technologies illustrates the demand for more creative and robust information retrieval technologies.

We also believe that information retrieval companies which now offer retrieval resources target primarily the largest customers (often having over 1,000,000 end-users) and are too costly to be used by a more diverse clientele, which would otherwise offer retrieval services to their end-users. We intend to fill this void by presenting a more competitive pricing structure consisting of

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less retrieval service sign up fees and inquiry charges to our customers, initially targeting providers of online content offerings and online communities with 10,000 to 1,000,000 users.

**Competition**

The market for Internet products, services, advertising and commerce is intensely competitive, and we expect that competition will continue to intensify. We believe that the principal competitive factors in these markets are name recognition, distribution arrangements, functionality, performance, ease of use, the number of value-added services and features, and quality of support. Our primary competitors for the quepasa.com Web site are other companies providing portal and online community services, especially to the Spanish-language Internet users, such as Yahoo!Español, America Online Latin America and Terra.com.

In addition, a number of companies offering Internet products and services, including our direct competitors, recently began integrating multiple features within the products and services they offer to users. Integration of Internet products and services is occurring through development of competing products and through acquisitions of, or entering into joint ventures and/or licensing arrangements involving other, Internet companies and our competitors.

Many large media companies have developed or are developing Internet navigation services to become gateway sites for Web users. As these companies develop such portal or community sites, we could lose a substantial portion of our user traffic. Further, entities that sponsor or maintain high-traffic Web sites or that provide an initial point of entry for Internet viewers, such as the Regional Bell Operating Companies or Internet service providers, such as Microsoft and America Online, currently offer and can be expected to consider further development, acquisition or licensing of Internet search and navigation functions. These functions may be competitive with those that we offer.

Most of our existing competitors, as well as new competitors such as Spanish-language media companies, other portals, communities and Internet industry consolidators, have significantly greater financial, technical and marketing resources than we do. Many of our competitors offer Internet products and services that are superior to ours and achieve greater market acceptance. There can be no assurance that we will be able to compete successfully against current or future competitors or that competition will not have a material adverse affect on our business.

Our online search and retrieval business will compete with a number of information retrieval services, most of whom have operated in the market longer, and have greater financial resources and marketing relationships than we. These competitors include Google, Inktomi, Ask Jeeves, FindWhat and Overture along with a number of smaller companies that provide similar search and retrieval services.

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**Employees**

As of June 30, 2005, we employed approximately 34 individuals in Sonora, Mexico and 18 individuals, including our executive officers, in the U.S. Our employees are not represented by a labor union and we have not experienced any work stoppages since our inception in June 1997.

**Properties**

We lease 6,500 square feet of office space at our corporate headquarters at 410 N. 44th Street, Suite 450, Phoenix, AZ 85008, under a one-year lease which expires in May 2005, for $10,600 per month. We also lease 3,200 square feet of office space in Sonora, Mexico, from which we operate our quepasa.com Web site, under a two-year lease which expires in August 2005, for $3,150 per month. We expect to renew the leases at both locations upon substantially similar terms and conditions. We locate the servers necessary to provide our search and retrieval services at the Limelight Networks facility in Tempe, Arizona, which is a third tier data center. We believe that our facilities are adequate for our current needs and that additional suitable space is available if required.

**Legal Proceedings**

On June 14, 2004, TIABFES filed suit against us in the United States District Court for the Central District of California in Los Angeles, California, under case caption TIABFES, a California corporation, d/b/a New Capital Advisors vs. Quepasa Corporation, Inc., a Nevada corporation, et. al. case number CIV 04-4198 (JTLX). The civil action was brought in connection with a claim by the Plaintiff for damages associated with an alleged professional financial advisory and business strategy services agreement between the parties. The action seeks damages under various causes of action, in amounts up to $2 million. We have reviewed the claims with our counsel, believe the claims to be without merit and intend to vigorously defend them. Moreover, management believes that the amount claimed has been grossly overstated, in an attempt to induce us to settle the action rather than litigate it.

During August, 2005, the Company formally agreed to dismiss the lawsuit it filed against TIABFES Corp. d/b/a New Capital Advisors ( New Capital ) in Superior Court at Phoenix, Arizona (#CV2004-015723) on August 13, 2004 and New Capital agreed to dismiss the lawsuit it filed against the Company in United States District Court, Central District of California (#04-4198) on June 14, 2004. On the same date, the Company agreed to transfer approximately 20,000 shares of its Common Stock to an assignee of New Capital in exchange for certain future Investor Relations services. No cash was paid to New Capital by Quepasa for the purpose of settling the lawsuit.

On March 14, 2005, Craig Behar filed a civil action against us entitled Craig Behar vs. Quepasa Corporation case number CV2005-004439 in the Maricopa County Superior Court, at Phoenix, Arizona. The civil action was brought in connection with a claim by the Plaintiff for damages associated with an alleged employment agreement. The action seeks damages under various causes of action, in amounts up to $418,700. We have reviewed the claims with our counsel, believe the claims to be wholly without merit and intend to vigorously defend them.

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We are not aware of any pending legal proceedings against us that, individually or in the aggregate, would have a material adverse effect on our business, operating results or financial condition. We may in the future be party to litigation arising in the course of our business, including claims that we allegedly infringe third-party trademarks and other intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

## MANAGEMENT

### Directors and Executive Officers

| Name | Age | Position | Officer or Director Since |
|---|---|---|---|
| Jeffrey S. Peterson | 32 | Chairman of the Board of Directors and Chief Executive Officer | From 1997 to 1999 and since 2002 |
| Fernando Ascencio | 54 | President | 2004 |
| Charles B. Mathews | 41 | Chief Financial Officer and Chief Operating Officer | 2004 |
| Juan Carlos Arellano | 40 | Director | 2004 |
| Marco Delgado | 29 | Director | 2004 |

Mr. Peterson is a Class A director, Mr. Arellano is a Class B director and Mr. Delgado is a Class C director. Class A directors serve for terms of three years, the Class B director will serve for an initial term of two years and thereafter, Class B directors will be elected for terms of three years, and the Class C director will serve for an initial term of one year and thereafter, Class C directors will be elected for terms of three years. Our officers are elected by, and serve at the discretion of, the board of directors. Our full board of directors acts as our Audit Committee, Compensation Committee and Nominating Committee. On February 4, 2005, Brian Lu resigned from our board of directors.

**Jeffrey S. Peterson** has been our Chairman since April 2002 and Chief Executive Officer from April 2002 to March 2005 and since June 2005. From June 1999 to June 2001, Mr. Peterson managed his personal investments. Mr. Peterson founded us and was our Chairman and Chief Executive Officer from May 1998 to June 1999 when he was appointed Chief Technology Officer. He was also our Chief Technology Officer from July 1997 until May 1998 and our President in June 1999. From January 1997 to June 1997, Mr. Peterson served as co-owner of NetCentury, an

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Internet design firm he founded. Mr. Peterson is an experienced Modula, Java and C++ programmer, who has been involved in the programming and operations of computers and digital communications for over 20 years. He has developed software applications for operating systems and digital platforms, beginning with Cp/M based systems in the early 1980s to Unix (Sun Solaris, BSD, Linux, Irix) and Windows NT. Mr. Peterson is bilingual in English and Spanish. Mr. Peterson has received national and international media attention for his accomplishments in the technology sector, currently serves on the board of directors of several privately-held technology related companies in both the United States and Latin America and serves as a technology consultant to the government of Mexico. In July 2003, Mr. Peterson was appointed by Arizona Governor Janet Napolitano to the board of directors of the Arizona Mexico Commission.

**Fernando Ascencio** has been employed by us from time to time since 1999 and became our President in January 2004 and our Chief Executive Officer from March 2005 through June 2005. Mr. Ascencio has considerable experience in strategic content and Hispanic business development. He was employed by the Univision Channel 33 news department from 1987 to 1997. He held a number of senior positions at Univision, including news anchor, reporter, producer and news director. From 1997 to 1999 he was employed by ABC Channel 15 in Phoenix, Arizona in the news department where he contributed his Hispanic and news media experience. In 2001 he was named the Vice President of News and Programming Development for Continental Radio Broadcasting where he helped launch a new Hispanic radio network based in Las Vegas, Nevada. Mr. Ascencio has an educational background in computers, broadcasting and accounting and holds an MBA from the University of Phoenix in Phoenix, Arizona.

**Charles B. Mathews** was appointed our Chief Financial Officer in March 2004 and our Chief Operating Officer and Chief Financial Officer in June 2004. From 2000 until he joined us, he was the managing member of Mathews & Mann, LLC, an accounting and business consulting firm in Phoenix, Arizona. From 1995 to 2000, Mr. Mathews served as Controller of a subsidiary of Consolidated Graphics. Mr. Mathews is a CPA and earned a B.A. in business administration from Alaska Pacific University and an M.B.A. from Arizona State University.

**Juan Carlos Arellano** has been a mortgage broker and private investor in the Phoenix, Arizona area since 1993.

**Marco Delgado** has been a Content Editor for Quepasa.com de Mexico, S.A. de C.V., our wholly-owned subsidiary, which operates in Sonora, Mexico since September 2002. From June 2001 to September 2002, he was Chief Editor for Editorial Adcebra, a publisher of business magazines in Mexico City. From April 2000 to June 2001, he was a content editor for Microsoft Latinamerica in Monterrey, Nuevo Leon, Mexico. Mr. Delgado received his Bachelor s degree from the Instituto Tecnologico in Monterrey, Nuevo Leon, Mexico.

**Executive Compensation**

Since October 1, 2004, Mr. Peterson has been paid a cash salary of $1.00 per year. No executive officer receives a cash salary in excess of $100,000 annually. The following table provides certain summary information concerning the compensation earned by our Chairman, Chief Executive Officer and Chief Financial Officer for services rendered in all capacities to us and our subsidiaries for the fiscal years ended December 31, 2004, and 2003.

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| | | Annual Compensation | | | Long Term Compensation | |
|---|---|---|---|---|---|---|
| **Name and Principal Position** | **Year** | **Salary** | **Bonus** | **Other Annual Compensation** | **Securities Underlying Options** | **All Other Compensation** |
| Jeffery S. Peterson<br>Chairman of the Board and CEO | 2004 | $ 120,000 | $ 0 | $ 441 | 0 | $ 0 |
| | 2003 | $ 120,000 | $ 0 | $ 2,114 | 900,000 | $ 23,000 |
| Fernando Ascencio<br>President | 2004 | $ 70,000 | $ 0 | $ 0 | 35,000 | $ 0 |
| | 2003 | $ 60,256 | $ 0 | $ 0 | 37,500 | $ 0 |
| Charles B. Mathews<br>Chief Financial Officer and<br>Chief Operating Officer | 2004 | $ 63,333 | $ 0 | $ 0 | 50,000 | $ 0 |
| John T. Kurtzweil<br>Interim Chief Financial Officer | 2004 | $ 0 | $ 0 | $ 26,000 | 20,000 | $ 0 |
| | 2003 | $ 0 | $ 0 | $ 108,307 | 130,855 | $ 0 |

**Option Grants Table**

We granted 140,000 stock options to our executive officers and directors during the year ended December 31, 2004 comprised of 35,000 options to Fernando Ascencio, our Chief Executive Officer, 50,000 options to Charles B. Mathews, our Chief Financial Officer, 20,000 options to John Kurtzweil, our former Interim Chief Financial Officer, and 35,000 options to David Hansen, a former executive officer and director.

**Aggregated Options in Last Fiscal Year**

**and Fiscal Year-End Option Values**

The following table provides information with respect to option exercises in the year ended December 31, 2004 by the named officers and the value of their unexercised options at fiscal year end. No stock appreciation rights were held or exercised by the named officers as of the end of the fiscal year.

| | | | Number of Unexercised Options at Year-end | | Value of Unexercised In-the-Money Options at Year-end($) | |
|---|---|---|---|---|---|---|
| **Name** | **Shares Acquired on Exercise(1)** | **Realized** | **Exercisable** | **Unexercisable** | **Exercisable** | **Unexercisable** |
| Jeffrey S. Peterson | 0 | 0 | 901,875 | 0 | 0 | 0 |
| Fernando Ascencio | 0 | 0 | 60,000 | 0 | 0 | 0 |
| Charles B. Mathews | 0 | 0 | 50,000 | 0 | 0 | 0 |

(1) No options were exercised during 2004 by our executive officers.

**Director Compensation**

Our directors do not receive compensation for their services as directors, although they are reimbursed for out-of-pocket expenses incurred in attending board meetings.

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**Stock Option Plan**

In October 1998 our stockholders adopted our 1998 Stock Option Plan, which provides for the grant to employees, officers, directors and consultants of options to purchase up to an aggregate of 6,000,000 shares of common stock, consisting of both incentive stock options within the meaning of Section 422A of the United States Internal Revenue Code of 1986 (the Code ) and non-qualified options. Incentive stock options are issuable only to employees, while non-qualified options may be issued to non-employee directors, consultants and others, as well as to employees.

The Plan is administered by our board of directors, which determines those individuals who are to receive options, the time period during which the options may be partially or fully exercised, the number of shares of common stock that may be purchased under each option, and the option price.

The per share exercise price of the common stock subject to an incentive stock option or non-qualified option may not be less than the fair market value of the common stock on the date the option is granted. The per share exercise price of the common stock subject to a non-qualified option will be established by the board of directors. The aggregate fair market value, determined as of the date the option is granted, of the common stock that any employee may purchase in any calendar year pursuant to the exercise of incentive stock options may not exceed $1,000,000. No person who owns, directly or indirectly, at the time of the granting of an incentive stock option to him, more than 10% of the total combined voting power of all classes of our stock is eligible to receive any incentive stock options under the Plan unless the option price is at least 110% of the fair market value of the common stock subject to the option, determined on the date of grant. Non-qualified options are not subject to this limitation.

No incentive stock option may be transferred by an optionee other than by will or the laws of descent and distribution, and during the lifetime of an optionee, the option will be exercisable only by him or her. In the event of termination of employment other than by death or disability, the optionee has three months after such termination during which he or she can exercise the option. Upon termination of employment of an optionee by reason of death or permanent total disability, his or her option remains exercisable for one year thereafter to the extent it was exercisable on the date of such termination. No similar limitation applies to non-qualified options.

Options under the Plan must be granted within ten years from the effective date as amended of the Plan. The incentive stock options granted under the Plan cannot be exercised more than ten years from the date of grant except that incentive stock options issued to 10% or greater stock-holders are limited to five year terms. All options granted under the Plan will provide for the payment of the exercise price in cash or by delivery to us of shares of common stock already owned by the optionee having a fair market value equal to the exercise price of the options being exercised, or by a combination of such methods of payment. Therefore, an optionee may be able to tender shares of common stock to purchase additional shares of common

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stock and may theoretically exercise all of his stock options with no additional investment other than his original shares.

Any unexercised options that expire or that terminate upon an optionee ceasing to be an officer, director or an employee become available once again for issuance.

**Liability and Indemnification of Officers and Directors**

Our Articles of Incorporation provide that our directors will not be liable for monetary damages for breach of their fiduciary duty as directors, other than the liability of a director for:

- A breach of the director s duty of loyalty to our company or our stockholders;
- Acts or omissions by the director not in good faith or which involve intentional misconduct or a knowing violation of law;
- Willful or negligent declaration of an unlawful dividend, stock purchase or redemption; or
- Transactions from which the director derived an improper personal benefit.

Our Articles of Incorporation require us to indemnify all persons whom we may indemnify pursuant to Nevada law to the full extent permitted by Nevada law.

In addition, our bylaws require us to indemnify our officers and directors and other persons against expenses, judgments, fines and amounts incurred or paid in settlement in connection with civil or criminal claims, actions, suits or proceedings against such persons by reason of serving or having served as officers, directors, or in other capacities, if such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to our best interests and, in a criminal action or proceeding, if he had no reasonable cause to believe that his/her conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction or upon a plea of no contest or its equivalent shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he or she reasonably believed to be in or not opposed to our best interests or that he or she had reasonable cause to believe his or her conduct was unlawful. Indemnification as provided in our bylaws shall be made only as authorized in a specific case and upon a determination that the person met the applicable standards of conduct. Insofar as the limitation of, or indemnification for, liabilities arising under the Securities Act of 1933 may be permitted to directors, officers, or persons controlling us pursuant to the foregoing, or otherwise, we have been advised that, in the opinion of the Securities and Exchange Commission, such limitation or indemnification is against public policy as expressed in the Securities Act of 1933 and is therefore, unenforceable.

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**SECURITY OWNERSHIP OF EXECUTIVE OFFICERS, DIRECTORS AND**

**BENEFICIAL OWNERS OF GREATER THAN 5% OF OUR COMMON STOCK**

The following table sets forth information with respect to the beneficial ownership of our common stock including common stock issuable upon exercise of stock options issuable within 60 days from the date hereof, by:

Each holder of more than 5% of our common stock;

Each of our directors; and

All of our directors and executive officers as a group.

Except as noted, each stockholder s address is in care of our company at 410 North 44th Street, Suite 450, Phoenix, Arizona 85008.

The following table sets forth certain information with respect to the beneficial ownership of our Common Stock (and stock options exercisable within 60 days) by (i) each person who is known by us to own of record or beneficially more than 5% of our Common Stock, (ii) each of our directors and (iii) all directors and officers as a group. The persons listed in the table have sole voting and investment powers with respect to the shares of Common Stock.

| Name and Address | Amount of Ownership | Percent of Class |
|---|---|---|
| Jeffrey S. Peterson | 2,084,235 | 28.3% |
| Fernando Ascencio | 92,500 | 1.3% |
| Charles B. Mathews | 300,000 | 4.1% |
| Juan Carlos Arellano | 0 | * |
| Marco Delgado | 5,000 | * |
| Penfield Partners 153 East 53rd Street New York, NY 10022 (1) | 585,000 | 7.8% |
| All officers and directors as a group (5 persons) | 2,481,735 | 33.7% |

* Less than 1%

(1) William D. Witter, Inc., Dean Witter III, President, is the Managing Partner of Penfield Partners

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## SELLING STOCKHOLDERS

The following tables set forth the names of selling stockholders who are offering common stock and the names of selling stockholders who are offering common stock upon exercise of warrants, together with the number of shares of our common stock beneficially owned by the selling stockholders as of the date hereof. Each selling stockholder is offering all shares owned by him or her.

The following shares may be offered from time to time by the selling stockholders named below who are not obligated to sell any of their shares of common stock. Since the selling stockholders may sell all or part of the shares of common stock offered in this prospectus, we cannot estimate the number of shares of our common stock that will be held by the selling stockholders upon termination of this offering.

None of the selling stockholders are officers, directors or 10% or greater stockholders of our company. One selling stockholder, Penfield Partners, owns 7.8% of our outstanding common stock and is offering 196,000 shares and shares underlying warrants, which represent a sale of 2.7% of our outstanding shares. All of the selling stockholders are accredited investors and received common stock warrants along with the common stock purchased in connection with our September 2004 and December 2004 private placements. In the September 2004 private placement we issued one warrant for each two shares purchased and in the December 2004 private placement we issued .2 warrants for each share purchased. The address of each selling stockholder is in care of our company at 410 North 44th Street, Suite 450, Phoenix, Arizona 85008.

**Common Stock**

| Name of Beneficial Owner | Shares Owned Prior to Offering | Shares Being Offered | Shares Owned After Offering | Percent Owned After Offering |
|---|---|---|---|---|
| Alan & Janee Loewenstein JTWROS | 5,250 | 5,250 | 0 | * |
| Barbara J. Gattermeir Rev. Trust | 16,800 | 16,800 | 0 | * |
| Bettingen, Grant | 29,400 | 18,900 | 10,500 | * |
| Challure Holdings | 33,600 | 33,600 | 0 | * |
| Chang, Vincent | 16,800 | 16,800 | 0 | * |
| Cohen, Arthur | 225,000 | 225,000 | 0 | * |
| Corcoran, James & Marnie | 10,500 | 10,500 | 0 | * |
| Dieball, Kevin | 10,000 | 10,000 | 0 | * |
| English, Clifford | 21,000 | 21,000 | 0 | * |
| Friedman, Douglas | 65,000 | 65,000 | 0 | * |
| Friedman, Rodd | 121,500 | 121,500 | 20,000 | * |

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| Name of Beneficial Owner | Shares Owned Prior to Offering | Shares Being Offered | Shares Owned After Offering | Percent Owned After Offering |
|---|---|---|---|---|
| Friedman, Steve | 25,000 | 25,000 | 0 | * |
| Global Capital Partners | 16,800 | 16,800 | 0 | * |
| Group V | 42,000 | 42,000 | 0 | * |
| Gurian, Philip | 33,600 | 33,600 | 0 | * |
| Gurley, Henry | 41,800 | 36,800 | 5,000 | * |
| J. Peter Gattermeir Rev. Trust | 16,800 | 16,800 | 0 | * |
| Joel & Doreen Bennett JTTEN | 10,500 | 10,500 | 0 | * |
| Karim, Abdul & Gulbanu JTTEE | 8,400 | 8,400 | 0 | * |
| Kwik, Derek Tsan | 50,000 | 50,000 | 0 | * |
| Lane, Stephan | 2,100 | 2,100 | 0 | * |
| Laplant, Gary | 21,000 | 21,000 | 0 | * |
| Left, Andrea | 100,800 | 100,800 | 0 | * |
| Levine, Robert | 10,500 | 10,500 | 0 | * |
| Lichtenstein, Eric | 15,000 | 15,000 | 0 | * |
| Meszaros, Robert | 21,440 | 13,440 | 8,000 | * |
| Morano, Christopher | 21,000 | 21,000 | 0 | * |
| Morrison, Roger | 21,000 | 21,000 | 0 | * |
| Newbridge Securities | 73,008 | 73,008 | 0 | * |
| Paulson Investment Co. | 105,000 | 105,000 | 0 | * |
| Penfield Partners, LP | 518,500 | 136,500 | 382,000 | 5.4% |
| Penfield Partners Offshore, Ltd. | 10,500 | 10,500 | 0 | * |
| Port, Jason | 16,800 | 16,800 | 0 | * |
| Randy & Cathy Bugna JTTEN | 31,500 | 21,000 | 10,500 | * |
| Riggs Partners, LLC | 168,000 | 168,000 | 0 | * |
| Rosen, Bruce | 40,000 | 40,000 | 0 | * |
| Schwartz, Alan | 13,440 | 13,440 | 0 | * |
| Stern Family Trust | 10,500 | 10,500 | 0 | * |

| Name of Beneficial Owner | Shares Owned Prior to Offering | Shares Being Offered | Shares Owned After Offering | Percent Owned After Offering |
|---|---|---|---|---|
| Talkot Capital, LLC | 50,400 | 50,400 | 0 | * |
| Taube, Darrin | 15,000 | 15,000 | 0 | * |
| Tenebruso, Ralph | 15,250 | 10,250 | 5,000 | * |
| Weber, Scott | 10,500 | 10,500 | 0 | * |
| Wolfe, Alvin | 10,000 | 10,000 | 0 | * |
| Wolfe, John | 10,000 | 10,000 | 0 | * |
| Yadgir, James | 51,000 | 21,000 | 30,000 | * |
| Yocca, Nicholas | 8,400 | 8,400 | 0 | * |
| TOTAL | 2,170,388 | 1,699,388 | 471,000 | 6.6% |

* Less than 1%

**Common Stock Purchase Warrants**

| Name of Beneficial Owner | Shares Owned Prior to Offer | Shares Being Offered | Shares Owned After Offering | Percent Owned After Offering |
|---|---|---|---|---|
| Alan & Janee Loewenstein JTWROS | 2,000 | 2,000 | 0 | * |
| Barbara J. Gattermeir Rev. Trust | 6,400 | 6,400 | 0 | * |
| Bettingen, Grant | 7,200 | 7,200 | 0 | * |
| Challure Holdings | 12,800 | 12,800 | 0 | * |
| Chang, Vincent | 6,400 | 6,400 | 0 | * |
| Cohen, Arthur | 112,500 | 112,500 | 0 | * |
| Corcoran, James & Marnie | 4,000 | 4,000 | 0 | * |
| English, Clifford | 8,000 | 8,000 | 0 | * |
| Friedman, Douglas | 7,500 | 7,500 | 0 | * |
| Friedman, Rodd | 72,000 | 72,000 | 0 | * |
| Friedman, Steve | 12,500 | 12,500 | 0 | * |
| Global Capital Partners | 6,400 | 6,400 | 0 | * |
| Grant Bettingen, Inc. (1)(2) | 413,000 | 413,000 | 0 | * |
| Group V | 16,000 | 16,000 | 0 | * |
| Gurian, Philip | 12,800 | 12,800 | 0 | * |
| Gurley, Henry | 16,400 | 16,400 | 0 | * |

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| Name of Beneficial Owner | Shares Owned Prior to Offer | Shares Being Offered | Shares Owned After Offering | Percent Owned After Offering |
|---|---|---|---|---|
| J. Peter Gattermeir Rev. Trust | 6,400 | 6,400 | 0 | * |
| Joel & Doreen Bennett JTTEN | 4,000 | 4,000 | 0 | * |
| Karim, Abdul & Gulbanu JTTEE | 3,200 | 3,200 | 0 | * |
| Lane, Stephan | 800 | 800 | 0 | * |
| Laplant, Gary | 8,000 | 8,000 | 0 | * |
| Left, Andrea | 38,400 | 38,400 | 0 | * |
| Levine, Robert | 4,000 | 4,000 | 0 | * |
| Lichtenstein, Eric | 7,500 | 7,500 | 0 | * |
| Meszaros, Robert | 5,120 | 5,120 | 0 | * |
| Morano, Christopher | 8,000 | 8,000 | 0 | * |
| Morrison, Roger | 8,000 | 8,000 | 0 | * |
| Newbridge Securities Corporation | 125,000 | 125,000 | 0 | * |
| Paulson Investment Co. | 40,000 | 40,000 | 0 | * |
| Penfield Partners, LP | 52,000 | 52,000 | 0 | * |
| Penfield Partners Offshore, Ltd. | 4,000 | 4,000 | 0 | * |
| Pierce, Mitchell | 100,000 | 100,000 | 0 | * |
| Port, Jason | 6,400 | 6,400 | 0 | * |
| Pring, Bradley T. | 100,000 | 100,000 | 0 | * |
| Randy & Cathy Bugna JTTEN | 8,000 | 8,000 | 0 | * |
| Riggs Partners, LLC | 64,000 | 64,000 | 0 | * |
| Rosen, Bruce | 20,000 | 20,000 | 0 | * |
| Schwartz, Alan | 5,120 | 5,120 | 0 | * |
| Stern Family Trust | 4,000 | 4,000 | 0 | * |
| Talkot Capital, LLC | 19,200 | 19,200 | 0 | * |
| Taube, Darrin | 7,500 | 7,500 | 0 | * |
| Tenebruso, Ralph | 4,500 | 4,500 | 0 | * |
| Weber, Scott | 4,000 | 4,000 | 0 | * |
| Wolfe, Alvin | 5,000 | 5,000 | 0 | * |
| Wolfe, John | 5,000 | 5,000 | 0 | * |
| Yadgir, James | 8,000 | 8,000 | 0 | * |
| Yocca, Nicholas | 3,200 | 3,200 | 0 | * |
| TOTAL | 1,394,240 | 1,394,240 | | |

* Less than 1%

(1) 338,000 issued to Grant Bettingen, Inc., a broker-dealer, as compensation in connection with our September 2004 and December 2004 private placements

(2) 75,000 previously registered and are being re-registered as a part of this prospectus

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**Information Regarding the Selling Stockholders**

The shares of our common stock which the selling stockholders are offering for resale will be sold from time to time in one or more of the following transactions:

Block transactions;

Transactions on the Bulletin Board or on such other market on which our common stock may trade from time to time;

Privately negotiated transactions;

Through the writing of options on the shares;

Short sales; or

Any combination of these transactions

The sale price to the public in these transactions may be:

The market price prevailing at the time of sale;

A price related to the prevailing market price;

Negotiated prices; or

Such other price as the selling stockholders determine from time to time.

In the event that we permit or cause this prospectus to lapse, the selling stockholders may sell shares of our common stock pursuant to Rule 144 under the Securities Act of 1933. The selling stockholders will have the sole and absolute discretion not to accept any purchase offer or make any sale of these shares of our common stock if they deem the purchase price to be unsatisfactory at any particular time.

The selling stockholders or their pledges, donees, transferees or other successors in interest, may also sell these shares of our common stock directly to market makers acting as principals and/or broker-dealers acting as agents for themselves or their customers. These broker-dealers may receive compensation in the form of discounts, concessions or commissions from the selling stockholders and/or the purchasers of these shares of our common stock for whom such broker-dealers may act as agents or to whom they sell as principal, or both. As to a particular broker-dealer, this compensation might be in excess of customary commissions. Market makers and block purchasers purchasing these shares of our common stock will do so for their own account and at their own risk. It is possible that a selling stockholder will attempt to sell shares of our common stock in block transactions to market makers or other purchasers at a price per share which may be below the prevailing market price of our common stock. There can be no assurance that all or any of these shares of our common stock offered hereby will be issued to, or sold by, the selling stockholders. Upon effecting the sale of any of these shares of our common stock offered under this prospectus, the selling stockholders and any brokers, dealers or agents, hereby, will be deemed to be underwriters as that term is defined under the Securities Act of 1933 or the Securities Exchange Act of 1934, or the rules and regulations thereunder.

Alternatively, the selling stockholders may sell all or any part of the shares of our common stock offered hereby through an underwriter. No selling stockholder has entered into any agreement with a prospective underwriter and there is no assurance that any such agreement will be entered into. If a selling stockholder enters into an agreement or agreements with an underwriter, then the relevant details will be set forth in a supplement or revision to this prospectus.

The selling stockholders and any other persons participating in the sale or distribution of these shares of our common stock will be subject to applicable provisions of the Securities Exchange Act of 1934 and the rules and regulations thereunder including, without limitation, Regulation M. These provisions may restrict activities of, and limit the timing of purchases and sales of any of these shares of our common stock by, the selling stockholders. Furthermore, pursuant to Regulation M, a person engaged in a distribution of our securities is prohibited from bidding for, purchasing, or attempting to induce any person to bid for or purchase our securities for a period beginning five business days prior to the date of this prospectus until such person is no longer a selling stockholder. These regulations may affect the marketability of these shares of our common stock.

We will pay substantially all of the expenses incident to the registration and offering of our common stock, other than commissions or discounts of underwriters, broker-dealers or agents.

## RELATED PARTY AND OTHER MATERIAL TRANSACTIONS

On October 30, 2002, we acquired all of the issued and outstanding common stock of Vayala Corporation initially for 500,000 shares of our common stock. We also agreed to issue up to 1,100,000 additional shares and stock options to purchase an additional 3,250,000 shares exercisable at $.002 per share based upon certain performance criteria to be met by Vayala. We issued a total of 500,000 shares and 750,000 stock options under the agreement, and no further securities are issuable under the agreement. Vayala was an affiliated company when we acquired it by virtue of the fact that Mr. Peterson and two of our then directors were our directors and were principal stockholders and executive officers and directors of Vayala at that time.

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## DESCRIPTION OF CAPITAL STOCK

### General

We are authorized to issue 50,000,000 shares of common stock, $.001par value per share, and 5,000,000 shares of preferred stock, no par value per share.

### Common Stock

As of the date hereof, there were 7,453,688 shares of common stock outstanding. The holders of common stock are entitled to one vote per share on all matters submitted to a vote of stockholders, including the election of directors. There is no right to cumulate votes in the election of directors. The holders of common stock are entitled to any dividends that may be declared by the board of directors out of funds legally available therefor subject to the prior rights of holders of preferred stock and any contractual restrictions we have against the payment of dividends on common stock. In the event of our liquidation or dissolution, holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities and the liquidation preferences of any outstanding shares of preferred stock.

Holders of common stock have no preemptive rights and have no right to convert their common stock into any other securities. All of the outstanding shares of common stock are fully paid and non-assessable.

### Preferred Stock

Shares of preferred stock may be issued from time to time in one or more series with such designations, voting powers, if any, preferences and relative, participating, optional or other special rights, and such qualifications, limitations and restrictions, as are determined by resolution of our board of directors. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change in control of our company without further action by stockholders and could adversely affect the rights and powers, including voting rights, of the holders of common stock. In certain circumstances, the issuance of preferred stock could depress the market price of the common stock.

We have issued an aggregate of 19,096 shares of Series A preferred stock, which we refer to as preferred stock, in face amount denominations of $100 per share none of which are currently outstanding.

The preferred stock may be converted into our common stock at any time at the holder s discretion at the lesser of $1.30 per share of common stock or 75% of the average closing price of the common stock on the Electronic Bulletin Board for the ten days preceding the date a registration statement registering the shares of common stock underlying the preferred stock is declared effective by the Securities and Exchange Commission (the Conversion Price ) provided that the Conversion Price shall not be less than $.85 per share. Fractional shares issuable upon such conversion will be rounded up to the nearest full share. We may, in our sole discretion, force conversion of the preferred stock into common stock at the Conversion Price if

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(1) the common stock has been registered with the Securities and Exchange Commission and (2) the closing price of the common stock has been at least $1.95 per share for at least 20 consecutive trading days.

We may redeem the preferred stock in whole or in part on ten days written notice to the holders based upon the payment schedule below. During the ten-day redemption period, holders will continue to have the rights to convert their preferred stock to our common stock at the Conversion Price.

| Date of Redemption | Redemption Price Per Share | Payment of Redemption Price |
|---|---|---|
| On or before March 31, 2006 | $ 115 | $110 in cash, plus accrued dividends and $5 in common stock (1) |
| On or before March 31, 2007 | $ 110 | $105 in cash, plus accrued dividends and $5 in common stock (1) |

(1) Common stock issued under the redemption provisions will be valued at the Conversion Price.

*Dividends.* Holders of shares of preferred stock are entitled to receive, out of funds at the time legally available thereof, dividends at the semi-annual rate of $5.00 per share, payable in arrears on June 30 and December 31 of each year beginning June 30, 2004. Dividends are paid in our common stock (and not in cash) based upon the Conversion Price.

*Liquidation Rights.* In the event of our liquidation, dissolution or winding up, holders of shares of preferred stock are entitled to receive, out of legally available assets, a liquidation preference of $100 per share plus accrued but unpaid dividends, before any payment or distribution is made to the holders of common stock or any series or class of our stock hereafter issued that ranks junior as to liquidation rights to the preferred stock. The holders of the shares of preferred stock will not be entitled to receive the liquidation preference on such shares until the liquidation preferences of any other series or class of our stock previously or hereafter issued that ranks senior as to liquidation rights to the preferred stock has been paid in full.

*Voting Rights.* The holders of the preferred stock have no voting rights except as to matters affecting the rights of preferred stockholders or as to matters that all stockholders are entitled to vote on as a matter of law, such as mergers or acquisitions. In connection with any such vote, each outstanding share of preferred stock is entitled to one vote, excluding any shares held by our company or any entity controlled by us, which shares have no voting rights.

**Common Stock Purchase Warrants**

In connection with our September 2004 and December 2004 private placements, we issued an aggregate of 994,240 warrants to a group of accredited investors whose names and warrant amounts are listed above under Selling Stockholders Common Stock Purchase Warrants. A total of 250,000 warrants exercisable at $2.00 per share were issued in the September 2004 private placement and 406,240 warrants exercisable at $4.50 per share were issued in the December 2004 private placement. The remaining 338,000 warrants were issued to Grant Bettingen, Inc., a broker-dealer, in connection with its assistance with the private

placements. The exercise prices of these warrants are as follows: 10,000 warrants at $2.00 per share; 50,000 warrants at $2.60 per share; and 278,000 warrants at $4.50 per share.

In addition, we are re-registering 400,000 warrants that were issued previously and registered under a prior registration, as a part of this prospectus.

**Dividends**

We do not intend to pay dividends on our common stock in the foreseeable future.

**Transfer Agent**

Corporate Stock Transfer, Inc., Denver, Colorado, is our transfer agent.

## SHARES ELIGIBLE FOR FUTURE SALE

We have a total of 7,453,688 shares outstanding, comprised of 5,764,300 shares which are free trading or may currently be sold under Rule 144 and 1,689,388 shares of common stock which are being registered by this prospectus and are free trading. We are also registering 1,394,240 shares of common stock underlying warrants which will be free trading upon exercise of the warrants.

In general, under Rule 144 as currently in effect, a person, or persons whose shares are aggregated, who owns shares that were purchased from us, or any affiliate, at least one year previously, including a person who may be deemed our affiliate, is entitled to sell within any three- month period, a number of shares that does not exceed the greater of:

- 1% of the then outstanding shares of our common stock; or
- The average weekly trading volume of our common stock during the four calendar weeks preceding the date on which notice of the sale is filed with the Securities and Exchange Commission.

Sales under Rule 144 are also subject to manner of sale provisions, notice requirements and the availability of current public information about us. Any person who is not deemed to have been our affiliate at any time during the 90 days preceding a sale, and who owns shares within the definition of restricted securities under Rule 144 under the Securities Act that were purchased from us, or any affiliate, at least two years previously, is entitled to sell such shares under Rule 144(k) without regard to the volume limitations, manner of sale provisions, public information requirements or notice requirements.

Future sales of restricted common stock under Rule 144 or otherwise or of the shares which we are registering under this prospectus could negatively impact the market price of our common stock. We are unable to estimate the number of shares that may be sold in the future by our existing stockholders or the effect, if any, that sales of shares by such stockholders will have on the market price of our common stock prevailing from time to time. Sales of substantial amounts of our common stock by existing stockholders could adversely affect prevailing market prices.

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## EXPERTS

Our financial statements included in this prospectus as of and for the years ended December 31, 2003 and 2004, have been included in reliance on the reports of Ehrhardt Keefe Steiner & Hottman, PC, independent registered public accounting firm, given on the authority of this firm as experts in accounting and auditing.

Ehrhardt Keefe Steiner & Hottman, PC has not audited any unaudited interim financial information and has not expressed an opinion or any other form of assurance with respect to any such financial information.

## LEGAL MATTERS

The validity of our common stock offered hereby will be passed upon for us by the Law Office of Gary A. Agron, Greenwood Village, Colorado.

## WHERE YOU CAN FIND MORE INFORMATION

We have filed with the Securities and Exchange Commission, Washington, D.C. 20549, a registration statement on Form SB-2 under the Securities Act of 1933 with respect to our common stock offered by this prospectus. This prospectus does not contain all of the information set forth in the registration statement and the exhibits to the registration statement. For further information with respect to our Company and our common stock offered hereby, reference is made to the registration statement and the exhibits filed as part of the registration statement. We are required to file periodic reports with the Securities and Exchange Commission, including quarterly reports, annual reports which include our audited financial statements and proxy statements. The registration statement, including exhibits thereto, and all of our periodic reports may be inspected without charge at the Securities and Exchange Commission s principal office in Washington, D.C., and copies of all or any part thereof may be obtained from the Public Reference Section of the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549, after payment of fees prescribed by the Securities and Exchange Commission. You may obtain additional information regarding the operation of the Public Reference Section by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission also maintains a Web site which provides online access to reports, proxy and information statements and other information regarding registrants that file electronically with the Securities and Exchange Commission at the address: http://www.sec.gov.

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**QUEPASA CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

| | June 30, 2005 | December 31, 2004 |
|---|---|---|
| | (unaudited) | |
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 2,047,538 | $ 3,069,571 |
| Accounts receivable - trade | 18,944 | 4,363 |
| Accounts receivable - other | 4,678 | 267 |
| Prepaid expenses | 1,542 | 17,654 |
| Total current assets | 2,072,702 | 3,091,855 |
| NON-CURRENT ASSETS: | | |
| Property and equipment - net | 213,116 | 234,159 |
| Deposits and other assets | 28,176 | 27,535 |
| Total noncurrent assets | 241,292 | 261,694 |
| Total assets | $ 2,313,994 | $ 3,353,549 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 280,837 | $ 144,301 |
| Accrued and other current liabilities | 39,293 | 55,345 |
| Dividends payable | 13,367 | 49,247 |
| Commissions payable | | 347,588 |
| Deferred revenue | 230,857 | 164,788 |
| Current portion of long-term debt | 7,773 | 7,473 |
| Total current liabilities | 572,127 | 768,742 |
| LONG-TERM DEBT - net of current portion | 24,812 | 29,388 |
| Total liabilities | 596,939 | 798,130 |
| STOCKHOLDERS' EQUITY: | | |
| 10% Convertible Preferred stock, no par value; authorized 5,000,000 shares; 0 and 3,337 shares issued and outstanding at June 30, 2005 and December 31, 2004, respectively | | 217,855 |
| Common stock, $.001 par value; authorized 50,000,000 shares; 7,322,739 and 6,851,395 shares issued and outstanding at June 30, 2005 and December 31, 2004, respectively | 7,323 | 6,852 |
| Additional paid-in capital | 114,805,680 | 113,856,594 |
| Accumulated deficit | (113,092,674) | (111,515,865) |
| Foreign currency translation adjustment | (3,274) | (10,017) |
| Total stockholders equity | 1,717,055 | 2,555,419 |
| Total liabilities and stockholders equity | $ 2,313,994 | $ 3,353,549 |

See notes to unaudited condensed consolidated financial statements.

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**QUEPASA CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

**(UNAUDITED)**

| | Six months ended June 30, | | Three months ended June 30, | |
|---|---|---|---|---|
| | **2005** | **2004** | **2005** | **2004** |
| REVENUES | $ 285,810 | $ 127,803 | $ 159,572 | $ 103,938 |
| OPERATING COSTS AND EXPENSES: | | | | |
| Search services expenses | 227,412 | 55,258 | 122,441 | 51,258 |
| Sales and marketing expenses | 147,107 | 240,221 | 58,111 | 140,262 |
| Product and content development expenses | 73,851 | 100,591 | 32,471 | 67,341 |
| General and administrative | 1,350,670 | 1,226,004 | 864,812 | 797,797 |
| Depreciation and amortization | 51,539 | 209,812 | 26,716 | 113,696 |
| | 1,850,579 | 1,831,886 | 1,104,551 | 1,170,354 |
| LOSS FROM OPERATIONS | (1,564,769) | (1,704,083) | (944,979) | (1,066,416) |
| OTHER INCOME (EXPENSE): | | | | |
| Interest income and other | 2,696 | 5,529 | 2,692 | 2,158 |
| Interest expense | (1,361) | (76,949) | (559) | (54,684) |
| TOTAL OTHER INCOME (EXPENSE) | 1,335 | (71,420) | 2,133 | (52,526) |
| NET LOSS | (1,563,434) | (1,775,503) | (942,846) | (1,118,942) |
| Accrued preferred stock dividend | (13,367) | (14,913) | (13,367) | (14,913) |
| Preferred stock dividends | (8) | | | |
| Net loss attributable to common stockholders | $ (1,576,809) | $ (1,790,416) | $ (956,213) | $ (1,133,855) |
| NET LOSS PER COMMON SHARE, BASIC AND DILUTED | $ (0.22) | $ (0.43) | $ (0.13) | $ (0.25) |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING BASIC AND DILUTED | 7,084,349 | 4,138,818 | 7,127,050 | 4,484,889 |
| NET LOSS | $ (1,563,434) | $ (1,775,503) | $ (942,846) | $ (1,118,942) |
| Foreign currency translation adjustment | 6,743 | (15,822) | 8,892 | (11,489) |
| COMPREHENSIVE LOSS | $ (1,556,691) | $ (1,791,325) | $ (933,954) | $ (1,130,431) |

See notes to unaudited condensed consolidated financial statements.

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QUEPASA CORPORATION AND SUBSIDIARIES

**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY**

**For the Three Months Ended June 30, 2005**

**(Unaudited)**

| | Preferred Stock | | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Foreign Currency Translation Adjustment | Total Stockholders Equity |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | | |
| Balance - December 31, 2004 | 3,337 | $ 217,855 | 6,851,395 | $ 6,852 | $ 113,856,594 | $ (111,515,865) | $ (10,017) | $ 2,555,419 |
| Issuance of stock options for services | | | | | 247,447 | | | 247,447 |
| Issuance of common stock for cash, net of offering costs of $65,000 | | | 160,000 | 160 | 434,840 | | | 435,000 |
| Issuance of common stock for preferred dividends | | | 40,045 | 40 | 49,215 | (8) | | 49,247 |
| Accrued dividends to preferred stockholders | | | | | | (13,367) | | (13,367) |
| Conversion of preferred to common | (3,337) | (217,855) | 271,299 | 271 | 217,584 | | | |
| Foreign currency translation adjustment | | | | | | | 6,743 | 6,743 |
| Net loss | | | | | | (1,563,434) | | (1,563,434) |
| Balance - June 30, 2005 | | $ | 7,322,739 | $ 7,323 | $ 114,805,680 | $ (113,092,674) | $ (3,274) | $ 1,717,055 |

See notes to unaudited condensed consolidated financial statements.

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**QUEPASA CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(UNAUDITED)**

| | Six months ended June 30, | |
|---|---|---|
| | **2005** | **2004** |
| OPERATING ACTIVITIES: | | |
| Net loss | $ (1,563,434) | $ (1,775,503) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 51,539 | 209,812 |
| Amortization of discount on note payable | | 64,000 |
| Warrants issued for professional services | | 256,396 |
| Issuance of additional common shares required in offering | | 44,168 |
| Issuance of common stock for services | | 118,750 |
| Issuance of common stock options for compensation | | 26,000 |
| Issuance of common stock options for services | 247,447 | |
| Change in assets and liabilities: | | |
| Receivables | (18,992) | (5,893) |
| Prepaid expenses and other assets | 15,471 | 5,491 |
| Accounts payable and other current liabilities | (227,104) | 75,424 |
| Deferred revenue | 66,069 | 201,952 |
| Net cash used in operating activities | (1,429,004) | (779,403) |
| INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (30,496) | (52,804) |
| Net cash used in investing activities | (30,496) | (52,804) |
| FINANCING ACTIVITIES: | | |
| Proceeds from issuance of common stock, net of commissions of $65,000 | 435,000 | 1,052,653 |
| Proceeds from issuance of preferred stock | | 532,125 |
| Proceeds from issuance of notes payable | | 225,000 |
| Payments on notes payable | (4,276) | (17,655) |
| Net cash provided by financing activities | 430,724 | 1,792,123 |
| Foreign currency translation adjustment | 6,743 | (15,822) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (1,022,033) | 944,094 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 3,069,571 | 37,942 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $ 2,047,538 | $ 982,036 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid for interest | $ 1,361 | $ 849 |

Cash paid for income taxes

(continued)

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(Continued from the previous page)

SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITY:

During the six months ended June 30, 2005, the Company had the following non-cash transactions:

The Company issued 40,045 shares of common stock valued at $49,255 for preferred stock dividends.

Certain stockholders converted 3,337 shares of preferred stock valued at $217,855 for 271,299 shares of common stock.

The Company has accrued preferred stock dividends of $13,367 which are unpaid at June 30, 2005.

The Company granted 250,000 common stock options valued at $247,447 for professional business services.

During the six months ended June 30, 2004, the Company had the following non-cash transactions:

The Company issued 25,000 shares of common stock along with debt. Such stock was valued at $64,000 and recorded as a discount on the note payable.

The Company granted 20,000 common stock options valued at $26,000 to an employee.

The Company issued 200,000 warrants valued at $256,396 for professional business advisory services.

The Company issued 33,975 common shares valued at $44,168 related to a private placement.

The Company issued 62,500 shares of common stock valued at $118,750 for professional business advisory services.

The Company issued 2,500 shares of preferred stock as payoff of outstanding bridge loans of $250,000.

Certain stockholders exchanged 180,100 common shares valued at $234,130 for 2,346 preferred shares.

The Company has recorded accrued dividends of $14,913 which are unpaid at June 30, 2004.

The Company acquired property and equipment with a recorded value of $63,442, of which $11,356 was paid with cash. The following details non-cash components of the acquisition:

| | |
|---|---|
| Net Book Value of old asset traded-in for new asset | $ 32,702 |
| Reduction in trade-in value for balance of note payable on old asset | (20,642) |
| Amount of note payable created as partial consideration of new asset acquisition | 40,026 |
| | $ 52,086 |

See notes to unaudited condensed consolidated financial statements.

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**QUEPASA CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Condensed Consolidated Statements**

**Note 1 Description of Business and Summary of Significant Accounting Policies**

Quepasa Corporation, (the Company or Quepasa), a Nevada Corporation, was incorporated in June 1997. The Company is a Spanish/English language Internet Portal and directory search platform with a proprietary search engine targeting the U.S. Hispanic and Latin American markets. The Company s web site provides users unique search engine capabilities and pay-per-performance marketing applications as well as traditional portal services centered around the Spanish market. The Quepasa.com web site is operated and managed by the Company s majority owned Mexico-based subsidiary, Quepasa.com de Mexico. Because the language preference of many U.S. Hispanics is English, it also offers users the ability to access information and services in the English language.

Concentrations of Credit Risk and Significant Customers

Financial instruments, which potentially subject the Company to concentration of credit risk, consist principally of cash and cash equivalents. The Company places their temporary cash investments with what management believes are high-credit, quality financial institutions.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

The Company recognizes revenue on arrangements in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104 Revenue Recognition, and Emerging Issues Task Force Issue 00-21, Revenue Arrangements with Multiple Deliverables. In all cases, revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed, and collectibility of the resulting receivable is reasonably assured.

Revenue is primarily generated from pay-for-performance search advertisements and banner advertisements. The Company recognizes revenue related to banner advertisements ratably over the contract period. Pay-for-performance search revenue is recognized in the period in which the click-throughs occur. Click-throughs are defined as the number of times an internet user clicks on an advertisement or search result.

Pay-for-performance revenue is recognized when there is evidence that the qualifying transactions have occurred.

*Pay-for-Performance Revenue*. Pay-for-performance search advertisements are recognized in the period in which the click-throughs occur. Click-throughs are defined as the number of times a user clicks on an advertisement or search result. Pay-for-performance revenue is recognized when there is evidence that the qualifying transactions have occurred. During the three months ended June 30, 2005 and 2004, pay-for-performance revenue accounted for 98% and 99% of total revenue, respectively. For the six months ended June 30, 2005 and 2004, pay-for-performance revenue accounted for 99% and 83% of total revenue, respectively.

*Banner Advertising Revenue.* The Company recognizes revenue related to banner advertisements ratably over the contract period. During the three months ended June 30, 2005 and 2004, banner advertising revenue accounted for 0% and 1% of total revenue, respectively. For the six months ended June 30, 2005 and 2004, banner advertising revenue accounted for 0% and 17% of total revenue, respectively. Payments received from advertisers prior to displaying their advertisements on our website are recorded as deferred revenue, as are all payments received from advertisers for performance based marketing initiatives.

Customers generally make advance deposits, which are recorded as deferred revenue, for pay-for-performance services which are recorded as revenue when an internet user clicks on a sponsored advertisement. Most advertisers utilize self-service tools to open and manage accounts online including tracking, price management and measurement features.

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**Note 2 Basis of Presentation**

The Company s accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for financial information and pursuant to rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for a complete financial statement presentation. In the Company s opinion, such unaudited information reflects all adjustments, consisting only of normal recurring adjustments, necessary to present the financial position and results of operations for the periods presented. The Company s results of operations for interim periods are not necessarily indicative of the results to be expected for a full fiscal year. The Company s condensed consolidated balance sheet as of December 31, 2004 was derived from its audited consolidated financial statements as of that date but does not include all the information and footnotes required by accounting principles generally accepted in the United States of America. The Company suggests that these unaudited condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements included in its Annual Report on Form 10-KSB as of and for the year ended December 31, 2004, plus other SEC filings made by the Company from time to time.

**Note 3 Liquidity**

The Company has incurred net losses from operations since inception and has an accumulated deficit of approximately $113.1 million through June 30, 2005. There is no assurance that the Company will earn profits in the future.

In order to generate significant revenue in the future, the Company must continue to enhance and make more robust its information retrieval and successful direct marketing to potential advertising customers and distribution partners. The Company intends to price the retrieval and information technology services competitively against other retrieval companies.

The Company expects to continue to incur substantial costs, particularly general and administrative costs during 2005, and does not expect sufficient revenue to be realized to offset these costs until later in 2005. The Company believes that its current cash balances, cash generated from its operations, and its financing activities are sufficient to finance its business objective through the next twelve months.

**Note 4 Stockholders Equity**

Common Stock Transactions

In January 2005, the Company completed an offering of common stock, $.001 par value, under a Selling Agreement, under which the Company issued 80,000 units for proceeds of $435,000, net of commissions of $65,000. Each unit is comprised of two shares of common stock and one warrant, for .4 of 1 share of common stock, resulting in the issuance of 160,000 shares of common stock and 64,000 warrants valued at $182,146. These warrants are exercisable by the holders at $4.50 per share through January 3, 2007.

In January 2005, the Company issued 40,045 shares of common stock valued at $49,255 for preferred stock dividends.

During the six months ended June 30, 2005, the Company converted 3,337 shares of preferred stock to 271,299 shares of common stock.

Subsequent to June 30, 2005, the Company committed to issuing 50,780 additional shares of common stock valued at $114,763, associated with a private placement.

Preferred Stock

During the six months ended June 30, 2005, certain preferred shareholders converted 3,337 shares of preferred stock valued at $217,855 to 271,299 shares of common stock.

In June 2005, the Company recorded accrued dividends of $13,367 related to the preferred stock.

Warrants

In January 2005, the Company issued 64,000 warrants valued at $182,146 related to a private placement.

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Stock Options

The Company has a stock-based compensation plan, which is fully described in Note 1 to the Audited Consolidated Financial Statements included in the Company s annual report on Form 10-KSB for the year ended December 31, 2004. The Company accounts for those plans using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The Company granted 1,200,000 stock options during the six months ended June 30, 2005, which expire at various times between May and June 2012. The Company granted 140,000 stock options during the six months ended June 30, 2004, which expire at various times between January and March 2011, all of which vested upon issuance. Stock based compensation totaled $247,447 and $26,000 for the six months ended June 30, 2005 and 2004, respectively.

Had compensation cost for the Company s stock-based employee compensation plans been determined based on the fair value of such awards at the grant dates consistent with the provisions of SFAS No. 123, the Company s total and per share net income would be reduced as follows:

| | For the 6 Months Ended June 30, | |
|---|---|---|
| | **2005** | **2004** |
| Net loss, as reported | $ (1,563,434) | $ (1,775,503) |
| Add back: stock based compensation expense recognized, net of related tax effects | 247,447 | 26,000 |
| Pro forma effect of stock based compensation expense determined under the fair value method for all awards, net of related tax effects | (1,511,310) | (274,333) |
| Net loss, pro forma | $ (2,827,297) | $ (2,023,836) |
| Basic loss per common share, as reported | $ (.22) | $ (.43) |
| Basic loss per common share, pro forma | $ (.40) | $ (.49) |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used:

| | For the 6 Months Ended June 30, | |
|---|---|---|
| | **2005** | **2004** |
| Approximate risk free rate | 4.5% | 4.5% |
| Average expected life | 3 years | 3 years |
| Dividend yield | 0% | 0% |
| Volatility | 123% | 274% |
| Estimated per share weighted average fair value of total options granted | $ 1.26 | $ 1.22 |

**Note 5 Commitments and Contingencies**

Litigation

On June 14, 2004, TIABFES, a California Corporation doing business as New Capital Advisors, filed suit against Quepasa Corporation, et. al., in the United States District Court for the Central District of California in Los Angeles, CA. The civil action was brought in connection with a claim by the Plaintiff through the Plaintiff s counsel, Sarah Jane Barney, Esq., for damages associated with an alleged professional financial advisory and business strategy services agreement. The action seeks damages under various causes of action, in amounts up to $2 million.

During August 2005, the Company formally agreed to dismiss the lawsuit it filed against TIABFES Corp. d/b/a New Capital Advisors ( New Capital ) in Superior Court at Phoenix, Arizona (#CV2004-015723) on August 13, 2004 and New Capital agreed to dismiss the lawsuit it filed against the Company in United States District Court, Central District of California (#04-4198) on June 14, 2004. On the same date, the Company agreed to transfer approximately 20,000 shares of its Common Stock to an assignee of New Capital in exchange for certain future Investor Relations services. No cash was paid to New Capital by Quepasa for the purpose of settling the lawsuit.

On March 14 2005, Mr. Craig Behar, filed case no. CV2005-004439 against Quepasa Corporation, et. al., in the Maricopa County Superior Court at Phoenix, AZ. The civil action was brought in connection with a claim by the Plaintiff for damages associated with an alleged employment agreement. The action seeks damages under various causes of action, in amounts up to $418,700.

The Company has reviewed the claims with its counsel, finds the claims to be wholly without merit, and intends to vigorously defend them. Moreover, management believes that the amount claimed has been grossly overstated, in an attempt to induce the company to settle the action rather than litigate it.

The Company is not aware of any additional pending legal proceedings against it that, individually or in the aggregate, would have a material adverse effect on our business, operating results or financial condition. The Company may in the future be party to litigation arising in the course of its business, including claims that the Company allegedly infringes third-party trademarks and other intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Quepasa Corporation and Subsidiaries

Phoenix, Arizona

We have audited the accompanying consolidated balance sheet of Quepasa Corporation and Subsidiaries as of December 31, 2004, and the related consolidated statements of operations, stockholders equity and cash flows for the years ended December 31, 2004 and 2003. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Quepasa Corporation and Subsidiaries as of December 31, 2004, and the results of their operations and their cash flows for the years ended December 31, 2004 and 2003 in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the consolidated balance sheet as of December 31, 2004, and the related consolidated statements of operations and changes in stockholders equity for the year then ended have been restated.

/s/ Ehrhardt Keefe Steiner & Hottman PC

Ehrhardt Keefe Steiner & Hottman PC

March 11, 2005 (except as to the

restatement discussed in Note 1,

as to which the date is July 15, 2005)

Denver, Colorado

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**QUEPASA CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEET**

| | | December 31, 2004 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ | 3,069,571 |
| Accounts receivable trade | | 4,363 |
| Accounts receivable other | | 267 |
| Prepaid expenses | | 17,654 |
| Total current assets | | 3,091,855 |
| NON-CURRENT ASSETS: | | |
| Property and equipment net | | 234,159 |
| Deposits | | 27,535 |
| Total noncurrent assets | | 261,694 |
| Total assets | $ | 3,353,549 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ | 144,301 |
| Accrued and other current liabilities | | 55,345 |
| Dividends payable | | 49,247 |
| Commissions payable | | 347,588 |
| Deferred revenue | | 164,788 |
| Current portion of long-term debt | | 7,473 |
| Total current liabilities | | 768,742 |
| LONG-TERM DEBT net of current portion | | 29,388 |
| Total liabilities | | 798,130 |
| COMMITMENTS AND CONTINGENCIES (Note 6) | | |
| STOCKHOLDERS' EQUITY: | | |
| 10% Convertible Preferred stock, no par value; authorized 5,000,000 shares; 3,337 shares issued and outstanding at December 31, 2004 (liquidaton preference of $217,855) | | 217,855 |
| Common stock, $.001 par value; authorized 50,000,000 shares; 6,851,395 shares issued and outstanding | | 6,852 |
| Additional paid-in capital | | 113,856,594 |
| Accumulated deficit | | (111,515,865) |
| Foreign currency translation adjustment | | (10,017) |

| | | |
|---|---|---|
| Total stockholders' equity | | 2,555,419 |
| Total liabilities and stockholders' equity | $ | 3,353,549 |

See notes to consolidated financial statements.

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**QUEPASA CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

| | For the Years Ended December 31, | |
|---|---|---|
| | **2004** | **2003** |
| REVENUES | $ 465,481 | $ 5,774 |
| OPERATING COSTS AND EXPENSES: | | |
| Search services expenses | 330,278 | 19,015 |
| Sales and marketing expenses | 426,601 | 104,775 |
| Product and content development expenses | 157,625 | 89,278 |
| General and administrative | 2,327,146 | 2,407,331 |
| Depreciation and amortization | 370,497 | 271,232 |
| | 3,612,147 | 2,891,631 |
| LOSS FROM OPERATIONS | (3,146,666) | (2,885,857) |
| OTHER INCOME (EXPENSE): | | |
| Interest income and other | 7,430 | 18,496 |
| Interest expense | (78,013) | (2,984) |
| TOTAL OTHER INCOME (EXPENSE) | (70,583) | 15,512 |
| NET LOSS | (3,217,249) | (2,870,345) |
| Preferred stock dividends | (64,160) | |
| Deemed preferred stock dividend | (1,897,700) | (34,286) |
| Net loss attributable to common stockholders | $ (5,179,109) | $ (2,904,631) |
| NET LOSS PER COMMON SHARE, BASIC AND DILUTED | $ (.70) | $ (1.25) |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING BASIC AND DILUTED | 4,612,198 | 2,294,592 |
| NET LOSS | $ (3,217,249) | $ (2,870,345) |
| Foreign currency translation adjustment | 5,379 | (3,720) |
| COMPREHENSIVE LOSS | $ (3,211,870) | $ (2,874,065) |

See notes to consolidated financial statements.

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**QUEPASA CORPORATION**

**Consolidated Statement of Changes in Stockholders' Equity**

**For the Years Ended December 31, 2004 and 2003**

| | Preferred Stock | | Common Stock | | Additional Paid-in | | Foreign Currency | Total |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Capital | Accumulated Deficit | Translation Adjustment | Stockholders' Equity |
| Balance December 31, 2002 | 300 | $ 29,980 | 1,476,065 | $ 1,476 | $ 105,135,054 | $ (103,432,125) | $ (11,676) | $ 1,722,709 |
| Effect of reverse split | | | 205 | | | | | |
| Issuance of stock and stock options in acquisition | | | 1,317,332 | 1,318 | 247,778 | | | 249,096 |
| Deemed preferred stock dividend | | | | | 34,286 | (34,286) | | |
| Issuance of stock and stock options for compensation | | | 525,000 | 525 | 870,782 | | | 871,307 |
| Return and cancellation of stock from employees | | | (200,000) | (200) | 200 | | | |
| Issuance of stock and warrants for cash | 500 | 50,000 | 400,000 | 400 | 407,100 | | | 457,500 |
| Conversion of preferred stock to common stock | (800) | (79,980) | 88,000 | 88 | 79,892 | | | |
| Foreign currency translation adjustment | | | | | | | (3,720) | (3,720) |
| Net loss | | | | | | (2,870,345) | | (2,870,345) |
| Balance December 31, 2003 | | $ | 3,606,602 | $ 3,607 | $ 106,775,092 | $ (106,336,756) | $ (15,396) | $ 426,547 |
| Deemed preferred stock dividend | | | | | 1,897,700 | (1,897,700) | | |
| Issuance of common stock for cash, net of offering costs of $1,396,938 | | | 2,262,831 | 2,263 | 2,938,949 | | | 2,941,212 |
| Issuance of common stock for services | | | 115,000 | 115 | 216,769 | | | 216,884 |
| Issuance of preferred stock for cash, net of offering costs of $82,875 | 7,373 | 564,625 | | | | | | 564,625 |
| Issuance of preferred stock as payoff of bridge loan, net of offering cost of $32,500 | 2,500 | 217,500 | | | | | | 217,500 |
| Issuance of warrants for services | | | | | 1,159,611 | | | 1,159,611 |
| Issuance of additional common shares for extension of offering | | | 33,975 | 34 | 44,134 | | | 44,168 |
| Issuance of common stock in connection with bridge loan | | | 25,000 | 25 | 63,975 | | | 64,000 |
| Issuance of common stock for preferred dividends | | | 12,138 | 12 | 14,901 | (14,913) | | |
| Accrued dividends to preferred stockholders | | | | | | (49,247) | | (49,247) |
| Exchange of common for preferred | 10,002 | 999,730 | (768,225) | (768) | (998,962) | | | |
| Conversion of preferred to common | (16,538) | (1,564,000) | 1,344,552 | 1,344 | 1,562,656 | | | |
| Issuance of stock options for compensation | | | | | 26,000 | | | 26,000 |
| Exercise of common stock options | | | 219,522 | 220 | 155,769 | | | 155,989 |
| Foreign currency translation adjustment | | | | | | | 5,379 | 5,379 |
| Net loss | | | | | | (3,217,249) | | (3,217,249) |
| Balance December 31, 2004 | 3,337 | $ 217,855 | 6,851,395 | $ 6,852 | $ 113,856,594 | $ (111,515,865) | $ (10,017) | $ 2,555,419 |

See notes to unaudited condensed consolidated financial statements.

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**QUEPASA CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | For the Years Ended December 31, | |
|---|---|---|
| | **2004** | **2003** |
| OPERATING ACTIVITIES: | | |
| Net loss | $ (3,217,249) | $ (2,870,345) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 370,497 | 271,232 |
| Amortization of discount on note payable | 64,000 | |
| Warrants issued for professional services | 256,396 | |
| Issuance of additional common shares required in offering | 44,168 | |
| Issuance of common stock for services | 216,884 | 763,000 |
| Issuance of common stock options for compensation | 26,000 | 108,307 |
| Forgiveness of forgivable loans | 17,000 | 11,000 |
| Change in assets and liabilities: | | |
| Receivables | 18,701 | (22,462) |
| Prepaid expenses and other assets | (9,337) | 229,115 |
| Accounts payable and other current liabilities | 454,504 | (161,028) |
| Deferred revenue | 143,242 | 21,546 |
| Net cash used in operating activities | (1,615,194) | (1,649,635) |
| INVESTING ACTIVITIES: | | |
| Issuance of notes receivable | (17,000) | (11,000) |
| Purchase of property and equipment | (78,487) | (96,429) |
| Net cash used in investing activities | (95,487) | (107,429) |
| FINANCING ACTIVITIES: | | |
| Proceeds from issuance of preferred stock, net of commissions of $115,375 | 532,125 | 50,000 |
| Proceeds from issuance of common stock, net of commissions of $493,723 | 4,000,416 | 407,500 |
| Proceeds from issuance of notes payable, net of commissions of $25,000 | 225,000 | |
| Proceeds from short term note payable | | 16,000 |
| Payments on notes payable | (20,610) | (5,366) |
| Minority interest | | (48) |
| Net cash provided by financing activities | 4,736,931 | 468,086 |
| Foreign currency translation adjustment | 5,379 | (3,720) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 3,031,629 | (1,292,698) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 37,942 | 1,330,640 |

| | | |
|---|---|---|
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $ 3,069,571 | $ 37,942 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid for interest | $ 1,913 | $ 2,984 |
| Cash paid for income taxes | | |

(continued)

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(Continued from the previous page)

SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITY:

The Company recorded a deemed preferred dividend of $1,897,700 based on the beneficial conversion feature imbedded in the issued convertible preferred stock.

In January 2004, the Company issued 25,000 shares of common stock along with debt. Such stock was valued at $64,000 and recorded as a discount on the note payable.

In March 2004, the Company granted 20,000 common stock options valued at $26,000 to an employee in lieu of cash compensation pursuant to an employment agreement.

In April and May 2004, the Company issued an aggregated amount of 200,000 warrants valued at $256,396 for professional business advisory services.

In April 2004, the Company issued 33,975 common shares valued at $44,168 as consideration for extending the services related to a private placement.

In April 2004, the Company issued 62,500 shares of common stock valued at $118,750 for professional business advisory services related to a private placement.

In April 2004, the Company issued 2,500 shares of preferred stock as satisfaction of outstanding bridge loans of $250,000.

In April 2004, the Company acquired property and equipment with a recorded value of $63,442, of which $11,356 was paid with cash.

Non-cash components of the acquisition:

| | |
|---|---|
| Net Book Value of old asset traded-in for new asset | $ 32,702 |
| Reduction in trade-in value for balance of note payable on old asset | (20,642) |
| Amount of note payable created as partial consideration of new asset acquisition | 40,026 |

| | |
|---|---|
| | $ 52,086 |

In July 2004, the Company issued 12,138 shares of common stock valued at $14,913 for preferred stock dividends.

In August and December 2004, the Company issued an aggregate amount of 52,500 shares of common stock valued at $98,134 to certain employees for compensation.

In September and December 2004, the Company issued an aggregate amount of 338,000 warrants valued at $903,215 related to the cost of raising capital.

In December 2004, the Company recorded accrued dividends of $49,247 related to the preferred stock.

During 2004, certain stockholders exchanged 768,225 common shares valued at $999,730 for 10,002 preferred shares.

During 2004, certain stockholders converted 16,538 preferred shares valued at $1,564,000 to 1,344,552 common shares.

In March 2003, the Company recorded a preferred stock dividend of $34,286 based on the discount feature included in recently issued convertible preferred stock.

In June 2003, the Company issued 598,788 shares of common stock, valued at $119,758, as contingent consideration for the acquisition of Vayala Corporation. The value of these shares has been recorded as an increase to acquired software.

In August 2003, the Company issued 718,544 shares of common stock valued at $129,338, for options granted as contingent consideration for the acquisition of Vayala Corporation. The value of these shares has been recorded as an increase to acquired software.

In September 2003, the Company issued stock awards to certain employees and a director of the company in the amount of 525,000 shares of common stock, valued at $763,200. However, 200,000 shares of the common stock issued were returned to the Company and cancelled in December 2003.

In September 2003, the Company issued 45,455 common stock options valued at $75,001 to an employee in lieu of cash compensation pursuant to an employment agreement.

In December 2003, the Company issued 42,700 common stock options valued at $33,306 to an employee in lieu of cash compensation pursuant to an employment agreement.

In December 2003, the Company issued 33,000 shares of common stock upon conversion of $29,980 of convertible preferred stock issued in November 2002 and 55,000 shares of common stock upon conversion of $50,000 of convertible preferred stock issued in January 2003.

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**Notes To Consolidated Financial Statements**

**QUEPASA CORPORATION**

**Note 1 Description of Business and Summary of Significant Accounting Policies**

Quepasa Corporation, (the Company or Quepasa), a Nevada Corporation, was incorporated in June 1997. The Company is a Spanish/English language Internet Portal with a proprietary search engine targeting the U.S. Hispanic and Latin American markets. The Company s web site provides users unique search engine capabilities and pay-per-performance marketing applications as well as traditional portal services centered around the Spanish market. The Quepasa.com web site is operated and managed by the Company s majority owned Mexico-based subsidiary, Quepasa.com de Mexico. Because the language preference of many U.S. Hispanics is English, it also offers users the ability to access information and services in the English language.

In August 2003, the Company s stockholders approved a change in the Company s name from quepasa.com, Inc. to Quepasa Corporation.

Restatement of Consolidated Financial Statements

The Company is restating its consolidated financial statements as of December 31, 2004 and for the year then ended to properly reflect the beneficial conversion feature amounting to $1,897,700 imbedded in the Company s preferred stock. In accordance with Emerging Issues Task Force ( EITF ) No. 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments , and EITF No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios (see Note 7 Stockholders Equity for additional information). The value of this beneficial conversion feature was previously not recorded.

A summary of the effects of these changes on the Company s consolidated balance sheet as of December 31, 2004 and the statement of operations for the year then ended is as follows:

| | As restated | As originally reported |
|---|---|---|
| Balance Sheet | | |
| Additional paid-in capital | $ 113,856,594 | $ 111,958,894 |
| Accumulated deficit | $ (111,515,865) | $ (109,618,165) |
| Total stockholders equity | $ 2,555,419 | $ 2,555,419 |
| Statement of Operations | | |

| | | | | |
|---|---|---|---|---|
| Net loss | $ | (3,217,249) | $ | (3,217,249) |
| Deemed preferred stock dividend | $ | (1,897,700) | | |
| Net loss attributable to common stockholders | $ | (5,179,109) | $ | (3,281,409) |

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Quepasa Corporation, and its subsidiaries, Vayala Corporation and quepasa.com de Mexico. All intercompany accounts and transactions have been eliminated in consolidation. All Vayala assets and liabilities have been transferred to Quepasa Corporation as of December 31, 2003.

Cash and Cash Equivalents

The Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. The Company continually monitors its positions with, and the credit quality of, the financial institutions it invests with. Periodically throughout the year, the Company has maintained balances in various operating accounts in excess of federally insured limits.

Concentrations of Credit Risk

Financial instruments, which potentially subject the Company to concentration of credit risk, consist principally of cash and cash equivalents. The Company places its temporary cash investments with what management believes are high-credit, quality financial institutions.

Property and Equipment

Property and equipment is stated at cost. Depreciation is provided utilizing the straight-line method over the estimated useful lives for owned assets, ranging from 2 to 10 years.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

Revenue Recognition

In the spring of 2002, the Company s founder re-joined the Company and began efforts in the development of a new business model. During the last quarter of 2003, the Company began to generate revenue under this new business model. Additional revenue growth has been generated during the year ended December 31, 2004.

The Company recognizes revenue on arrangements in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104 Revenue Recognition, and Emerging Issues Task Force Issue 00-21, Revenue Arrangements with Multiple Deliverables. In all cases, revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed, and collectibility of the resulting receivable is reasonably assured.

Revenue is primarily generated from pay-for-performance search advertisements and banner advertisements. The Company recognizes revenue related to banner advertisements ratably over the contract period. Pay-for-performance search advertisements are recognized in the period in which the click-throughs occur. Click-throughs are defined as the number of times an internet user clicks on an advertisement or search result. Pay-for-performance revenue is recognized when there is evidence that the qualifying transactions have occurred.

Customers generally make advance deposits, which are recorded as deferred revenue, for pay-for-performance services which are recorded as revenue when an internet user clicks on a sponsored advertisement. Most advertisers utilize self-service tools to open and manage accounts online including tracking, price management and measurement features.

Income Taxes

The Company recognizes deferred tax liabilities and assets based on the differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements that will result in taxable or deductible amounts in future years. The Company s temporary differences result primarily from net operating loss carryforwards.

Advertising Costs

The Company expenses advertising costs as incurred. Advertising expense for the years ended December 31, 2004 and 2003 was approximately $15,020 and $3,200 respectively.

Reclassifications

Certain amounts in the 2003 consolidated financial statements have been reclassified to conform to the 2004 presentation.

Comprehensive Income

The Company has adopted SFAS No. 130, Reporting Comprehensive Income. The statement establishes standards for reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. The statement requires that all items that are required to be recognized under accounting standards as components of comprehensive income be disclosed in the financial statements. Comprehensive income is defined as the change in equity during a period from transactions and other events from non-owner sources. Comprehensive income is the total of net income and other comprehensive income.

Basic and Diluted Earnings (Loss) Per Common Share

In accordance with SFAS No. 128, Earnings Per Share , basic earnings (loss) per share is computed based upon the weighted average number of common shares outstanding during the period. The Company has presented only basic earnings (loss) per share as it had no dilutive potential common shares outstanding.

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

Recently Issued Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ( FASB ) issued a revision of Statement of Financial Accounting Standards No. 123, Share-Based Payment ( SFAS123R ). This statement revises FASB Statement No. 123, Accounting for Stock-Based Compensation and requires companies to recognize the cost of employee stock options and other awards of stock-based compensation based on the fair value of the award as of the grant date. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. This statement supersedes Accounting Principles Board ( APB ) Opinion No. 25, which allowed companies to compute compensation cost for each employee stock option granted as the amount by which the quoted market price of the common stock on the date of grant exceeds the amount the employee must pay to acquire the stock. The Company currently accounts for its stock option and stock-based compensation plans using the intrinsic-value method under APB Opinion No. 25. SFAS123R is effective as of the beginning of the first interim or annual period that begins after June 15, 2005. For a discussion of the pro forma effect on the Company s earnings for the two-year period ended December 31, 2004, had compensation cost for our stock-based compensation plans been recognized based on fair values as of the dates of grant, see Stock-Based Compensation in Note 1 of Notes to the Consolidated Financial Statements.

In December 2004 the Financial Accounting Standards Board ( FASB ) issued SFAS No. 153 Exchange of Nonmonetary Assets An Amendment of APB Opinion No. 29. SFAS No. 153 amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is to be applied prospectively for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. Our adoption of SFAS No. 153 is not expected to have a material impact on our financial position or results of operations.

Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recovered. The Company looks primarily to the undiscounted future cash flows in its assessment of whether or not long-lived assets have been impaired.

Fair Value of Financial Instruments

The carrying amounts of financial instruments including cash and cash equivalents, accounts receivable, prepaids and accounts payable approximated fair value as of December 31, 2004 and 2003 because of the relatively short maturity of these instruments.

The carrying amounts of notes payable and debt issued approximate fair value as of December 31, 2004 and 2003 because interest rates on these instruments approximate market interest rates.

Product and Content Development Costs

Costs incurred in the classification and organization of listings within the Company s website are charged to expense as incurred. In accordance with Statement of Position (SOP) 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, material software development costs, costs of development of new products and costs of enhancements to existing products incurred during the application development stage are capitalized. Based upon the Company s product development process, and the constant modification of the Company s website, costs incurred by the Company during the application development stage have been insignificant.

In March 2000, EITF No. 00-02, Accounting for Website Development Costs, was issued which addresses how an entity should account for costs incurred in website development. EITF 00-02 distinguishes between those costs incurred during the development, application and infrastructure development stage and those costs incurred during the operating stage. EITF 00-02 was effective on and after June 30, 2000 although early adoption was encouraged. The adoption of EITF No. 00-02 did not have a material impact on the Company s consolidated financial statements.

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

Stock-Based Compensation

The Company accounts for its stock option plan in accordance with the provisions of Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. As such, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. The Company has adopted the disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation, which permits entities to provide pro forma net earnings (loss) and pro forma net earnings (loss) per share disclosures for employee stock option grants as if the fair-value-based method as defined in SFAS No. 123 had been applied.

The Company uses the Black-Scholes model (Model), for purposes of valuing its stock option grants. The Model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, it requires the input of highly subjective assumptions, including the expected stock price volatility, expected dividend yields, the risk free interest rate, and the expected life. Because the Company s stock options have characteristics significantly different from those of traded options, and because changes in subjective input assumptions can materially affect the fair value estimate, in management s opinion, the value determined by the Model is not necessarily indicative of the ultimate value of the granted options.

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 148 ( SFAS 148 ), Accounting for Stock-Based Compensation Transition and Disclosure. Accordingly, no compensation cost is recognized for the issuances of stock options to employees when the exercise price approximates market. Pursuant to the Accounting Principles Board Opinion No. 25 the Company would recognize compensation expense on issuances of stock options to employees when the exercise price is less than the fair value of the stock. Had compensation cost for the Company s option plan been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS 148, the Company s net loss and basic loss per common share would have been changed to the pro forma amounts indicated below:

| | For the 12 months Ended December 31, | |
|---|---|---|
| | **2004** | **2003** |
| Net loss as reported | $ (3,217,249) | $ (2,870,345) |
| Add back: stock based compensation expense recognized, net of related tax effects | 124,134 | 871,307 |
| Pro forma effect of stock based compensation expense determined under the fair value method for all awards, net of related tax effects. | (248,333) | (2,657,598) |
| Net loss pro forma | $ (3,341,448) | $ (4,656,636) |
| Basic loss per common share as reported | $ (.70) | $ (1.25) |

| | | | | |
|---|---|---|---|---|
| Basic loss per common share pro forma | $ | (.72) | $ | (2.03) |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used:

| | For the Years Ended December 31, | |
|---|---|---|
| | **2004** | **2003** |
| Approximate risk free rate | 4.5% | 4.5% |
| Average expected life | 3 years | 3 years |
| Dividend yield | 0% | 0% |
| Volatility | 274% | 276% |
| Estimated per share weighted average fair value of total options granted | $ 1.51 | 1.16 |

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

**Note 2 Liquidity**

The Company has incurred net losses from operations since inception and has an accumulated deficit of approximately $111.5 million through December 31, 2004.

In the spring of 2002, the Company s founder re-joined the Company and began efforts in the development of a new business model. The new revenue model includes offering Internet search and retrieval capacities for wholesale users, and paid link capabilities for advertisers. Because the Company intends to target online content providers who in turn service a large number of users, the Company believes it can limit its advertising and marketing expenses. In order to generate significant revenue in the future, the Company must continue to enhance and make more robust its information retrieval and successfully direct marketing to potential advertising customers and distribution partners. The Company intends to price the retrieval and information technology services competitively against other retrieval companies.

During 2004, we obtained gross proceeds of $4.8 million from the combination of our equity financing agreements signed in January, August and November 2004 and funds received directly from accredited investors found apart from these financing agreements. We believe that our current cash balances, cash generated from our operations, and our financing activities are sufficient to finance our level of operations through the next twelve months.

The Company expects to continue to incur costs, particularly general and administrative costs during 2005, and does not expect sufficient revenue to be realized to offset these costs until later in 2005. The Company believes that its current cash balances, cash generated from its operations, and its financing activities are sufficient to finance its business objective through the next twelve months.

**Note 3 Acquisition of Vayala Corporation**

On October 30, 2002, the Company acquired 100% of the outstanding common stock of Vayala Corporation for a purchase price of $500,000, consisting of 500,000 shares of the Company s common stock valued at $1.00 per share. Vayala was engaged in the development of Internet information retrieval and management software technology products. Prior to the acquisition, Vayala was controlled by two officers/directors of the Company. In June 2003, the Company issued 598,788 shares of common stock, valued at $119,758, to the former stockholders of Vayala. The issuance of such shares represents contingent consideration related to the achievement of certain performance milestones by Vayala as defined in the acquisition agreement between the Company and Vayala. The performance milestones achieved relate to bringing Vayala s search and e-mail products fully on-line and to the attainment of certain growth requirements for search and e-mail databases. The value of these shares has been recorded as an increase to the software acquired in the original acquisition. In September 2003, the Company issued 718,544 shares of common stock, for cash of $1,437 to the former stockholders of Vayala upon the exercise of options to purchase the Company s common stock. Such options, with an exercise price of $0.002 per share, and valued at $127,901, were issued in August 2003 and were related to the achievement of certain milestones as previously mentioned.

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

**Note 4 Balance Sheet Disclosures**

Property and equipment consist of the following at December 31, 2004:

| | |
|---|---|
| Software | $ 489,449 |
| Computer equipment | 196,886 |
| Vehicles | 116,382 |
| Office furniture and equipment | 56,498 |
| Other equipment | 10,038 |
| Subtotal cost | 869,253 |
| Less accumulated depreciation and amortization | (635,094) |
| Net property and equipment | $ 234,159 |

Accrued and other current liabilities consist of the following at December 31, 2004:

| | |
|---|---|
| Payroll taxes | $ 38,299 |
| Other accrued expenses | 17,046 |
| Total | $ 55,345 |

**Note 5 Long-Term Debt**

Long-term debt consists of the following at December 31, 2004:

| | |
|---|---|
| Note payable to a financing company, due in monthly installments of $804 including principal and interest at 6.61% through May 2009, secured by a vehicle. | $ 36,861 |
| Less current portion | (7,473) |
| | $ 29,388 |

Maturities of long-term obligations are as follows:

| Year Ending December 31, | |
|---|---|
| 2005 | $ 7,473 |
| 2006 | 8,092 |
| 2007 | 8,490 |
| 2008 | 9,069 |
| 2009 | 3,737 |
| | $ 36,861 |

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**Notes To Consolidated Financial Statements  (Continued)**

**QUEPASA CORPORATION**

**Note 6  Commitments and Contingencies**

Operating Leases

The Company leases its facilities under non-cancelable operating leases. Rent expense for these leases was:

| Year Ended December 31, | |
|---|---|
| 2004 | $ 146,696 |
| 2003 | $ 95,971 |

Future minimum lease payments under these leases are as follows:

| Year Ending December 31, | |
|---|---|
| 2005 | $ 78,200 |

Employment Agreements

The Company has entered into employment and other agreements with all of its employees and all of its executive officers and non-employee directors. During 2004 and 2003, the Company satisfied all its obligations under these agreements. The agreements are for terms varying from one to two years with its employees and call for base salaries of no higher than $120,000, which was the salary of the Company s chief executive officer for the year ended December 31, 2004.

Litigation

On June 14, 2004, TIABFES, a California Corporation doing business as New Capital Advisors, filed suit against Quepasa Corporation, et. al., in the United States District Court for the Central District of California in Los Angeles, CA. The civil action was brought in connection with a claim by the Plaintiff through the Plaintiff s counsel, Sarah Jane Barney, Esq., for damages associated with an alleged professional financial advisory and business strategy services agreement. The action seeks damages under various causes of action, in amounts up to $2 million.

The company has reviewed the claims with its counsel, finds the claims to be wholly without merit, and intends to vigorously defend them. Moreover, management believes that the amount claimed has been grossly overstated, in an attempt to induce the company to settle the action rather than litigate it.

On March 14 2005, Mr. Craig Behar, filed case no. CV2005-004439 against Quepasa Corporation, et. al., in the Maricopa County Superior Court at Phoenix, AZ. The civil action was brought in connection with a claim by the Plaintiff for damages associated with an alleged employment agreement. The action seeks damages under various causes of action, in amounts up to $418,700.

The company has reviewed the claims with its counsel, finds the claims to be wholly without merit, and intends to vigorously defend them. Moreover, management believes that the amount claimed has been grossly overstated, in an attempt to induce the company to settle the action rather than litigate it.

The Company is not aware of any additional pending legal proceedings against it that, individually or in the aggregate, would have a material adverse effect on our business, operating results or financial condition. The Company may in the future be party to litigation arising in the course of its business, including claims that the Company allegedly infringes third-party trademarks and other intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

**Note 7 Stockholders Equity**

On June 21, 2004, the Company filed a Registration Statement under the Securities Act of 1933 for an aggregate of 2,515,096 shares of common stock for sale, comprised of 651,231 shares of common stock, 1,463,865 shares of common stock issuable upon conversion of preferred stock and 400,000 shares of common stock issuable upon exercise of common stock warrants. On July 6, 2004, the Registration Statement was declared effective by the Securities and Exchange Commission.

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

Common Stock Transactions

In June 2003, the Company issued 598,788 shares of common stock, valued at $119,758, to the former stockholders of Vayala. The issuance of such shares represents contingent consideration related to the achievement of certain performance milestones by Vayala as defined in the acquisition agreement between the Company and Vayala. The performance milestones achieved relate to bringing Vayala s search and e-mail products fully on-line and to the attainment of certain growth requirements for search and e-mail databases. The value of these shares has been recorded as an increase to the software acquired in the original acquisition. In August 2003, the Company issued options, with an exercise price of $0.002 per share, and valued at $127,901, related to the achievement of these same milestones. In September 2003, the Company issued 718,544 shares of common stock, for cash of $1,437, to the former stockholders of Vayala upon the exercise of the options.

In August 2003, the Company issued an additional 205 shares of common stock to current shareholders to reflect the shareholder approved reverse split on a one for 20 shares basis.

In August 2003, the Company issued 525,000 shares of common stock to certain employees of the Company as compensation for services valued at $763,000. For company performance reasons, 200,000 shares of the common stock issued were returned to the Company in December 2003.

In August and September 2003, the Company issued a total of 300,000 shares of common stock for cash of $307,500 to three accredited private investors.

In December 2003, the Company issued 100,000 shares of common stock and 100,000 warrants to purchase shares of common stock at a price of $2.60 that expire on December 31, 2005 to an accredited investor for cash of $100,000. As a fee for the service of finding this accredited investor, the Company also issued warrants to an individual to purchase 100,000 shares of common stock at the price of $2.60 that expire on December 31, 2005.

In September and December 2003, the Company issued a total of 88,155 options valued at $108,307 to purchase the common stock of the Company as compensation to an employee of the Company.

In December 2003, the Company issued 88,000 shares of common stock upon conversion of $79,980 of convertible preferred stock.

In January 2004, the Company initiated an offering of common stock, $.001 par value, under an Financial Advisory Services Agreement with a proposed closing date of April 9, 2004. During the year ended December 31, 2004, the Company issued 739,500 shares of common stock under this agreement for proceeds of $865,215, net of commissions of $96,135.

In April 2004, the Company elected to keep open the private placement for common stock under the Financial Advisory Services Agreement. As a result, the Company issued an additional aggregate amount of 33,975 shares of common stock as consideration for this extension, valued at $44,168 to all subscribers in place under the common stock private placement as of April 9, 2004.

In July 2004, the Company issued 12,138 shares of common stock valued at $14,913 for preferred stock dividends.

In September 2004, the Company initiated a second offering of its common stock under a new Financial Advisory Services Agreement, under which the Company issued 250,000 units for proceeds of $450,000, net of commissions of $50,000. Each unit is comprised of two shares of common stock and one warrant, resulting in the issuance of 500,000 shares of common stock and 250,000 warrants valued at $317,168. The warrants are exercisable by the holders at $2.00 per share through December 31, 2007. In addition, the Company issued warrants to the placement agent valued at $70,930 which is included in additional paid-in capital and also recorded as a cost of raising capital.

In November 2004, the Company initiated a third offering of its common stock under a Selling Agreement, under which the Company issued 427,800 units for proceeds of $2,326,162, net of commissions of $347,588. Each unit is comprised of two shares of common stock and one warrant, for .4 of 1 share of common stock, resulting in the issuance of 855,600 shares of common stock and 342,240 warrants valued at $974,029. These warrants are exercisable by the holders at $4.50 per share through January 3, 2007. In addition, the Company issued 278,000 warrants to the selling agents valued at $832,285 which is included in additional paid-in capital and also recorded as a cost of raising capital. Subsequent to December 31, 2004, the Company issued an additional 80,000 units resulting in the issuance of 160,000 shares of common stock and 64,000 warrants for proceeds of $435,000, net of commissions of $65,000.

During 2004, the Company issued 52,500 shares of common stock to 9 employees as compensation valued $98,134. In addition, the Company issued 62,500 shares of common stock valued at $118,750 for professional services.

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

During the year ended December 31, 2004, the Company issued 167,731 shares of common stock for cash of $203,050 to accredited private investors, 219,522 shares of common stock for cash of $155,989 upon exercise of stock options, and 25,000 shares of common stock valued at $64,000 in conjunction with the issuance of notes payable.

Subsequent to December 31, 2004, the Company issued 80,000 units for proceeds of $435,000, net of commissions of $65,000.

Private Placement Preferred Stock

In November 2002, the Company initiated an offering of up to $2,000,000 of 9.5% convertible, no par value, non-cumulative preferred stock at $100 per share under a Private Placement Memorandum. The preferred stock was convertible into common stock at any time at a 30% discount from the sales price of the common stock on the closing date of the conversion. The Company received $50,000 in January 2003 for the issuance of 500 shares of preferred stock under this private placement. In December of 2003, all outstanding preferred stock was converted into 88,000 shares of common stock. There was no preferred stock outstanding as of December 31, 2003.

In February 2004, the Company initiated an offering of up to $2,000,000 of its 10% convertible redeemable, no par value, Series A preferred stock at $100 per share under a Private Placement Memorandum. Dividends are required to be paid semi-annually at a rate of 10% in shares of the Company s common stock. Through this offering, the Company received $564,625, net of commissions of $82,875, for the issuance of 7,373 shares of preferred stock and received $217,500, net of commissions of $32,500 for the issuance of 2,500 shares of preferred stock as satisfaction of the outstanding bridge loans of $250,000.

The Company may redeem the preferred stock in whole or in part on ten days written notice to the holders based on the payment schedule below:

| Date of Redemption | Redemption Price Per Share | Payment of Redemption Price |
|---|---|---|
| On or before March 31, 2005 | $120 | $110 in cash, plus accrued dividends and $10 in common stock (1) |
| On or before March 31, 2006 | $115 | $110 in cash, plus accrued dividends and $5 in common stock (1) |
| On or before March 31, 2007 | $110 | $105 in cash, plus accrued dividends and $5 in common stock (1) |

(1) Common stock issued under the redemption provisions will be valued at the Conversion Price.

In May 2004, the Company offered an Exchange Agreement whereby certain investors could exchange their aggregate common shares for preferred stock at an equivalent value. As of December 31, 2004, the Company had received subscriptions to 10,002 shares of preferred stock in exchange for 768,255 shares of common stock valued at $999,730. As of December 31, 2004, all the available common shares have been exchanged for preferred shares under this agreement.

Pursuant to the PPM, the preferred shareholders may convert their shares into common stock at anytime. In addition, the Company has the right to cause the Investors in preferred shares to convert to common stock at any time after the closing price of the Company s stock has closed at or above $1.95 for 20 consecutive trading days. As of December 31, 2004, the Company has not caused the Investors to convert their outstanding shares of preferred stock. The preferred stock has a conversion price of $1.23 which is 75% of the average closing price of the common stock for the ten days preceding the effective date of the Registration Statement (July 6, 2004) under the Securities Act of 1933.

In accordance with Emerging Issues Task Force ( EITF ) No. 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments , and EITF No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios , and after considering the terms of the transaction, the Company recorded the effect of the imbedded beneficial conversion feature associated with the convertible preferred stock.

This beneficial conversion feature was measured as $1.9 million, which represents the difference between the fair value of the common stock and the effective conversion price. This beneficial conversion feature was recorded to additional paid-in capital as a deemed dividend to preferred stockholders.

As of December 31, 2004, certain preferred shareholders have elected to convert 16,538 shares of preferred stock valued at $1,564,000 to 1,344,522 shares of common stock.

In December 2004, the Company recorded accrued dividends of $49,247 related to the preferred stock.

Subsequent to December 2004, certain preferred shareholders have elected to convert 815 shares of preferred stock valued at $81,500 to 66,260 shares of common stock.

Stock Options

In October 1998, the Company adopted and later amended a Stock Option Plan (the Plan ), which provides for the granting of options to officers, directors, and consultants. The plan permits the granting of incentive stock options meeting the requirements of Section 422A of the Internal Revenue Code as well as nonqualified which do not satisfy the requirements of that section. 6,000,000 shares of common stock have been reserved under the plan for the granting of options. The Plan will be in effect until November 1, 2009, unless extended by the Company s stockholders. The options are generally exercisable to purchase stock for a period of ten years from the date of grant.

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

Incentive stock options granted pursuant to this Plan may not have an option price that is less than the fair market value of the stock on the date the option is granted. Incentive stock options granted to significant stockholders shall have an option price of not less than 110% of the fair market value of the stock on the date of the grant. Options granted under the plan vest one-third at the end of each of the three years of service following the grant date. The Board of Directors of the Company may waive the vesting requirements at its discretion. Except as noted, all stock options issued under the Plan are exercisable for a period of 7 to 10 years from the date of grant.

Stock-based compensation totaled $124,134 and $871,307 for the years ended December 31, 2004 and 2003, respectively, and is classified as sales and marketing, product and content development and general and administrative expenses in the accompanying financial statements.

The following table presents the activity for options outstanding:

| | Common Stock Options | Weighted Average Exercise Price |
|---|---|---|
| Outstanding December 31, 2002 | 107,125 | $ 134.200 |
| Granted | 3,003,399 | 1.150 |
| Forfeited/canceled | (105,250) | 136.000 |
| Exercised | (718,544) | 0.002 |
| Outstanding December 31, 2003 | 2,286,730 | $ 1.540 |
| Granted | 265,000 | 1.260 |
| Forfeited/canceled | (840,833) | 1.600 |
| Exercised | (219,522) | 0.710 |
| Outstanding December 31, 2004 | 1,491,375 | $ 1.570 |

On August 4, 2003, the shareholders of the Company approved to effect a reverse split of our Common Stock. The reverse split, as approved, combined our outstanding Common Stock on a 1 share for 20 shares basis.

The following table presents the composition of options outstanding and exercisable:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| **Range of Exercise Prices** | **Number** | **Price*** | **Life*** | **Number** | **Price*** |
| $0.75 | 20,000 | $ 0.75 | 6.6 | | $ |
| $1.25 $1.50 | 390,000 | $ 1.40 | 6.3 | 285,000 | $ 1.39 |
| $1.60 | 1,079,500 | $ 1.60 | 5.7 | 1,079,500 | $ 1.60 |
| $30.00 | 1,875 | $ 30.00 | 3.9 | 1,875 | $ 30.00 |
| Total December 31, 2004 | 1,491,375 | $ 1.57 | 6.4 | 1,366,375 | $ 1.60 |

* Price and Life reflect the weighted average exercise price and weighted average remaining contractual life, respectively.

Warrants

In December 2003, the Company issued 200,000 warrants to purchase shares of common stock at the price of $2.60 that expire on December 31, 2005.

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

As compensation for financial advisory services under a Financial Advisory Agreement, the Company issued three 25,000 warrant packages valued at $72,245 in total during the year ended December 31, 2004. The Company has accounted for the warrants as professional services and they are included in general and administrative expenses. The warrants are for the purchase of common stock and are exercisable for two years at prices of $1.50, $2.00 and $2.50 and expire ratably in February, March and April 2006. The warrants were valued using the Black-Scholes option-pricing model using assumptions as follows: expected dividend yield 0%, risk free interest rate of 4.5%, expected volatility 154%, and expected life of two years.

On May 5, 2004, as compensation for general business advisory services under a different business advisory agreement, the Company issued a 125,000 warrant package valued at $184,151. The Company has accounted for the warrants as professional services and they included in general and administrative expenses. The warrants are for the purchase of common stock and are exercisable for two years at a price of $2.00 and expire in May 2006. The warrants were valued using the Black-Scholes option-pricing model using assumptions as follows: expected dividend yield 0%, risk free interest rate of 4.5%, expected volatility 170%, and expected life of two years.

On September 15, 2004, as additional compensation for services related to the second offering of common stock, the Company issued a 60,000 warrant package valued at $70,930. The Company has accounted for the warrants as a cost of raising capital and included the value in additional paid in capital. The warrant package includes 50,000 and 10,000 warrants at prices of $2.00 and $2.60, respectively. The warrants are exercisable for two years and expire in September 2006. The warrants were valued using the Black-Scholes option-pricing model using assumptions as follows: expected dividend yield 0%, risk free interest rate of 4.5%, expected volatility 170%, and expected life of two years.

In September 2004, the Company issued to investors 250,000 warrants valued at $317,168 related to a private placement. The warrants are a part of the units offered to investors where each unit consisted of two shares of common stock and one warrant. The warrants are exercisable by the holders at $2.00 per share through December 31, 2007.

In December 2004, as compensation related to the third offering of common stock, the Company issued 278,000 warrants valued at $832,285. The Company has accounted for the warrants as a cost of raising capital and included the value in additional paid in capital. The warrants are for the purchase of common stock and are exercisable for two years at a price of $4.50 and expire in January 2007. The warrants were valued using the Black-Scholes option-pricing model using assumptions as follows: expected dividend yield 0%, risk free interest rate of 4.5%, expected volatility 172%, and expected life of two years.

On December 30, 2004, the Company issued to investors 342,240 warrants valued at $974,029 related to a private placement. The warrants are a part of the units offered to investors where each unit consisted of two shares of common stock and one warrant for .4 of 1 of common stock. The warrants are for the purchase of common stock and are exercisable for two years at a price of $4.50 and expire in January 2007.

Subsequent to December 31, 2004, the Company issued 64,000 warrants valued at $182,146 related to the above private placement.

**Note 8 Income Taxes**

The Company did not provide a current or deferred US federal, state or foreign income tax provision or benefit for any of the periods presented because it has experienced recurring operating losses. The Company has provided a full valuation allowance on the deferred tax asset, consisting primarily of the net operating losses, because it is more likely than not that the deferred tax asset will not be realized.

At December 31, 2004, the Company had net operating losses of approximately $68,620,000 related to US federal, foreign and state jurisdictions. Utilization of the net operating loss, which expires at various times starting in 2017 through 2024, may be subject to certain limitations under Section 382 of the Internal Revenue Code of 1986, as amended, and other limitations under state and foreign tax laws.

Actual income tax benefit differs from the amount calculated using the Federal statutory tax rate as follows:

| | 2004 | 2003 |
|---|---|---|
| Expected tax benefit | $ (1,094,000) | $ (976,000) |
| Effect of permanent differences | 33,000 | 37,000 |
| Change in valuation allowance for deferred tax assets | 1,490,000 | 980,000 |
| State tax benefit, net of federal provision (benefit) | (112,000) | (100,000) |
| Other | (317,000) | 59,000 |
| Income tax expense | $ | $ |

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company s deferred tax assets (liabilities) are approximately as follows:

| | December 31, | |
|---|---|---|
| | 2004 | 2003 |
| Net operating loss | $ 26,419,000 | $ 24,950,000 |
| Deferred revenue | 63,000 | |
| Fixed assets | (42,000) | |
| Total net deferred tax assets | 26,440,000 | 24,950,000 |
| Valuation allowance for deferred tax assets | (26,440,000) | (24,950,000) |
| Net deferred tax asset | $ | $ |

**Note 9 Loss Per Share**

The following table sets forth the computation for basic and diluted earnings per share:

| | For the Years Ended December 31, | |
|---|---|---|
| | 2004 | 2003 |
| Net loss | $ (3,217,249) | $ (2,870,345) |
| Basic earnings per share-weighted average shares | 4,612,198 | 2,294,592 |
| Basic and diluted loss per common share | $ (0.70) | $ (1.25) |

Where the inclusion of potential common shares is anti-dilutive, such shares are excluded from the computation. Such anti-dilutive potential shares amounted to 1,491,375 and 2,506,730 at December 31, 2004 and 2003, respectively.

**Note 10 Related Party Transactions**

On October 30, 2002, the Company acquired 100% of the outstanding common stock of Vayala Corporation for a purchase price of $500,000, consisting of 500,000 shares of the Company s common stock valued at $1.00 per share. Vayala was engaged in the development of Internet information retrieval and management software technology products. Prior to the acquisition, Vayala was controlled by two officers/directors of the Company. In June 2003, the Company issued 598,788 shares of common stock, valued at $119,758, to the former stockholders of Vayala. The issuance of such shares represents contingent consideration related to the achievement of certain performance milestones by Vayala as defined in the acquisition agreement between the Company and Vayala. The performance milestones achieved relate to bringing Vayala s search and e-mail products fully on-line and to the attainment of certain growth requirements for search and e-mail databases. The value of these shares has been recorded as an increase to the software acquired in the original acquisition. In September 2003, the Company issued 718,544 shares of common stock, for cash of $1,437 to the former stockholders of Vayala upon the exercise of options to purchase the Company s common stock. Such options, with an exercise price of $0.002 per share, and valued at $127,901, were issued in August 2003 and were related to the achievement of certain milestones as previously mentioned.

During 2004 and 2003, the Company made forgivable loans to employees of the Company totaling $17,000 and $11,000 respectively, all of which have been forgiven as of December 31, 2004.

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

**Note 11 Quarterly Financial Data Unaudited**

A summary of the quarterly data for the years ended December 31, 2004 and 2003 follows (in thousands, except net loss per share):

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter | Total |
|---|---|---|---|---|---|
| 2004 | | | | | |
| Revenue | $ 24 | $ 104 | $ 216 | $ 121 | $ 465 |
| Operating expenses | $ 662 | $ 1,170 | $ 893 | $ 887 | $ 3,612 |
| Loss from operations | $ (638) | $ (1,066) | $ (677) | $ (766) | $ (3,147) |
| Net loss | $ (657) | $ (1,118) | $ (676) | $ (766) | $ (3,217) |
| Net loss per share, basic and diluted | $ (0.17) | $ (0.25) | $ (0.15) | $ (0.13) | $ (0.70) |
| 2003 | | | | | |
| Revenue | $ 0 | $ 0 | $ 0 | $ 6 | $ 6 |
| Operating expenses | $ 334 | $ 471 | $ 1,492 | $ 595 | $ 2,892 |
| Loss from operations | $ (334) | $ (471) | $ (1,492) | $ (589) | $ (2,886) |
| Net loss | $ (324) | $ (469) | $ (1,489) | $ (588) | $ (2,870) |
| Net loss per share, basic and diluted | $ (0.22) | $ (0.29) | $ (0.62) | $ (0.12) | $ (1.25) |

**Note 12 Business Segment Information**

The Company conducts operations in the United States of America through the parent company, Quepasa Corporation, and in Mexico through the Company s Mexico-based subsidiary, quepasa.com de Mexico, which operates and manages the quepasa.com web site. The following presents segment information, by geographic area, for the Company for 2004 and 2003 (in thousands).

| | United States | Mexico | Total |
|---|---|---|---|
| 2004 | | | |
| Revenues | $ 465 | $ | $ 465 |
| Loss from operations | (3,111) | (36) | (3,147) |
| Other income (expense) | (71) | | (71) |
| Net loss | $ (3,181) | $ (36) | $ (3,217) |
| Depreciation and amortization | $ 350 | $ 20 | $ 370 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Capital expenditures | $ | 53 | $ | 31 | $ | 84 |
| Identifiable assets at December 31, 2004 | $ | 3,272 | $ | 82 | $ | 3,354 |
| 2003 | | | | | | |
| Revenues | $ | 6 | $ | | $ | 6 |
| Loss from operations | | (2,620) | | (266) | | (2,886) |
| Other income (expense) | | 16 | | | | 16 |
| Net loss | $ | (2,604) | $ | (266) | $ | (2,870) |
| Depreciation and amortization | $ | 252 | $ | 19 | $ | 271 |
| Capital expenditures | $ | 345 | $ | | $ | 345 |
| Identifiable assets at December 31, 2003 | $ | 506 | $ | 73 | $ | 579 |

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**Notes To Consolidated Financial Statements (Continued)**

**QUEPASA CORPORATION**

**Note 13 Subsequent Events**

On January 3, 2005, the Company issued 160,000 shares of common stock valued at $435 thousand, net of commissions, related to a private placement (Note 7 Common Stock Transactions)

On January 13, 2005, the Company issued 40,053 shares of common stock valued at $49,247 for preferred stock dividends.

On February 4, 2005, Brian Lu, resigned as a Director of the Company.

On March 3, 2005, Fernando Ascencio, President of Quepasa Corporation, was appointed Chief Executive Officer.

Subsequent to December 2004, certain preferred shareholders have elected to convert 815 shares of preferred stock valued at $81,500 to 66,260 shares of common stock.

On March 14 2005, Mr. Craig Behar, filed case no. CV2005-004439 against Quepasa Corporation, et. al., in the Maricopa County Superior Court at Phoenix, AZ. The civil action was brought in connection with a claim by the Plaintiff for damages associated with an alleged employment agreement. The action seeks damages under various causes of action, in amounts up to $418,700.

The Company has reviewed the claims with its counsel, finds the claims to be wholly without merit, and intends to vigorously defend them. Moreover, management believes that the amount claimed has been grossly overstated, in an attempt to induce the Company to settle the action rather than litigate it.