

MPHASE TECHNOLOGIES INC

Form 10-K/A

January 28, 2004

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934 (NO FEE REQUIRED) FOR THE YEAR ENDED JUNE 30, 2003

COMMISSION FILE NO. 000-24969

mPHASE TECHNOLOGIES, INC.

(Name of issuer in its charter)

NEW JERSEY

(State or other jurisdiction
of
incorporation or
organization)

22-2287503
(I.R.S. Employer
Identification Number)

**587 CONNECTICUT AVE.,
NORWALK,**

CT 06854-1711
(Zip Code)

(Address of principal executive offices)

Registrant's telephone number, including area code: (203) 838-2741

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT:

COMMON STOCK, NO PAR VALUE

(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, during the preceding 12 months (or for shorter period that the registrant was required to file such report), and (2) has been subject to such filing requirements for the past 90 days. Yes
No

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

As of August 11, 2003, there were 71,628,182 shares of common stock, no par value, stated value \$.01, outstanding and the aggregate market price of shares held by non-affiliates was approximately \$14,800,000 (Based upon a closing common stock price of \$.30 on August 11, 2003) (solely for the purpose of calculating the preceding amount, all directors and officers of the registrant are deemed to be affiliates.)

mPHASE TECHNOLOGIES, INC.

**ANNUAL REPORT ON FORM 10-K/A
FOR THE YEAR ENDED JUNE 30, 2003**

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PART I

FORWARD-LOOKING STATEMENTS

This report contains "forward-looking statements". In some cases, you can identify forward-looking statements by terms such as "may," "intend," "might," "will," "should," "could," "would," "expect," "believe," "estimate," "predict," the negative of these terms and similar expressions intended to identify forward-looking statements. These statements reflect the Company's current views with respect to future events and are based on assumptions and subject to risks and uncertainties. The Company discusses many of these risks and uncertainties in greater detail in Part I, Item 1 of this 10-K/A under the heading "Risk Factors." These risks and uncertainties may cause the Company's actual results, performance, or achievements to be materially different from any future results, performance, or achievements expressed or implied by the forward-looking statements. You should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent the Company's estimates and assumptions as of the date of this report. The Company is under no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

The following discussion should be read in conjunction with mPhase Technologies' financial statements and related notes included elsewhere in this report.

ABOUT THIS AMENDMENT

Management has reevaluated the adequacy clarity and completeness of the Form 10-K and certain disclosures in the accompanying consolidated financial statements including Schedule II (Valuation and Qualifying Accounts, Item 14B). As a result of this reevaluation, management has reissued the Form 10-K and the June 30, 2003 consolidated financial statements with expanded and clarified information.

The amendment includes expanded and clarified disclosure in the Consolidated Financial Statements, primarily note 10 and note 11, which begin on page F-1, technical and clerical edits, expanded and clarified disclosure in "Risk Factors", which begin on page 11, and Item 7 "Management's Discussion and Analysis of Financial Condition and Results and Plan of Operations", which begin on page 20 in addition to expanding information pertaining to the Company's equity and related parties discussed elsewhere in this Form 10-K/A as well as updated certifications by the certifying officers of the Company

The aforementioned changes to the consolidated financial statements have no effect on the financial position and results of operations for the year ended June 30, 2003 or the results of operations and loss per share for the years ended June 30, 2001, 2002 and 2003.

ITEM 1. BUSINESS

GENERAL DESCRIPTION OF THE BUSINESS

mPhase Technologies, Inc. ("mPhase" or the "Company") is a development stage technology company headquartered in Norwalk, Connecticut with offices in Little Falls, New Jersey and Atlanta, Georgia. The Company is a developer of broadband communications products, specifically, digital subscriber line ("DSL") products for telecommunications service providers around the world. mPhase shares common office space and common management with Microphase Corporation, a privately-held company. Microphase is a seller of radio frequency and filtering technologies to the defense and telecommunication industries. Microphase has been in operation for almost 50 years and supports mPhase with engineering, administrative and financial resources, as needed.

Since our inception in 1996, mPhase has been a development-stage company. Our primary activities have consisted of designing, manufacturing and testing our flagship products designed to deliver digital broadcast television over DSL. We have not, as yet, derived any significant revenue from such products.

mPhase introduced its first TV over DSL platform, the Traverser Digital Video and Data Delivery System ("DVDDS"), in 1998. The DVDDS is a patented end to end system that enables a telecommunications service

provider to deliver up to several hundred channels of motion picture experts group two (MPEG-2) standard broadcast digital television, high speed internet and voice over copper telephone lines between a central office facility of the provider and a customer's premise. mPhase has not, as yet, derived any material revenues from sales of the DVDDS. The DVDDS is a proprietary technology developed in conjunction with Georgia Tech Research Corporation which allows for the delivery of any channel to all users at any given time without any dilution in quality. The DVDDS consists of an Access Shelf located at a telephone service provider's central office (CO) and an Intelligent Network Interface (INI) set top box located in a customer's home. Because it is a proprietary end to end system, the DVDDS does not interoperate with other manufacturer's DSL central office (CO) equipment or customer premises equipment. The DVDDS utilizes Asymmetric DSL (ADSL) that allows for significantly more downstream than upstream bandwidth for transmission that is well suited for delivery of broadcast television. The system is the only system on the market that utilizes non- Internet Protocol (IP) transmission over ADSL. The DVDDS is installed at Hart Telephone Company in Hartwell, Georgia, where a limited user system is currently operational. A DVDDS system is also installed at the BMW manufacturing plant in Spartanburg, South Carolina for use as a television broadcast system in a commercial setting.

The mPhase TV+ platform, a new product recently developed in conjunction with Bell Laboratories, like the legacy DVDDS platform, is designed to allow for the simultaneous delivery of voice, high speed data, and broadcast TV over copper telephone lines between a telephone service provider's CO and the customer premises. The mPhaseTV+ platform formerly named Simple TV is a modular solution for delivery of several hundred broadcast television channels over ADSL that utilizes an industry-leading, standards-based Lucent Technologies, Inc.'s (Lucent) Stinger DSL Access Concentrator for transport of digital television plus high speed internet and voice. The mPhase TV+ platform consists of a cost reduced Traverser INI set top box located in a telephone customer's premises plus the Lucent Stinger located at the CO. A newly developed mPhase Broadcast Television Switch (BTS) interfaces with the Stinger and a video headend built by a telephone service provider to downlink broadcast television programming from satellites. The BTS formats the video data prior to the distribution to a customer by the Stinger and supports administrative tasks associated with subscriber management. The use of the Lucent Stinger (digital subscriber line access multiplexer commonly known as a DSLAM) for transport in the TV+ platform results in a highly scalable architecture for the delivery of video. This is accomplished by internally multicasting each television channel for delivery from the CO to a larger number of end users. We believe that the TV+ platform is the most cost-effective standards-based solution for delivery of broadcast television using ADSL. For mPhase the alliance with Lucent marks a change in strategy from selling a complete proprietary platform to providing an industry-standard modular solution.

Both the TV+ platform and the legacy DVDDS products are aimed for use in markets primarily outside of the United States that do not have a hybrid fiber coaxial cable (HFC) infrastructure necessary for cable TV or fiber to the curb necessary for very fast DSL (VDSL). We believe there is a significant cost advantage when our mPhase TV+ solution is compared against other platforms utilizing existing telephone lines containing the same features. The mPhase TV+ platform does not contain the features such as the delivery of two or more TV channels to a single set top box over copper telephone lines or video on demand and interactive TV features. As ADSL technology migrates forward to ADSL2 or ADSL2+, mPhase will include additional features to its TV+ platform in a modular scalable cost effective manner depending upon actual market demand for such features in markets that mPhase is targeting.

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We believe the legacy DVDDS developed by GTRC, when combined with a version of the cost-reduced Traverser INI set top box redesigned by Lucent, continues to be a cost effective TV platform. The DVDDS can be sold in international markets where primary demand is for multi-channel digital broadcast television plus voice only and there is little demand for high speed internet. We believe the mPhase TV+ platform is the optimal solution for both a telecommunications service provider and the ultimate customer who requires high-speed internet, voice and digital quality broadcast television over ADSL.

For those television markets in the United States that are not served by HFC, we believe that the availability of programming content is essential to facilitate potential sales of our TV platforms over ADSL. In March of 2000, we established mPhase Television net., Inc. (mPhase TV), a joint venture between mPhase and Alphastar International, Inc. mPhase TV is capable of contracts, licensing agreements, marketing and legal support to service providers interested in deploying television over ADSL for U.S. markets. mPhase TV has secured licenses to resell programming for approximately 80 channels of U.S. broadcast television. mPhase TV enables telecommunications service providers in the U.S. to provide customers a full complement of television programming. This enables a U.S. telecommunications service provider to avoid the necessity of securing such contracting rights individually with many different providers of broadcast television content. It is important to note that the role of mPhase TV has changed since its inception. Originally, mPhase TV was to utilize a satellite uplink/downlink facility and serve as an aggregator of television content. This would eliminate the need for a telecommunications service provider, purchasing a TV delivery platform from mPhase, from having to build a full scale television reception facility (head-end) to downlink broadcast television channels from satellites orbiting the earth. However, recent advances in technology have significantly reduced the costs for a telephone company to build a full scale headend. The role of mPhaseTV is now limited to providing the appropriate licenses and relationships as opposed to offering a content aggregation solution. As part of its cost reduction efforts mPhase terminated its lease of Alphastar's earth station satellite uplink and downlink facility in Oxford, CT to aggregate broadcast television content. mPhase owns approximately 57% of mPhase TV.

mPhase also has designed and markets a line of DSL component products ranging from items such as Plain Old Telephone Service (POTS) splitters to innovative loop management products. From our inception in 1996 to date virtually all of mPhase's revenue has been derived from sales of our DSL products such as POTS splitters and low pass filters. Our newest innovation in our suite of DSL component products is our iPOTS or Intelligent POTS splitter product. This product enables telephone service providers comprehensive remote and automated test access to all elements of a DSL network. The iPOTS, and iPOTS3 allow a telephone service provider to bypass POTS splitters on a DSL network and avoid having to manually intervene and disrupt line usage so a test signal can pass through a DSL network. This product marks an advancement in automating DSL loop management. As DSL deployments increase, it is becoming more important for telecommunications service providers to streamline the process for rolling-out and troubleshooting DSL services. Additionally, as competition for high speed Internet expands, the market is witnessing a reduction in the price for such service. Therefore, it has become imperative that telecommunications service providers lower the operational costs involved with supporting DSL services. Currently our iPOTS1 is designed for use with the Lucent Stinger, whereas, the iPOTS3 is compatible with DSLAM's manufactured by other vendors. mPhase currently has a non-exclusive worldwide distribution agreement with Corning Cable Systems for the sale of the iPOTS products. Such arrangement potentially expands exposure for this product, as Corning is one of the largest vendors of central office DSL filtering equipment. The Company is also aggressively pursuing direct efforts with respect to sales of the iPOTS product.

Business Development, Organization, and Acquisition Activities

mPhase was incorporated in New Jersey in 1979 under the name Tecma Laboratory, Inc. In 1987, the Company changed its name to Tecma Laboratories, Inc. As Tecma Laboratories, Inc., the Company was primarily engaged in the research, development and exploitation of products in the skin care field. On February 17, 1997, the Company acquired Lightpaths, Inc., a Delaware corporation, which was engaged in the development of telecommunications products incorporating DSL technology, and the Company changed its name to Lightpaths TP Technologies, Inc.

On January 29, 1997, the Company formed another wholly-owned subsidiary called TLI Industries, Inc. The shares of TLI were spun off to its stockholders on March 31, 1997 after the Company transferred the assets and liabilities, including primarily fixed assets, patents and shareholder loans related to the prior business of Tecma Laboratories. As a consequence of these transactions, the Company became the holding company of its wholly-owned subsidiary, Lightpaths, Inc. on February 17, 1997.

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On May 5, 1997, the Company completed a reverse merger with Lightpaths TP Technologies, Inc. and thereafter changed its name to mPhase Technologies, Inc. on June 2, 1997.

On March 26, 1998 the Company entered into a Licensing Agreement with Georgia Tech Research Corporation (GTRC) in which mPhase became the exclusive licensee of all patents received by GTRC in connection with development of the Traverser, GTRC receives a royalty equal to 5% of gross sales of the Traverser and 30% of any lump sum payments under the terms of its license, as amended.

On June 25, 1998, mPhase acquired Microphase Telecommunications, Inc., a Delaware corporation, from Microphase Corporation by issuing 2,500,000 shares of its common stock. Microphase Telecommunications' principal assets were patents and patent applications utilized in the development of its proprietary Traverser technology.

In March, 2000, mPhase entered into a joint venture with AlphaStar International, Inc. to form an entity called mPhaseTelevision.Net, Inc. in which the Company held a 50% interest. On May 1, 2000, the Company acquired an additional 6.5% interest in mPhaseTelevision.Net, Inc. and made it one of its consolidated subsidiaries.

On March 14, 2000, mPhase entered into an agreement with BMW Manufacturing Corp., located in South Carolina. Under the agreement, the Company installed version 1.0 of the Traverser for BMW's telephone transmission network. BMW has agreed that, upon its notice and consent, mPhase will be able to demonstrate to potential customers the functioning system at BMW's facilities. BMW has made two (2) subsequent purchases increasing the size of the deployment to 48 unique units.

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Our flagship installation, Hart Telephone, has completed the building and development of its digital headend during the fourth quarter of 2001. Hart currently has approximately 70 customers receiving about 80 channels of television services utilizing such platform.

In May of 2002 mPhase initiated discussion for development of a cost-reduced set top box (INI) with the Bell Laboratories division of Lucent Technologies, Inc.

Effective December 1, 2002, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. for the development of mPhase's broadcast television switch as an integrated platform with the Lucent Stinger DSL Access Concentrator.

On December 9, 2002, pursuant to a Statement of Work, Lucent commenced development of the BTS for mPhase.

On December 15, 2002, mPhase engaged Lucent for the cost reduction of its Traverser INI set top box.

On January 21, 2003 mPhase entered into a Co-Branding Agreement with Lucent Technologies under which mPhase's INI set top box would be co-branded with the Lucent Technologies name and logo.

On April 4, 2003, mPhase entered into a Systems Integration Agreement with Lucent Technologies. Under the terms of such an agreement mPhase has been given the exclusive rights to sell worldwide as a "bundled" solution the Stinger in connection with mPhase's BTS.

Our revenue, historically, has been derived exclusively from sales of DSL component telephone equipment parts, the majority of which has come from our sales of POTS Splitter Shelves. We have derived no material revenue to date with respect to our broadcast television over DSL platforms. In our fiscal years ended June 30, 2003 and June 30, 2002 we generated approximately \$1.6 million and \$2.6 million in revenue, respectively, from the commercial sale of our component products and overall losses for such years of \$6,650,211 and \$11,245,361, respectively. These component products, including filters and Central Office POTS Splitter Shelves, are marketed to other DSL equipment vendors. We do not believe that either our legacy DVDDS platform developed by GTRC or our new TV+ platform developed by Lucent will be materially impaired by the sale of these component products to these potential competitors.

Products & Services

Our primary business is to develop and market our platforms that are capable of delivering broadcast television by domestic and international telephone companies and other communications service providers over twisted pair copper telephone lines. We believe our flagship products are the most cost-effective, reliable, scalable and easiest to operate platforms for delivery of broadcast television, data and voice over ADSL on the market. mPhase primarily is targeting its marketing of its television delivery systems to international telephone companies. Telephone companies around the world are experiencing negative pressures on their wireline calling revenues and need to increase their per subscriber revenue and margins. Outside of the United States, service providers are particularly reliant on their copper infrastructure, as few countries have upgraded their infrastructure to optics. Beyond that, the options for pay-tv services outside the U.S. are, for the most part, limited. Consumers living abroad have less access to digital television, leaving international telecommunication companies well-positioned to capture a large percentage of the market. Hence, we believe the market conditions that exist abroad are stronger for our products than those that exist domestically. mPhase intends to utilize its own sales force, in addition to strategic partners to distribute its products worldwide.

Television over DSL Platforms

mPhase's first TV platform, the Traverser Digital Video and Data Delivery System ("DVDDS") introduced in 1998, is a patented end-to-end system enabling the delivery of digital broadcast television, analog voice service and high-speed data, as well as other ancillary services, over a single copper telephone wire using ADSL. Telephone service providers using the mPhase legacy DVDDS need to build a digital video headend or programming and control center ("PCC") to downlink broadcast television programming content from satellites. This includes installing a satellite receiving dish, off-the-shelf video equipment and mPhase's software to manage the video

content at the PCC. Local off-air channels are received, digitized and combined with the signals received via satellite at the PCC. The PCC can be co-located with a single central office or remotely located and connected to each Central Office (CO) via fiber. The DVDDS CO equipment, known as the mPhase Universal Access Shelf, integrates video signals from the PCC with Internet and voice signals. The output of the Universal Access Shelf consists of DSL "lines" capable of carrying a single digital broadcast television channel, high-speed data and POTS (Plain Old Telephone Service) to subscribers over existing telephone lines. Upon reaching the home or business, the DSL line is fed into the mPhase intelligent network interface INI , or digital set top box. The INI separates the three signals and routes them to the television, PC and telephone.

The Company believes that the DVDDS is best suited for markets outside of the United States that do not have a fiber-optic infrastructure and where there is a demand for voice and multi-channel digital broadcast TV over DSL. The patented bus architecture utilized by the DVDDS platform allows a plurality of channels to be delivered to a plurality of users all of the time ensuring unequivocal system reliability. The Company believes it to be a very effective method to deliver realtime broadcast television over copper phone wires. Additionally, the DVDDS does not require an upgrade of the existing infrastructure thereby avoiding the capital expense required to support certain competing video over DSL platforms.

The DVDDS utilizes technology that mPhase licenses exclusively from Georgia Tech Research Corporation (GTRC) and DSL semiconductor chip technology purchased from GlobeSpan Semiconductor, Inc. Georgia Tech Applied Research Corporation (GTARC) provided a significant portion of the engineering research and design to develop the DVDDS. The DVDDS also utilizes component technology developed by Microphase Corporation.

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The DVDDS is currently deployed with two customers, BMW Manufacturing in Spartanburg, South Carolina and Hart Telephone in Hartwell Georgia and has not, as yet, generated material revenues.

mPhase has recently introduced its second television platform that utilizes the industry-leading, standards-based Lucent Technologies, Inc.'s (Lucent) Stinger DSL Access Concentrator for transport of digital television plus high speed-internet from a telephone service provider's CO to a customer's premises. The TV+ platform consist of a cost reduced INI set top box located in a telephone customer's premises and central office equipment consisting of the Lucent Stinger DSL equipment plus a new mPhase Broadcast TV Switch (BTS).

The mPhase TV+ platform, like the DVDDS, is designed to allow for the simultaneous delivery of analog voice plus digital high speed data, and broadcast TV over copper telephone lines between a telephone service provider's CO and the Customer Premises. As noted above, the TV+ platform is aimed for use in markets primarily outside of the United States that do not have a fiber optic infrastructure necessary for cable TV or fiber to the curb necessary for very fast DSL (VDSL). Our solution is more cost effective for both a telecommunications service provider and the end user in such areas since it delivers any given broadcast television the channels to the largest number of users. We believe the mPhase TV+ solution provides the lowest capital cost for telephone service providers to enter the market for broadcast television.

The mPhase TV+ platform does not contain features that currently would require significant and expensive upgrades to its telephone service provider's current infrastructure. Our goal is to achieve wide acceptance of our television platforms in developing markets outside of the United States for multi-channel digital broadcast television at significant gross margins by creating an extremely cost-effective product. We believe such markets do not demand, or can afford, feature-rich and expensive solutions available with alternative technologies such as cable, VDSL and much more expensive platforms for ADSL. As ADSL technology migrates forward to ADSL2 or ADSL2+, mPhase will include some or all of these features in its TV+ platform in a modular scalable cost effective manner depending upon *actual* market demand for such features in markets that mPhase is targeting.

For mPhase, the alliance with Lucent marks a change in strategy from selling a complete proprietary platform to providing an industry-standard, modular solution. Under our Co-Branding Agreement with Lucent, mPhase's Traverser INI set top box is co-branded with Lucent and results in greater product recognition. Under our Systems Integration Agreement with Lucent, mPhase has the exclusive worldwide right to resell the Lucent Stinger as part of the bundled "value added" TV+ platform. By utilizing the Lucent Stinger for transport together with the mPhase TV+ platform, service providers can capitalize upon the proven and extremely robust and cost effective method of supporting and delivering data combined with the mPhase BTS supporting delivery of broadcast TV. In addition, the TV+ platform is compatible with DSLAM's manufactured by other vendors.

Since the mPhaseTV+ platform solution is modular, telephone companies that already have deployed the Stinger can quickly and easily upgrade to support broadcast television in addition to data and voice services. There are over 4 million Stinger DSL ports currently deployed in 20 countries around the globe. As noted above, the hybrid solution is based upon industry-standard transport technology as opposed to the proprietary transport utilized in the Traverser. Finally, by utilizing the Lucent Stinger for transport, mPhase is able to capitalize upon future engineering and design efficiencies of the Stinger. The mPhaseTV+ platform is ideally suited for large-scale deployments in parts of the world where there either is currently or will likely be demand to support data AND television services simultaneously.

mPhase's original set top box designed by GTRC to be used as the CPE portion of the Traverser has recently been reduced in size and costs by Lucent. This product called the Traverser INI is a low-cost set-top box developed specifically for delivering (MPEG2) standard video bitstreams over DSL links. mPhase's new version of its set top box utilizes standard ADSL transport. Such set top box can be sold as a stand-alone product that supports the Lucent Stinger DSLAM's designed by Lucent as well as other manufacturers based upon an open form of standards-based technology.

To date, Next Level Communications appears to have the lead among our competitors in terms of the number of deployments of broadcast television over DSL. However, the majority of such deployments utilize very fast DSL (VDSL) as opposed to our Asynametric DSL (ADSL) solution that has a much shorter reach from its source and requires a fiber to the neighborhood infrastructure. We believe the cost of such solution is prohibitive to many telecommunications service providers in the developing international markets where such an upgrade to such infrastructure is not economic nor feasible.

The Company believes the initial major deployments and the revenues for its flagship television platform, the Traverser[®] DVDDS and the TV+ will not occur prior to the second quarter of fiscal year 2005. Such deployments together with an upturn of spending in the telephone industry should increase sales and improve the Company's margins and provide the Company with the opportunity to attain profitability.

Other Products

POTS Splitter Shelves

A Plain Old Telephone Service (POTS) Splitter Shelf is a low pass/high pass filter that separates voice and data transmissions. POTS Splitter Shelves are necessary to permit simultaneous voice and data transmissions over the same twisted copper wire pair. POTS splitter shelves and the individual cards that populate the shelf, separate and combine traffic traveling along each twisted pair of wires into the analog voice portion of a transmission and the digital data portion, so that each signal can travel independent of the other. This product allows for increased clarity of both voice and data information and decreased crosstalk or interference.

Our POTS Splitter products are available in a domestic and European version.

Intelligent POTS Splitter (iPOTS), iPOTS3 and Universal Bypass

The mPhase iPOTS and the recently introduced iPOTS 3 are innovative products for the DSL industry that enables remote and cost effective testing of a copper telephone loop for DSL deployment by a telephone service provider. Loop management and maintenance including line testing, qualification and troubleshooting from a telecommunication service providers central office (CO) can be accomplished by use of these products. Prior to the introduction by mPhase of the iPOTS product line, testing by a telephone company of its copper wires for DSL, qualification and troubleshooting required the dispatching of personnel to the field. Thus the iPOTS product reduces the cost for a telephone service provider seeking to deploy and maintain DSL services. The (patent pending) iPOTS and new iPOTS3 products allow both wideband and narrowband testing of a telephone service provider's copper loop. The iPOTSi is designed for use with the Lucent Stinger, whereas, the iPOTS3 product is compatible with any vendors DSLAM.

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mPhase is party to a non-exclusive distribution agreement with Corning Cable Systems for its line of intelligent products. This agreement increases the potential exposure of this product line, as Corning has a global sales force and established relationships with the largest telephone companies in the world.

mPhaseStretch

mPhase has recently developed a new product known as the mPhaseStretch targeted for emerging markets outside of the U.S. This product is a digital loop extender that enhances the performance of the legacy DVDDS platform by extending the transmission distance for the delivery of voice, video and data up to 30,000 feet. The mPhaseStretch is a powered device that is placed on the line at approximately 9,000 feet intervals or before the signal begins to degrade. We believe, the addition of the Stretch could give mPhase the greatest serviceable distance radius for the delivery of converged services over copper telephone wires. The current mPhaseStretch is compatible only with the legacy Traverser DVDDS television platform.

Microfilters

We have developed a complete line of microfilters, including a 2 and 4 pole filter for use in single and multi-phone households, as well as a Network Interface Device Splitter. These products, similar to POTS splitters, ensure clear and reliable service of voice, high-speed data, and television when these two services are transported over the same line.

Target Market

mPhase's primary target market for the DVDDS and TV+ digital broadcast television delivery platforms over ADSL includes international and rural domestic telephone companies. Specifically, we believe our TV over DSL platform products are the most competitive in markets that currently have limited access to multi-channel television services such as many parts of Eastern Europe, Africa, Latin America, Asia and the Middle East, as well as parts of the rural United States.

Competitive Business Conditions

The telecommunications sector continues to experience significant weakness in capital spending by service providers globally. The downturn in spending has continued for the last two fiscal years of mPhase ending June 30, 2003 and June 30, 2002 respectively. The dramatic pull back in equipment purchased by service providers, has significantly reduced earnings and resulted in dramatically reduced stock prices of telecommunications equipment vendors. This, together with the tremendous correction of stock prices in general during the past three years, has halted the growth of the sector. The Company remains optimistic about the future of DSL and the potential of its broadcast television platforms and the market for its component DSL products as the rollout of DSL continues globally. We anticipate some upturn in capital spending during fiscal year 2004, however, service providers still face significant challenges of overcapacity and declining margins for traditional services globally.

In addition to the overall economic climate, the telecommunications equipment market is also characterized by swift technological change. Currently, communications service providers have the option to offer several broadband solutions in the last mile, including the existing ISDN or T-1 technologies, fiber optics or hybrid coaxial cable and wireless and satellite delivery methods. Communications service providers may use these other technologies instead of DSL to offer their subscribers broadband access. Based upon current telecommunications industry standards and deployment methodologies, mPhase believes that DSL can compete favorably with these other technologies, especially outside of the United States. In particular, telephone companies and other copper-wire based service providers, that are interested in maximizing revenues associated with the installed copper wire infrastructure, will favor DSL or other copper-based broadband technologies.

Alcatel is the leading supplier of DSLAMS (digital subscriber line access multiplexers) around the globe having deployed several video over DSL installations with telephone service providers. Historically, Alcatel has worked with multiple equipment vendors to create a complete, end-to-end video solution, including middleware (i.e., software) providers iMagicTV and set top box provider, Pace. Recently, however, Alcatel acquired iMagicTV, bringing at least some of the third party required equipment, in-house. Alcatel has announced upgrades to its ASAM 7301 specifically to better support the delivery of converged voice, video and data.

There are a number of telecommunications equipment providers competing in the television over DSL market. For instance, Next Level Communications (NLC), which has recently become a division of Motorola, has secured over 100 customers predominantly in the United States. The majority of their deployments utilize a specific form of DSL known as VDSL (very fast digital subscriber line). VDSL requires that telecommunications service providers install fiber optics into the neighborhood, or close to the customer premises because signals can only travel up to 5,000 feet over copper telephone wires. As a result, relative to the mPhase solutions, the NLC platform is more capital intensive due to the cost of the infrastructure upgrade (i.e., installing fiber optics closer to the customer premises). NLC has also introduced an ADSL version of its equipment, which enables greater serviceable distance radius of approximately 8,000 feet. This newer product could compete more directly with both of mPhase's TV platforms over ADSL solutions. In general, NLC's products tend to be more feature rich and therefore more costly. NLC concentrates the majority of its sales efforts within the US market where consumers demand a robust viewing experience due to the plethora of alternatives for television services.

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Lucent also offers another video over DSL solution currently deployed at SasTel in Saskatchewan Canada. This solution, similar to NLC's products, offers greater functionality and features, however is more costly in terms of per port equipment cost than the mPhaseTV+ platform. Finally, other smaller vendors are emerging, partnering with other equipment vendors to create a video over DSL platform. Equipment providers such as Net to Net and Paradyne are modifying their data platforms to support the delivery of television services. However, mPhase believes it has certain cost of equipment advantages over other vendors making its system more economically viable for potential customers. The Company believes that the strength of the video-centric BTS coupled with the strength of the data-centric Lucent Stinger make its solution extremely competitive in its target markets.

Other vendors that offer complete platforms for delivery of TV over DSL or hardware or software portions of such platforms that incorporate broadband solutions over copper wire include: ADC, Advanced Fiber Communications, Innovia, NEC, Motorola, Huawei Technologies Corporation Limited, Paradyne Networks, Samsung, 2Wire, Siemens, TUT Systems, Motorola, UTSTARCOM and Westell. In addition, we also compete with Minerva and Myrio Corporation, which provide infrastructure software products to deliver multi-channel digital television over telephone networks by using Internet Protocol.

Cable television providers are also competing in the space for converged services using analog and digital cable connections that have been upgraded for digital two-way services. In the United States, the majority of cable connections have already been upgraded and can support the delivery of television and high-speed Internet, and in many cases, cable telephony. In fact, the imposing threat that cable companies present has created a catalyst among telephone companies to expand their service offering to include advanced services such as digital television.

While satellite delivered television services in the U.S. have experienced significant growth over the past several years, the ability for satellite providers to offer reliable, consistent and cost-effective high speed data is still in its infancy and too expensive to commercially deploy. Furthermore, satellite providers are not typically equipped to offer telephony services, unless they were to partner with a telephony provider. Beyond that, particularly outside of the U.S., the direct-to-home satellite options are limited due to either low channel counts or unreliable quality. Satellite signals are often affected by weather events such as severe snow or rain, unlike DSL-delivered services which remain unaffected by weather patterns.

Manufacturing

mPhase subcontracts all of the manufacturing of its products to outside sources including related parties such as Janifast Ltd. and Microphase Corporation. We currently have no contracts in place for the manufacturing of our products with either Microphase Corporation or Janifast Ltd. or any other non-affiliated third party manufacturers. We periodically execute purchase orders for the manufacture of quantities of POTS Splitters that are produced by Janifast Ltd.

Outsourcing

The Company practices an outsourcing model whereby it contracts with third party vendors to perform certain functions rather than performing those functions internally. For instance, mPhase out sources digital engineering development for the Traverser System to GTARC. It also out sources analog engineering development and certain administrative functions to Microphase Corporation. mPhase has outsourced to Lucent Technologies, Inc. cost reduction of its Traverser INI set top box and development of its new mPhaseTV+ platform. With respect to manufacturing of its TV+-Platform, mPhase is targeting leading contract manufacturing companies with strategically located facilities globally with which it can establish long-term relationships. By using contract manufacturers, mPhase will attempt to avoid the substantial capital investments required for internal production.

As described in detail on page 5, the Company has entered into a number of significant agreements with Lucent Technologies, Inc which include a Co-Branding Agreement, dated as of January 21, 2003, allowing the Company to add the Lucent name and Logo to its cost-reduced Traverser INI set top box. Such agreement is for an initial period of one year and is subject to renewal on an annual basis by mutual consent. In addition, the Company has entered into a Systems Integrator Agreement, dated as of April 4, 2003 designating the Company as a reseller of the Lucent Stinger DSL transport product when bundled as part of the mPhase TV+ platform globally. Such agreement gives mPhase the exclusive right to sell the TV+ product worldwide containing the

Lucent Stinger as the DSL transport mechanism for delivering broadcast television, high speed data and voice over copper telephone wires. In order to qualify for such status, as an accredited reseller, Lucent Technologies, Inc. determined that the Company's TV+ platform added significant software and hardware value to the Stinger DSL product by enabling such product to deliver broadcast television over ADSL in addition to the Stinger's well known existing world class capabilities for the delivery of voice and high-speed data over copper telephone lines. Such agreement is for an initial two year term provided that either party may cancel such agreement with 60 days notice to the other party.

Patents and Licenses

We have filed and intend to file United States patent and/or copyright applications relating to some of our proposed products and technologies, either with our collaborators, strategic partners or on our own. There can be no assurance, however, that any of the patents obtained will be adequate to protect our technologies or that we will have sufficient resources to enforce our patents.

Because we may license our technology and products in foreign markets, we may also seek foreign patent protection. With respect to foreign patents, the patent laws of other countries may differ significantly from those of the United States as to the patentability of our products or technology. In addition, it is possible that competitors in both the United States and foreign countries, many of which have substantially greater resources and have made substantial investments in competing technologies, may have applied for, or may in the future apply for and obtain, patents which will have an adverse impact on our ability to make and sell our products. There can also be no assurance that competitors will not infringe on our patents or will not claim that we are infringing on their patents. Defense and prosecution of patent suits, even if successful, are both costly and time consuming. An adverse outcome in the defense of a patent suit could subject us to significant liabilities to third parties, require disputed rights to be licensed from third parties or require us to cease our operations.

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The intellectual property owned and licensed by the Company falls into two general categories, analog and digital intellectual property.

mPhase owns the analog intellectual property which can be characterized as filter technology. This intellectual property includes:

- Low pass filter shelves and POTS Splitters, which separate and combine the DSL spectrum from the traditional voice service;
- ADSL filters, which are filters that conform to the worldwide DSL standard and are utilized in the transmission of data and voice service; and
- Bypass for telephone Splitter System, which enables an automated and remote bypass of the POTS Splitter so full metallic testing can be performed.

We have a pending patent application which was filed in June 1999 claiming priority to three provisional patent applications for the analog portion of our technology.

mPhase exclusively licenses our digital intellectual property from GTRC. We also have an exclusive, worldwide license to manufacture and market products using the technology developed by GTARC under our contract with them. The exclusive license with GTRC is applicable for the duration of their patent protecting the system design and other technology related to the Traverser[®]. The digital intellectual property that we license provides several unique aspects of the Traverser[®]. Among them is the backplane design, which provides every subscriber the ability to view any channel available. All subscribers in a given system could be watching the same channel at the same time. The intellectual property licensed exclusively to mPhase by GTRC includes the below mentioned patents. A patent for the System and Method for the Delivery of Digital Video and Data over a Communications Channel was issued on November 28, 2000 to the Georgia Tech Research Corporation.

A patent was issued on March 27, 2001 to the Georgia Tech Research Corporation for the System and Method for Maintaining Timing Synchronization in a Digital Video Network. This patent covers the development of the Framer and the Framer chip. The Framer is an Integrated Circuit which gives the Traverser[®] the capability of allocating both the downstream and upstream bandwidth into virtually any application required. This feature allows the Traverser[®] to deliver both MPEG-2 digital video and Internet data simultaneously and also allows for future applications of the Traverser[®].

A patent was issued on November 27, 2001 to the Georgia Tech Research Corporation for the Method and Apparatus for Combining a Plurality of 8B/10B Encoded Data Streams addresses video data transport between digital headends and the access network serving subscribers. A further patent is pending covering other methods of video program transport.

Another patent was issued on August 13, 2002 covering what mPhase calls the System Management Workstation (SMW). Specifically, this patent entitled, □Computer System and Method for Providing Digital Video and Data Over a Communication Channel□ addresses the means by which the computer system and method manages the already patented bus or broadcast backplane, for the delivery of converged voice, video and data. The management system covered by this patent performs functions such as monitoring the health of the Traverser[®] system, managing a database of user information, as well as linking multiple central offices to a master system control station.

Georgia Tech also has patents pending that protect:

- o apparatus and methods of remote control of the Intelligent Network Interface[®]; and,
- o systems and methods to provide subscribers means to playback previously recorded video content.

We also rely on unpatented proprietary technology, and we can make no assurance that others may not independently develop the same or similar technology to ours or otherwise obtain access to our unpatented technology. If we are unable to maintain the proprietary nature of the Traverser[®] technology, our future operations would likely be adversely affected.

Government Regulation

The Federal Communication Commission, or FCC, and various state public utility and service commissions, regulate most of mPhase's potential domestic customers. Changes to FCC regulatory policies may affect the accessibility of communications services, and otherwise affect how telecommunications providers conduct their business. These regulations may adversely affect the Company's potential penetration into certain markets. In addition, its business and results of operations may also be adversely affected by the imposition of certain tariffs, duties and other import restrictions on components, which mPhase obtains from non-domestic component suppliers. Changes in current or future laws or regulations, in the U.S. or elsewhere, could materially adversely affect the Company's business.

To the best of our knowledge, there are no state or local laws to which we are subject that are relevant to our system from a regulation and certification standpoint. At the Federal level, we are subject to Federal Communications Commission (FCC) Regulations Under the Code of Federal Regulations, Title 47, Chapter 1, Part 15-RADIO FREQUENCY DEVICES, and Part 68-CONNECTION OF TERMINAL EQUIPMENT TO THE TELEPHONE NETWORK. Part 15 sets out the requirements to obtain a license for operating a radiator of electromagnetic energy, and the technical and administrative specifications relating to the marketing of such radiators. Part 68 sets out the rules and regulations to provide for uniform standards for the protection of the telephone network from harms caused by the connection of terminal equipment and associated wiring thereto, and for the compatibility of hearing aids and telephones so as to ensure that persons with hearing aids have reasonable access to the telephone network.

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Our products and equipment were designed to comply with the aforementioned rules and regulations. The POTS splitter and filter products were already certified with FCC Part 68. The Traverser[] is still undergoing FCC Part 15 certification process.

Compliance with FCC rules and regulations allows our equipment to be marketed and sold in the United States. While the certification process and costs associated have no material effect on mPhase's financial condition, failure to comply with FCC rules and regulations would result in loss of revenue and additional costs on product revision and/or redesign.

Research and Development

mPhase has designed the legacy Traverser[] DVDDS and its ancillary component parts in conjunction with multiple research and development partners. On March 26, 1998, we entered into a license agreement with GTRC which has the patent on the Digital Video and Data Delivery System technology. GTRC has granted us the exclusive license to use and re-sell this technology in the legacy Traverser[] DVDDS TV platform. We are required to pay GTRC royalties of 5% on the sales of the legacy Traverser[] DVDDS platform. The agreement expires automatically when the patents covering the invention expire. GTARC conducts the majority of our digital research and development for the Traverser[]. Microphase Corporation contributed the analog technology incorporated in the design of the Traverser[], as well as providing ongoing development of analog DSL components. As of June 30, 2003, we had been billed a cumulative total of approximately \$13,524,300 for research and development conducted by GTARC.

Our new cost-reduced feature enhanced Traverser[] INI set top box together with our TV+ platform is being developed by Lucent Technologies, Inc. for a cost of approximately \$1.6 million and we have engaged and expect to continue to engage Lucent for assistance with our development of other product refinements and enhancements on a project by project basis. As of June 30, 2003 we have been billed a cumulative total of approximately \$1,268,750 for research and development conducted by Lucent, of which we have paid approximately \$898,000.

Employees

mPhase presently has approximately 13 full-time employees, two of whom are also employed by Microphase Corporation. See the description in the section entitled []Certain Relationships and Related Transactions.[]

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RISK FACTORS

RISKS RELATED TO FINANCIAL ASPECTS OF OUR BUSINESS

mPhase's Stock Price Has Suffered Significant Declines During the Past Three Years and Remains Volatile.

The market price of our common stock closed at \$2.72 on December 12, 2000 and closed at \$.43 on December 12, 2003. Stocks in telecommunications equipment providers of DSL products have been very volatile during such period. Our common stock is a highly speculative investment and is suitable only for such investors with financial resources that enable them to sustain the loss of their entire investment in such stock. Because the price of our common stock is less than \$5.00 per share and is not traded on the NASDAQ National or NASDAQ Small Cap exchanges, it is considered to be a "penny stock" limiting the type of customers that broker/dealers can sell to. Such customers consist only of "established customers" and "Accredited Investors" (within the meaning of Rule 501 of Regulation D of the Securities Act of 1933, as amended-generally individuals and entities of substantial net worth) thereby limiting the liquidity of our common stock.

We have reported net losses for each of our fiscal years from our inception in 1996 and for the first quarter (unaudited) ended September 30, 2003 and may not be able to operate profitability in the future.

We have had substantial operating losses since our inception in 1996 (including \$6,649,011 and \$11,361,372 for the fiscal year ended June 30, 2003 and fiscal year ended June 30, 2002, respectively and (unaudited) \$ 864,511 and \$1,801,425 for the quarters ending September 30, 2003 and September 30, 2002 respectively) and cannot be certain when or if we will ever be profitable. We expect to continue to have net losses for the foreseeable future and have a need to raise not less than \$2 million in additional cash in the next 12 months through further offerings to continue operations. We have never been profitable from our inception in October, 1996 through September 30, 2003 (unaudited) and we have incurred (a) accumulated losses of \$108,881,008 and a stockholder's deficit of \$3,881,154 and (b) cumulative negative cash flow of \$44,031,903. As of September 30, 2003 (unaudited) we have a negative net worth of \$3,881,154 and a negative working capital of \$2,385,525.

Our Independent Auditor's Report Express Doubt About Our Ability to Continue as a Going Concern.

The reports of the Company's outside auditors, Rosenberg, Rich, Baker, Berman & Company with respect to its latest audited 10K for the fiscal years ended June 30, 2003, June 30, 2002 and June 30, 2001 stated that "there is substantial doubt of the Company's ability to continue as a going concern." We may be unsuccessful in raising additional needed capital necessary to continue our operations in the current capital markets because of the depressed price of our stock as a telecommunications equipment provider.

Our Common Stock is Subject to Significant Dilution Upon Issuance of Shares We Have Reserved for Future Issuance.

As of October 27, 2003, we have warrants and options outstanding convertible into approximately 31,775,735 shares and 14,876,000 shares of mPhase common stock which, upon conversion, may adversely affect the future price of our common stock. As of October 27, 2003 we have warrants and options convertible into approximately 23,002,011 and 2,435,000 shares of our common stock at \$.30 per share or less that, upon exercise, will result in significant dilution to many of our current shareholders and may adversely affect the future price of our common stock. As of October 27, 2003, the Company has approximately 3,130,330 shares of common stock reserved for the issuance upon the conversion of certain 12% convertible notes to related parties at \$.30 per share which may adversely affect the future price of our common stock. We may be forced to raise additional cash for operations by selling additional shares of our common stock at depressed prices causing further dilution to our shareholders.

RISK FACTORS RELATED TO OUR OPERATIONS

We Have Been a Development-Stage Company Since Our Inception in 1996 and Have Not To Date Had a Significant Deployment of Either of Our Main Platforms for Delivery of Television over DSL.

We have had to date no material revenues derived from sales of our Traverser Digital Video Data Delivery System (DVDDS) or our mPhaseTV+ products or our new line of Intelligence POTS Splitters. There have been to date no major deployments of Television over DSL by telephone service providers globally and there currently is uncertainty as to the extent, if at all, that deployments will occur in the future.

We Depend Upon Outsourcing of our Research and Product Development of Our Television Platforms to Two Outside Entities.

We depend upon GTRC for continued technical assistance in connection with deployment of the Traverser[®] DVDDS platform and our business would be materially adversely affected if GTRC were to terminate our relationship. We owe GTRC approximately \$1.8 million and are attempting to finalize an agreement in principal to convert a portion of such payables into our common stock on terms to be agreed upon, however, no assurances can be given that such an agreement will be reached. We depend upon Lucent for the successful development of our TV+ product and our business would be materially adversely affected if Lucent were to terminate our relationship.

The Loss of Key Personnel Could Adversely Effect Our Business.

Management and employment contracts with all of our officers have expired and no assurances can be given that such executives will remain with the Company or that the Company will be able to successfully enter into agreements with such key executives. All of our officers have been granted stock options that are intended to represent a key component of their compensation. Such options may not provided the intended incentives to such officers if our stock price declines or experiences significant volatility.

Economic Support from Affiliated Companies has been Significant During the Downturn in The Telecommunications Industry.

Both Microphase corporation, and Janifast Ltd. had provided significant financial support to mPhase during the past two years in the form of either cash infusions or conversions of related party debt. No assurances can be given that such companies, which share common management with mPhase, will be able to sustain such economic support of mPhase in the future should such support be necessary.

Sales and Margins form Our Component DSL Products has Varied Dramatically during the Past Two Years and Remains Volatile.

Sales and gross margins from our POTS Splitter and other DSL products have experienced a significant decline during the period from June 30, 2001 through June 30, 2003 as a result of the significant downturn in capital spending by telecommunications service providers and although there has been a significant recovery in such sales during the quarter ended September 30, 2003 the outlook for continuing growth in sales remains uncertain.

We Rely On Single Sources for Supply of a Certain Component for our POTS Splitter Product that has been the Source of all of Our Revenues to Date.

We purchase the core torroid which is a key component in our POTS Splitter Product from VAC corporation. We purchase such component on a purchase order basis and have no long term contract for the supply of such component. The loss of this current source of supply could result in us having to redesign our product at additional cost and result in lost revenues from our main source of sales to date.

We May Incur Substantial Expenditures in the Future In Order To Protect Our Intellectual Property.

Although our Traverser[®] DVDDS television platform is patent-protected and not the subject of any infringement allegations we do not have currently patents or patents pending for our TV+ product. The telecommunications industry, in general, is characterized by a large number of patents and frequent patent litigation based upon claims of patent infringement when compared to other industries.

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RISK FACTORS RELATED TO OUR TARGETED MARKETS

Historically the Sale of Infrastructure in the International Markets is Difficult and Uncertain.

We expect the majority of our future revenues to be derived from international emerging markets and our success depends upon our ability to sell our flagship television platforms outside of the United States where political, currency and regulatory risks are significantly greater. As a result of their distance from the United States, different time zones, culture, management and language differences, these operations pose greater risk than selling in the United States. Our sales cycle for our TV over DSL platforms is lengthy (since it involves a major strategic decision by an international telecommunications service provider) and we may incur significant marketing expenses with no guarantee of future sales. A significant market for our Traverser[®] DVDDS, mPhaseTV+ products may never develop if international telephone service providers fail to successfully deploy broadband services including high speed data and television Telephone service providers worldwide have significantly decreased capital expenditures for broadband and other deployment as a result of the current economic downturn in the industry. Future market demand that will cause telephone service providers to continue to aggressively roll out DSL, in general, and ADSL, ADSL2 and ADSL2+ in particular, is highly unpredictable especially in markets outside of the United States. Certain telephone companies (especially in developing international economies) may have copper wire infrastructure that is not of sufficient quality to accommodate the Traverser[®] or mPhaseTV+ platform. Currency fluctuations, changes in foreign taxes and import duties and economic and political instability in international markets pose a greater risk to our operations than U.S. markets.

Our Television Platforms May Not Achieve Compliance with Regulatory Requirements in Foreign Countries.

Our Traverser[®] DVDDS and mPhaseTV+ platforms may fail to meet foreign regulatory standards. Since our targeted markets for our Television platforms involves countries outside of the United States, such products are subject to greater regulatory risks since they must comply with different standards of different countries than can vary widely in the telecommunications industry.

The Telecommunications Industry is Subject to Intense Competition Characterized by Swift Changes in Technology.

The Telecommunications equipment industry is subject to swift and continuing innovation and technological changes that could render our Traverser[®] DVDDS and TV+ products obsolete and intense competition in the industry could prevent our ever becoming profitable. Our competitors that sell DSL systems that compete with the Traverser[®] and mPhaseTV+ system include much larger and better known and capitalized companies with significantly greater selling and marketing experience and financial resources such as ADC, Alcatel S.A., Calix Catena Networks, Copper Mountain, Advanced Fiber Communications, ECT Telecommunications, Ericsson, Fujitsu, Marconi, Motorola, NEC, Nortel, Huawei Technologies, Net to Net Technology, Nokia, UTS Starcom, DVTEL, Inc., Turnstone, Paradyne Networks, Samsung, 2 Wire, Siemens, TuT Systems, and Optibase Wesell. We also face competition from companies that provide infrastructure software products to deliver multi-channel digital television over telephone such as Imagic TV, Minerva Corporation and Myrio Corporation. Telephone service providers that are our targeted customers face competition from cable-based technologies, fixed wireless technologies and satellite technologies that may cause them not to deploy our Traverser[®] DVDDS or TV+ products.

Deployment of Our Television Platforms Requires Certain Additional Investments By Telecommunications Service Providers.

Our Customers may need to build a digital head-end to download television content from satellites involving a significant additional capital expenditure to utilize the digital Television capabilities of our Traverser[®] DVDDS and TV+ products.

We may not be able to evolve our technology, products and services or develop new technology, products and services that are acceptable to our customers.

The market for our broadcast digital television platforms over DSL is characterized by:

Rapid technology change;

New and improved product introductions;

Changing customer Demands; and

Evolving industry standards and product obsolescence.

Our future success will depend upon our ability to continually enhance our existing broadcast digital television platforms as Asymmetric Digital Subscriber Line (ADSL) technology migrates forward to ADSL2 and ADSL2+ with enhanced features such as the ability to deliver multiple television channels to one set top box and continually cost-reduce our platforms consistent with the demands of telecommunications service providers. The development of enhanced and new technology, products and services is a complex and uncertain process requiring high levels of innovation, highly-skilled engineering and development personnel, and the accurate anticipation of technological and market trends. We may not be able to identify, develop, market or support new or enhanced technology, products, or services on a timely basis, if at all owing to our size and limited financial resources.

Telecommunications Service Providers outside of the United States must be able to access sources for Broadcast Television Content in order to deploy our either of our Television Platforms.

In order to have an incentive to deploy either the TV+ or the Traverser DVDDS platforms, an international telecommunications service provider must have access, to multiple channels of Television programming from content providers at prices that enable such provider to earn a profit from the deployment of television programming. In certain of our key target markets, such as Brazil, only cable companies are permitted under current law to provided such content and therefore a local service provider must either establish a working relationship with such a cable provider to have an incentive to utilize our products.

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ITEM 2. PROPERTIES

Our corporate headquarters is located at 587 Connecticut Avenue, Norwalk, CT 06854-1711. The Company leases this office space from Microphase Corporation under a facilities agreement with Microphase that provides that mPhase lease office space, lab facilities and administrative staff on a month-to-month basis for \$11,340/month. The Company also maintains an office in Little Falls, New Jersey and at the Georgia Advanced Telecommunications Research Technology Center in Atlanta, Georgia.

ITEM 3. LEGAL PROCEEDINGS

The Company has recently been advised that, following an investigation by the staff of the Securities and Exchange Commission, the staff intends to recommend that the Commission file a civil injunctive action against Packetport.com, Inc. (hereinafter "Packetport") and its Officers and Directors. Such recommendation relates to alleged civil violations by Packetport and such Officers and Directors of various sections of the Federal Securities Laws. The staff has alleged civil violations of Sections 5 and 17(a) of the Securities Act of 1933 and Sections 10(b) and 13(d) of the Securities Exchange Act of 1934. As noted in other public filings of mPhase, the CEO and COO of mPhase also serve as Directors and Officers of Packetport. Such persons have advised mPhase that they deny any violation of law on their part and intend to vigorously contest such recommendation.

From time to time we may be involved in various legal proceedings and other matters arising in the normal course of business.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

[Back to Contents](#)**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS****(A) MARKET PRICES OF COMMON STOCK**

The primary market for mPhase's common stock is the NASDAQ OTC Bulletin Board, where it trades under the symbol "XDSL." The Company became publicly traded through a merger with Lightpaths TP Technologies, formerly known as Tecma Laboratories, Inc. pursuant to an agreement dated February 17, 1997. The following table sets forth the high and low closing prices for the shares for the periods indicated as provided by the NASDAQ's OTCBB System. The quotations shown reflect inter-dealer prices, without retail mark-up, markdown, or commission and may not represent actual transactions. These figures have been adjusted to reflect a 1 for 10 reverse stock split on March 1, 1997.

| YEAR/QUARTER | HIGH | LOW |
|---------------------------------|---------|---------|
| Fiscal year ended June 30, 2000 | | |
| First Quarter | \$ 9.25 | \$ 2.97 |
| Second Quarter | 6.19 | 2.50 |
| Third Quarter | 19.13 | 6.50 |
| Fourth Quarter | 14.13 | 6.00 |
| Fiscal year ended June 30, 2001 | | |
| First Quarter | \$ 9.25 | \$ 3.00 |
| Second Quarter | 5.94 | 1.47 |
| Third Quarter | 3.38 | 1.22 |
| Fourth Quarter | 2.61 | 1.03 |
| Fiscal year ended June 30, 2002 | | |
| First Quarter | \$ 1.67 | \$.31 |
| Second Quarter | .86 | .31 |
| Third Quarter | .62 | .27 |
| Fourth Quarter | .50 | .23 |
| Fiscal Year ended June 30, 2003 | | |
| First Quarter | \$.32 | .15 |
| Second Quarter | .31 | .15 |
| Third Quarter | .36 | .19 |
| Fourth Quarter | .42 | .28 |

(B) HOLDERS

As of June 30, 2003, mPhase had 71,453,521 shares of common stock outstanding and approximately 11,200 stockholders of record. As of June 30, 2003 we have approximately 31,777,735 shares and 17,167,000 shares of stock reserved for issuance upon the conversion of warrants and options respectively.

(C) DIVIDENDS

mPhase has never declared or paid any cash dividends on its common stock and does not anticipate paying any cash dividends in the foreseeable future. The Company currently intends to retain future earnings, if any, to finance operations and the expansion of its business. Any future determination to pay cash dividends will be at the discretion of the Board of Directors and will be based upon mPhase's financial condition, operating results, capital requirements, plans for expansion, restrictions imposed by any financing arrangements and any other factors that the Board of Directors deems relevant.

Issuance of Unregistered Securities

The following securities were issued by us within the past three years and were not registered under the Securities Act of 1933, as amended (the "Act"). Each of the transactions is claimed to be exempt from registration under the Act.

During the year ended June 30, 1999, we issued 1,599,332 shares of common stock to employees and consultants pursuant to Section 4(2) of the Act for services performed. We recognized a charge to operations of \$8,760,866, based upon the fair market value of the shares.

In April 1999, we issued 642,000 shares of our common stock and warrants to purchase up to 642,000 shares of our common stock at a combined price of \$2.50 per share and warrant pursuant to Rule 506 of Regulation D of the Act for an aggregate of \$1,605,000 in cash.

In June and July, 1999, we issued 4,426,698 shares of our common stock at \$2.50 per share pursuant to Rule 506 of Regulation D of the Securities Act for an aggregate of \$11,066,745 in cash.

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On July 26, 1999, 400,000 warrants were converted into 352,239 shares of common stock in a cashless exercise.

In June 1999, we also issued 400,000 warrants each to purchase one share of common stock at an exercise price of \$1.00 per share which expire in June 2004.

During the year ended June 30, 2000 warrants to purchase 400,000 shares of common stock were exercised generating proceeds of \$400,000.

In December 1999 and January 2000, we sold, pursuant to Rule 506 of Regulation D of the Act, 1,000,000 shares of common stock at a price of \$4.00 per share, for an aggregate of \$4,000,000. In connection with the private placement, we issued 200,000 and 50,000 warrants to purchase common stock for services rendered pursuant to Section 4(2) of the Act. The warrants had an exercise price of \$4.00 and \$5.00, respectively.

During February 2000, warrants to purchase 200,000 and 50,000 shares of common stock were exercised, at an exercise price of \$4.00 and \$5.00, respectively, generating additional proceeds of \$1,050,000.

In May 2000, we issued 1,040,625 shares of our common stock at \$8.00 per share pursuant to Rule 506 of Regulation D of the Act for an aggregate of \$8,325,000 in cash.

In September 2000, we issued 510,000 shares of our common stock at \$5.00 per share pursuant to Rule 506 of Regulation D of the Act for an aggregate of \$2,550,000 in cash and in connection therewith 38,250 shares of common stock for services rendered pursuant to Section 4(2) of the Act.

During the year ended June 30, 2000, we issued 1,164,215 shares of common stock to employees and consultants for services rendered.

On November 30, 2000, we granted 150,000 shares of common stock for services rendered pursuant to Section 4(2) of the Act.

During the quarter ended December 31, 2000, we granted 30,000 warrants to a consultant for services rendered pursuant to Section 4(2) of the Act.

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During the nine month period ended December 31, 2000, we issued 320,000 shares of our common stock following the exercise of options and warrants resulting in gross proceeds of \$327,500 and granted 1,035,000 options to employees and 1,572,000 options to consultants for services performed pursuant to Section 4(2) of the Act.

In January 2001, we granted 102,000 shares of common stock for services rendered pursuant to Section 4(2) of the Act.

In January 2001, we granted 250,000 shares of common stock for services rendered pursuant to Section 4(2) of the Act.

On January 26, 2001 and February 9, 2001 we raised approximately \$4,685,000 in cash through the issuance of 2,342,500 shares of our common stock and a like amount of warrants to purchase one share each of our common stock at an exercise price of \$3.00 and a term of four years pursuant to Rule 506 of Regulation D of the Act. The Company issued 162,000 warrants to purchase one share each of our common stock at an exercise price of \$3.00 and a term of four years to consultants in connection with these private placements.

On April 3, 2001 we issued warrants to purchase 1,550,625 shares of common stock at an exercise price of \$3.00 per share expiring on April 3, 2005 as consideration for consent to certain additional issuances.

On April 16, 2001, we issued warrants to purchase 250,000, 250,000 and 500,000 shares of common stock at respective exercise prices of \$5.00, \$2.50 and \$1.25 per share in connection with consulting services rendered pursuant to Section 4(2) of the Act.

On May 7, 2001, we issued 300,000 shares of common stock and warrants to purchase 150,000 shares of common stock at an exercise price of \$5.00 per share expiring on May 7, 2006 in connection with consulting services rendered pursuant to Section 4(2) of the Act.

On May 25, 2001, we issued 587,000 shares of our common stock and a like amount of warrants at an exercise price of \$3.00 per share and a term of five years pursuant to Rule 506 of Regulation D of the Act for approximately \$587,000 in cash.

On July 18, 2001 we issued 575,000 shares of our common stock and a like amount of warrants at an exercise price of \$3.00 per share and a term of five years pursuant to Rule 506 of Regulation D of the Act for approximately \$575,000 in cash.

Effective June 30, 2001 the Company converted \$2,420,039 of liabilities due to directors and related parties into 4,840,077 shares of the Company's common stock pursuant to debt conversion agreements pursuant to Section 3(a)(9) of the Act.

In September 2001, certain of our officers and directors purchased an aggregate of 2,000,000 shares of common stock for an aggregate investment of \$1,000,000. This issuance was exempt pursuant to Section 4(2) and/or Rule 506 of Regulation D of the Act.

During December 2001, the Company converted \$1,020,000 of liabilities due to Microphase and Janifast into 3,400,000 shares of the Company's common stock and a like amount of warrants to purchase one share each of the Company's common stock at an exercise price of \$.30 pursuant to debt conversion agreements pursuant to Section 3(a)(9) of the Act.

In December 2001 and January 2002, we issued 6,797,643 shares of common stock and a like amount of warrants at an exercise price of \$.30 per share for a term of five (5) years pursuant to Rule 506 of Regulation D of the Act for approximately \$2,000,000 in cash. This issuance was exempt pursuant to Section 4(2) and/or Rule 506 of Regulation D of the Act.

Effective March 31, 2002, the Company converted \$420,872 of liabilities due to Piper Rudnick LLP, outside legal counsel to mPhase pursuant to Section 3(a)(9) of the Act into a warrant to purchase up to a total of \$1,683,490 shares of the Company's common stock which pursuant to EITF 96 18, has an approximate value of

\$.30 per share and a warrant to purchase 550,000 shares of the Company's common stock at an exercise price of \$.30 per share pursuant to the terms of payment agreement. In addition, Piper agreed to accept a Promissory note for \$420,872 of current payables at an interest rate of 8% with payments of \$5,000 per month commencing June 1, 2002 and continuing through December 1, 2003, with a final payment of principal plus accrued interest due at maturity on December 31, 2003.

From August 2001 to June 2002, we issued an aggregate of 2,976,068 shares of common stock to consultants for an aggregate of \$1,202,997. We also issued an aggregate of 2,675,000 warrants to consultants for an aggregate of \$1,040,000. Each transaction was pursuant to Section 4(2) of the Act.

Effective June 30, 2003, we issued 4,296,680 shares of Common Stock at \$.30 per share plus 5 year warrants to purchase 4,296,680 shares of Common Stock at \$.30 per share in a Private Placement pursuant to Rule 506 of Regulation D of the Act.

During the year ended June 30, 2003, the Company issued 426,000 shares of its common stock valued at \$112,245 and 1,690,000 warrants, valued at \$203,150 based upon the fair market value of the Company's common stock on the date of the grant using the Black-Scholes option pricing model. The Company recorded these charges, totaling \$318,395 to operations for the year ended June 30, 2003.

During the fiscal year ended June 30, 2003, the Company converted certain payables and accrued expenses with officers, related parties and strategic vendors pursuant to Section 4(2) of the Act aggregating approximately \$1.9 million into 5,923,333 restricted shares of the Company's common stock and 5 year warrants to purchase an additional 3,706,800 restricted shares of the Company's common stock, of which 5,533,333 shares of common stock and 3,491,800 warrants were issued in settlement of \$1,748,756 of debt to related parties.

[Back to Contents](#)**ITEM 6. SELECTED CONSOLIDATED 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] and the historical financial statements and notes included in this annual report. The statement of operations data from October 2, 1996 (date of inception) to June 30, 1997 and for the year ended June 30, 1998, and the balance sheet data as of June 30, 1997 and 1998, are derived from financial statements that have been audited by Schuhalter, Coughlin & Suozzo, LLC, independent auditors, and are included in this document. The statement of operations data for the years ended June 30, 1999, 2000, and 2001 and the balance sheet data as of June 30, 1999, 2000, and 2001 are derived from financial statements that have been audited by Arthur Andersen LLP., independent auditors. The statement of operations data for the years ended June 30, 2002, and June 30, 2003 and the balance sheet data as of June 30, 2002 and June 30, 2003 are derived from financial statements that have been audited by Rosenberg Rich Baker Berman & Company, independent auditors, and are included in this document.

| | Year Ended June 30, | | | | | Cumulative from inception October 2, 1996 to June 30, 2003 |
|--------------------------------------|-----------------------------------|-------------|-------------|-------------|-------------|---|
| | 1999 | 2000 | 2001 | 2002 | 2003 | |
| | (in thousands, except share data) | | | | | |
| STATEMENT OF OPERATIONS DATA: | | | | | | |
| Total revenues | \$ | \$ | \$ | \$ | \$ | \$ |
| | □ | 279 | 10,524 | 2,582 | 1,582 | 14,968 |
| Costs and Expenses: | | | | | | |
| Cost of sales | □ | 132 | 5,805 | 2,415 | 1,493 | 9,845 |
| Research and development | 3,563 | 10,157 | 10,780 | 3,820 | 3,538 | 34,347 |
| General and administrative | 17,686 | 27,859 | 17,322 | 7,039 | 2,684 | 74,877 |
| Depreciation and amortization | 410 | 471 | 660 | 670 | 515 | 2,767 |
| Operating loss | (21,659) | (38,340) | (24,043) | (11,361) | (6,649) | (106,868) |
| Other income (expense), net | (1,162) | 20 | □ | 142 | 50 | (1,254) |
| Interest income (expense) | (18) | 158 | 43 | (26) | (51) | 106 |
| Net loss | \$ (22,839) | \$ (38,162) | \$ (24,000) | \$ (11,245) | \$ (6,650) | \$ (108,016) |
| Basic and diluted net loss per share | \$ (1.42) | \$ (1.41) | \$ (.72) | \$ (.23) | \$ (.10) | |

Shares used in basic
and diluted
net loss per share

| | | | | |
|------------|------------|------------|------------|------------|
| 16,038,009 | 26,974,997 | 33,436,641 | 49,617,280 | 65,217,088 |
|------------|------------|------------|------------|------------|

Year Ended June 30,

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
| BALANCE SHEET DATA: | | | | | | |
| Cash and cash equivalents | \$ 0 | \$ 7,978 | \$ 6,432 | \$ 31 | \$ 47 | \$ 397 |
| Working capital (deficit) | (3,073) | 4,936 | 3,557 | (1,458) | (94) | (1,405) |
| Total assets | 2,175 | 10,624 | 11,184 | 8,997 | 6,942 | 3,782 |
| Long-term obligations, net of current portion | 0 | 0 | 0 | 90 | 2,891 | 2,608 |
| Total stockholders' equity (deficit) | \$ (915) | \$ 6,974 | \$ 7,329 | \$ 1,865 | \$ (42) | \$ (3,229) |

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The statement of operations data as of the periods indicated below are derived from unaudited financial statements. The operations data for the quarterly periods ended September 30, 1999 and each quarter thereafter to and including the quarter ended December 31, 2001 are derived from unaudited financial statements reviewed by Arthur Andersen LLP and the operations data for the quarterly periods from March 31, 2002 and each quarter thereafter through and including the quarter ended September 30, 2003, have been derived from unaudited financial statements reviewed by Rosenberg, Rich, Baker, Berman & Company, and include all adjustments (consisting of normal recurring items) that management considers necessary for a fair presentation of the financial statements.

| | Three months ended | | | |
|--|---------------------------|------------------------|-----------------|----------------|
| | September 30 | December 31 | March 31 | June 30 |
| FISCAL 2003 QUARTERLY STATEMENT OF OPERATIONS DATA: | | | | |
| Total revenues | \$ 210 | \$ 562 | \$ 210 | \$ 600 |
| Costs and Expenses: | | | | |
| Cost of sales | 197 | 547 | 205 | 544 |
| Research and development | 803 | 753 | 906 | 1,077 |
| General and administrative | 893 | 731 | 544 | 516 |
| Depreciation and amortization | 131 | 129 | 129 | 127 |
| Operating loss | (1,814) | (1,598) | (1,574) | (1,664) |
| Interest expense, Net | (18) | (15) | (11) | (6) |
| Gain on debt extinguishment | 41 | □ | 9 | 11 |
| Gain (Loss) on investments | | (16) | (12) | 17 |
| Net Loss | \$ (1,791) | \$ (1,629) | \$ (1,588) | \$ (1,642) |
| Basic and diluted net loss per share | \$ (.03) | \$ (.07) | \$ (.02) | \$ (.02) |
| Shares used in basic and diluted net loss per share(1) | 60,881,131 | 65,914,466 | 65,956,810 | 68,164,160 |

| | Three months ended | | | |
|--|---------------------------|------------------------|-----------------|----------------|
| | September 30 | December 31 | March 31 | June 30 |
| (in thousands, except share amounts) | | | | |
| FISCAL 2002 QUARTERLY STATEMENT OF OPERATIONS DATA: | | | | |
| Total revenues | \$ 537 | \$ 545 | \$ 866 | \$ 634 |
| Costs and Expenses: | | | | |
| Cost of Sales | 457 | 530 | 724 | 704 |
| Research and development | 1,111 | 1,257 | 539 | 912 |
| General and administrative | 2,862 | 1,641 | 1,355 | 1,182 |
| Depreciation and amortization | 193 | 209 | 136 | 132 |

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| | | | | |
|--|------------|------------|------------|------------|
| Operating loss | (4,086) | (3,092) | (1,888) | (2,296) |
| Interest expense, Net | (10) | (1) | (5) | (10) |
| Gain (Loss) on debt extinguishment | 33 | 5 | 85 | 19 |
| Net Loss | \$ (4,063) | \$ (3,088) | \$ (1,808) | \$ (2,287) |
| Basic and diluted net loss per share | \$ (.10) | \$ (.07) | \$ (.03) | \$ (.04) |
| Shares used in basic and diluted net loss per share(1) | 42,037,506 | 44,645,458 | 55,606,168 | 56,459,167 |

(1) The quarterly earnings per share data above are computed independently for each of the quarters presented. As such, the sum of the quarterly per common share information may not equal the full year amounts due to rounding differences resulting from changes in the weighted-average number of common shares outstanding.

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The statement of operations data as of the periods indicated below are derived from unaudited financial statements. The operations data for the quarterly periods ended September 30, 1999 and each quarter thereafter to and including the quarter ended December 31, 2001 are derived from unaudited financial statements reviewed by Arthur Andersen LLP and the operations data for the quarterly periods from March 31, 2002 and each quarter thereafter through and including the quarter ended September 30, 2003, have been derived from unaudited financial statements reviewed by Rosenberg, Rich, Baker, Berman & Company, and include all adjustments (consisting of normal recurring items) that management considers necessary for a fair presentation of the financial statements.

| | Three months ended | | | |
|--|---|------------------------|-----------------|----------------|
| | September 30 | December 31 | March 31 | June 30 |
| | (in thousands, except share amounts) | | | |
| FISCAL 2001 QUARTERLY STATEMENT OF OPERATIONS DATA: | | | | |
| Total revenues | \$ 1,865 | \$ 5,231 | \$ 2,959 | \$ 469 |
| Costs and Expenses: | | | | |
| Cost of Sales | 872 | 2,779 | 1,689 | 465 |
| Research and development | 3,162 | 3,318 | 2,220 | 2,080 |
| General and administrative | 3,485 | 3,314 | 3,105 | 7,406 |
| Depreciation and amortization | 123 | 136 | 200 | 201 |
| Operating loss | (5,779) | (4,316) | (4,255) | (9,683) |
| Interest income, Net | 28 | 8 | 4 | 3 |
| Net loss | \$ (5,751) | \$ (4,308) | \$ (4,251) | \$ (9,680) |
| Basic and diluted net loss per share | \$ (.18) | \$ (.13) | \$ (.12) | \$ (.27) |
| Shares used in basic and diluted net loss per share(1) | 31,562,727 | 32,324,964 | 34,205,000 | 35,702,797 |

(1) The quarterly earnings per share data above are computed independently for each of the quarters presented. As such, the sum of the quarterly per common share information may not equal the full year amounts due to rounding differences resulting from changes in the weighted-average number of common shares outstanding.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS AND PLAN OF OPERATIONS

The following is management's discussion and analysis of certain significant factors, which have affected mPhase's financial position and should be read in conjunction with the accompanying financial statements, financial data and the related notes.

RESULTS OF OPERATIONS

OVERVIEW

mPhase develops, markets and sells a line of innovative DSL based broadband communications equipment. mPhase is a development-stage company that has designed, patented and is currently engaged in commercialization of the Company's primary flagship products that enable telephone service providers to deliver multiple channel digital broadcast television programming, high-speed Internet and voice service over existing copper telephone lines. From inception, the Company's operating activities have consisted primarily of research and development, establishing third-party manufacturing and distribution relationships and developing product brand recognition among telecommunications service providers for its flagship products. These activities included establishing trials and field tests of the legacy DVDDS and, more recently, its TV+ platforms with Hart Telephone Company in Georgia and establishing a core administrative and sales organization. The Company believes that its television broadcast platforms provide the most cost effective, reliable and scaleable solution for many telephone companies seeking to provide television, high-speed internet and voice utilizing Asymmetric Digital Subscriber Line, or ADSL technology. Such platforms are designed for markets primarily outside of the United States where there is a lack of fiber-optic infrastructure necessary to deliver cable television.

mPhase also designs and markets a line of DSL component products ranging from commodity items such as POTS splitters to innovative loop management products. Most notable in the suite of DSL component products is the recently introduced iPOTS3 or Intelligent POTS Splitter product. This product marks a significant advancement in automating loop management and is interoperable with DSLAM's of any vendor. As DSL deployments scale, it is becoming increasingly more important for telecommunications service providers to streamline the process for provisioning and troubleshooting DSL services. Additionally, as competition for high speed Internet expands, the market is witnessing a reduction in price. Therefore, it has become increasingly more important for telecommunications service providers to lower the operational costs involved with supporting DSL services. The iPOTS3 is a device that allows service providers to perform full loop testing without having to deploy manual assets by allowing service providers to temporarily bypass the POTS Splitter and have a comprehensive view of their DSL networks. Prior to the introduction of this product in order to perform full testing, service providers would have to manually intervene so that test signals could be passed through the network. mPhase has established a worldwide distribution agreement with Corning Cable Systems for the sale of its iPOTS product line. Utilizing Corning as a distribution channel expands exposure for this product, as Corning is one of the largest vendors of central office DSL filtering equipment.

mPhase was organized on October 2, 1996. On February 17, 1997, the Company acquired Tecma Laboratories, Inc., a public corporation in a reverse merger transaction. This resulted in the Company's stock becoming publicly traded on the NASDAQ Over-the-Counter Bulletin Board. On June 25, 1998, the Company acquired Microphase Telecommunications, Inc. in a stock for stock exchange, whose principal assets included patents and patent applications utilized in the Company's legacy Traverser DVDDS product. On August 21, 1998, mPhaseTV.net, Inc. was organized as a wholly-owned subsidiary to market interactive television and e-commerce revenue opportunities. This subsidiary is dissolved. On March 2, 2000, mPhase acquired an interest in mPhaseTelevision.Net, Inc., a joint venture organized to provide digital television programming content to service providers in the United States deploying TV over DSL.

On March 14, 2000, we entered into an agreement with BMW Manufacturing Corp., located in South Carolina. Under the agreement, we installed version 1.0 of the Traverser for BMW's telephone transmission network. BMW has agreed that, upon its notice and consent, we will be able to demonstrate to potential customers the functioning system at BMW's facilities. BMW has made two (2) subsequent purchases increasing the size of its deployment to 62 unique units.

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Our flagship installation, Hart Telephone, has completed the build and development of its digital headend during fourth quarter of 2001. The completion of their digital headend marks the move from beta to commercial deployment of the Traverser platform. Hart currently has approximately 70 customers receiving about 80 channels of television services.

Effective December 1, 2002, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. for the development of mPhase's broadcast television switch as an integrated platform with the Lucent Stinger DSL Access Concentrator.

On December 9, 2002, pursuant to a Statement of Work, Lucent commenced development of the BTS for mPhase.

On December 15, 2002, mPhase engaged Lucent for the cost reduction of its Traverser INI set top box.

On January 21, 2003 mPhase entered into a Co-Branding Agreement with Lucent Technologies under which mPhase's INI set top box would be co-branded with the Lucent Technologies name and logo.

On April 4, 2003, mPhase entered into a Systems Integration Agreement with Lucent Technologies. Under the terms of such an agreement mPhase has been given the exclusive rights to sell worldwide as a "bundled" solution the Stinger in connection with mPhase's BTS.

In July of 2003, mPhase successfully deployed for testing the TV+ platform for 3 customers of Hart Telephone Company.

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The Company has incurred net losses totaling approximately \$108,016,497 million during the development of its flagship product from inception through June 30, 2003. In fiscal 2001, the Company had anticipated that the sales of its component products would be able to supplement the underwriting of the completion of our flagship product, the Traverser[®]. In fiscal 2002 these sales declined with the overall decline of DSL deployments and spending in the telephonic industry. The Company sales of its POTS splitter product continued to slow during most of fiscal year 2003 with overall revenue decreasing approximately \$1 million as telecommunications spending continued to decline. The Company believes that its new iPOTS product will benefit from some of the existing DSL deployments in the future. Until such time such revenues are realized, the Company intends on maintaining its reduced cost structure to minimize its losses, which management believes will permit the Company to ultimately achieve profitability. The Company believes the initial deployments and the resultant revenues of its flagship television products are not expected to occur until the second quarter of fiscal year 2005. An upturn of spending in the telephonic industry for DSL component products should increase sales and improve the Company's margins and provide the Company the opportunity to attain profitability.

Revenues. To date, all material revenues have been generated from sales of POTS Splitter Shelves and other DSL component products to a small number of telecommunications companies. mPhase believes that future revenues are difficult to predict because of the length and variability of the commercial roll-out of the Traverser[®] to various telecommunications service providers. Since the Company believes that there may be a significant international market for the Traverser[®], involving many different countries with different regulations, certifications and commercial practices than the United States, future revenues are highly subject to changing variables and uncertainties. Additionally, the recent instability of the telecommunications market evidenced by reduction in capital spending across the whole telecom sector contributes to our difficulty in accurately predicting future revenues.

Cost of revenues. The costs necessary to generate revenues from Microphase and the sale of POTS Splitter Shelves and other DSL component products include direct material, labor and manufacturing. mPhase paid these costs to Janifast, Ltd., which has facilities in the People's Republic of China and is owned by and managed by certain senior executives of the Company. The cost of revenues also includes certain royalties paid to Microphase Corporation, a privately held corporation organized in 1955, which shares certain common management with the Company. Costs for future production of the Traverser[®] product will consist primarily of payments to manufacturers to acquire the necessary components and assemble the products and future patent royalties payable to GTRC.

Research and development. Research and development expenses consist principally of payments made to GTRC, Lucent and Microphase Corporation for development of the Traverser[®] product. All research and development costs are expensed as incurred.

General and administrative. Selling, general and administrative expenses consist primarily of salaries and related expenses for personnel engaged in direct marketing of the Traverser[®], the POTS Splitter Shelves and other DSL component products, as well as support functions including executive, legal and accounting personnel. Certain administrative activities are outsourced on a monthly fee basis to Microphase Corporation. Finally, mPhase leases the principal office from Microphase Corporation.

Litigation. mPhase has not incurred any material expenses due to litigation since its inception.

Non-cash administrative stock-based employee compensation charge. mPhase incurred non-cash administrative stock-based employee compensation charges of \$28,563 and \$548,550, for the fiscal years ended 2003 and 2002, respectively. The Company has reduced its use of stock options and warrants as a form of compensation to employees, directors and outside consultants as part of its current austerity program.

TWELVE MONTHS ENDED JUNE 30, 2003 VS. JUNE 30, 2002

Revenues. Total revenues for the year ended June 30, 2003 decreased to \$1,581,639 from \$2,582,446 for the year ended June 30, 2002. The decrease was primarily attributable to reduced sales of POTS Splitter Shelves and other DSL component products.

Cost of revenues. Total cost of revenues decreased to \$1,493,394 for the year ended June 30, 2003 from \$2,415,219 for the year ended June 30, 2002 due to the decrease in sales of POTS Splitter Shelves and other DSL

component products. Gross margins for the period ended June 30, 2003 were unchanged from the 6% margins for the period ended June 30, 2002. During the year ended June 30, 2003 there was a continued slump in telecommunications spending negatively affecting sales of POTS Splitter Shelves and other DSL component products.

Research and development. Research and development expenses decreased to \$3,538,305 in the year ended June 30, 2003 from \$3,819,583 for the year ending June 30, 2002. This represents a decrease of \$281,278 in fiscal 2003, the major components of which include reductions in most categories of research and development expenses, including reductions of expenses incurred with Microphase Corporation of \$322,640, GTRC of \$350,000, and other research expenses of \$265,871, offset by an increase in expenses incurred with Lucent of \$956,250 for the year ended June 30, 2003.

Such amount includes \$1,112,500 incurred with Lucent Technologies for the year ended June 30, 2003, primarily in connection with the cost-reduction to mPhases' Traverser' INI set top box and development of its new mPhase TV+ platform, as compared to \$156,250 during the comparable period in 2002, which we expect to be developed by Lucent Technologies, Inc. for a total cost of approximately \$1.6 million. We have engaged and expect to continue to engage Lucent for assistance with our development of other product refinements and enhancements on a project by project basis.

Research and development expenses incurred primarily with respect to Microphase Corporation decreased from \$751,074 to \$428,434 for the twelve-month period ended June 30, 2003 as compared to the twelve-month period ended June 30, 2002. The decrease in research and development expenses with Microphase in fiscal 2003 is the result of less costs incurred for product enhancement projects since the completion of the development of the original POTS Splitter product line, while still maintaining the continuing development of the Company's DSL component products. This includes the Company's line of POTS Splitters and Microfilters and the Company's newest products, the iPOTS' and mPhase Stretch. We believe the mPhase iPOTS' offers a much needed solution for the DSL industry; the iPOTS' enables telcos to remotely and cost-effectively perform loop management and maintenance including line testing, qualification and troubleshooting. The unique (patent pending) iPOTS' circuit allows most test heads to perform both narrow and wideband testing of the local loop through the central office POTS Splitter without having to physically disconnect the POTS Splitter, thereby eliminating the need to dispatch personnel and a truckroll. Another of our newer products we developed is the DSL loop extender, called mPhaseStretch. This product extends the service distance for the mPhase Traverser' and may be used in conjunction with other DSL services. The Company anticipates demand to be created for its new products both collectively should an upturn occur in DSL deployments, and individually in current market conditions, as the iPOTS' significantly reduces the cost of deploying and maintaining DSL services and the Stretch loop extender product addresses a primary issue in DSL services.

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Research and development expenses with GTRC declined to \$100,000 for the fiscal year ended June 30, 2003 as compared to \$450,000 for the fiscal year ended June 30, 2002 as a result of the legacy DVDDS television platform nearing completion. Generally, as the Company anticipates the completion of its Traverser product, overall research and development expenses incurred with GTRC are expected to decline, with variations based upon product cost reductions, product enhancements, if any, when such are undertaken with GTRC.

General and administrative expenses. General and administrative expenses were \$2,654,971 for the twelve-month period ended on June 30, 2003 as compared to \$6,490,373 for the same period ended June 30, 2002. This represents a decrease of these expenses of \$3,835,402, or approximately 59% in fiscal 2003 as a percentage of these expenses in Fiscal 2002. The decrease in administrative costs included a decrease of \$1,696,721 in non-cash charges for the issuance of options to consultants which totaled \$748,840 for the year ended June 30, 2003 as compared to \$2,445,561 during the comparable period in 2002. The decrease also occurred as a result of the reduction in workforce and the reduction in marketing response to the current contraction in the telecommunications equipment market. Other components of the decrease in selling, general and administrative expenses were decreases in executive compensation and payroll and related costs by approximately \$775,000, marketing expenses such as trade shows by approximately \$250,000, occupancy costs by approximately \$290,000, shareholder services and related expenses by approximately \$190,000, insurance and risk management costs by approximately \$145,000 and various decreases in other administrative categories aggregating approximately \$490,000, all of which approximated reductions of general and administrative other than non-cash charges of \$2,125,000. We do not expect such downward trend to continue but these expenses should remain at the current reduced levels until the Company commences deployment of its Television over DSL platforms. When the Company begins its marketing effort to roll out its DSL platform products, administrative and selling payroll and related costs will increase as the Company takes on new employees.

Depreciation and Amortization. Depreciation and Amortization expense was \$515,417 in fiscal 2003 as compared to \$670,183 for 2002. These expenses decreased \$154,766, or approximately 23% of the prior year's expense, as a result of the Company's reduced need for and outlays on capital expenditures in its two preceding fiscal years. We do not expect such downward trend to continue but such depreciation and amortization expense should remain at the current reduced levels until the Company commences deployment of its Television over DSL platforms. We expect to increase capital expenditures in connecting with the deployment of equipment at test sites with various telecommunications service providers globally as deployment of our TV+ product progresses and such equipment will need to be depreciated or amortized, as the case may be.

Net loss. mPhase recorded a net loss of \$6,650,211 for the year ended June 30, 2003 as compared to a loss of \$11,245,361 for the same period ended June 30, 2002. This represents a loss per common share of \$(.10) in 2003 as compared to \$(.23) in 2002, based upon weighted average common shares outstanding of 65,217,088 and 49,617,780 during the periods ending June 30, 2003 and June 30, 2002, respectively.

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TWELVE MONTHS ENDED JUNE 30, 2002 VS. JUNE 30, 2001

Revenues. Total revenues for the year ended June 30, 2002 decreased to \$2,582,446 from \$10,524,134 for the year ended June 30, 2001. The decrease was primarily attributable to slowing sales of the Company's POTS Splitter product line, caused by the general downturn in the telecommunications market, including among customers that order component products from the Company. The Company continues to believe that its line of POTS Splitter products is positioned to be competitively priced with high reliability and connectivity, and as such has the potential to be significant part of DSL deployment. The Company cannot predict when the demand for telecommunication equipment will resume, however we do not expect significant sales in the first two quarters of fiscal 2003.

Cost of revenues. Cost of sales was \$2,415,129 for the year ended June 30, 2002 as compared to \$5,804,673 in the year ended June 30, 2001. Cost of revenues declined for the twelve months ended June 30, 2002 compared to the prior period ending June 30, 2001 primarily because of decreased sales. Operating margins for the period ended June 30, 2002 were 6%. The gross margins have varied dramatically as spending among telecommunication providers has contracted, coupled with downward pressures related to the supply and demand of telecommunications products. The single most significant reason the margins decreased dramatically was due to the reduced selling price of our POTS Splitter product. Discounts, consisting of a 2% discount from the amount invoiced if paid within 29 days. Such discounts amounted to \$14,389 for the period ended June 30, 2002, and were offered to Covad Communication and Bell South Corporation two leading telecommunications service providers. In each case, the discount was offered to an existing customer to accelerate collections in connection with an order of our POTS Splitter product and was treated as a purchase discount to each our customers, and the reduction to net sales lowered the gross margins in the period.

Research and Development. Research and development expenses were \$3,819,583 for the year ended June 30, 2002 as compared to \$10,779,570 in the year ended June 30, 2001. Such expenditures include \$450,000 incurred with GTRC for the year ended June 30, 2002 as compared to \$3,814,000 during the comparable period in 2001. In addition we incurred \$1,212,594 with Microphase and additional expenses with other strategic vendors for the year ended June 30, 2002 as compared to \$3,405,975 during the comparable period in 2001.

The decrease in research and development expenses with Microphase is due to the completion of the development of the POTS Splitter product line. The decrease in research and development expense of approximately \$3.1 million is due to the termination of the Company's relationship with a third party manufacturer, Flextronics, with whom the Company had incurred substantial costs for prototypes and pre-manufacturing costs.

The decrease in research expenditures incurred with GTRC is due to the Company's nearing completion of the design and manufacture of prototypes of the set top box and the central office equipment associated with its Traverser product in 2002. Generally, as the Company anticipates the completion of its Traverser product, overall research and development expenses are expected to decline, with variations based upon product cost reductions, product enhancements, if any, when such are undertaken.

Research expenditures incurred with Microphase were related to the continuing development of the Company's DSL component products, including the Company's line of POTS Splitters and Microfilters and the Company's newest products, the iPOTS and mPhase Stretch. We believe the mPhase iPOTS offers a much needed solution for the DSL industry; the iPOTS enables telcos to remotely and cost-effectively perform loop management and maintenance including line testing, qualification and troubleshooting. Prior to the introduction of the iPOTS, loop management could not be remotely performed through a conventional POTS Splitter without the use of expensive cross connects or relay banks because of the mandatory direct current blocking capacitors in traditional POTS splitters, as required by various regulatory standards. The unique (patent pending) iPOTS circuit allows most test heads to perform both narrow and wideband testing of the local loop through the central office POTS Splitter without having to physically disconnect the POTS Splitter, thereby eliminating the need to dispatch personnel and a truckroll. The Company anticipates significant demand for this product, as it significantly reduces the cost of deploying and maintaining DSL services. Also recently developed is the DSL loop extender product called mPhaseStretch. This product extends the service distance for the mPhase Traverser and can be used in conjunction with other DSL services. The Company anticipates significant demand for the Stretch loop extender product as it addresses a primary issue in DSL services.

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General and Administrative Expenses. Selling, general and administrative expenses were \$6,490,373 for the year ended June 30, 2002 down from \$16,150,711 for the comparable period in 2001. The decrease in the selling, general and administrative costs included a decrease of non-cash charges relating to the issuance of common stock and options to consultants, which totaled \$2,445,561 for the year ended June 30, 2002 as compared to \$6,227,552 during the comparable period in 2001. The decrease also occurred as a result of the reduction in workforce in Fiscal 2002 and the reduction in marketing expenses in Fiscal 2002 in response to the current contraction in the telecommunications equipment market. Other components of the decrease in selling, general and administrative expenses were a substantial decrease in payroll of approximately \$1,100,000 to \$450,000, use of outside consultants of approximately \$870,000 to \$70,000, marketing expenses such as trade shows of \$1,200,000 to \$270,000, and advertising expenses of \$415,000 to \$13,000, all of which approximated \$2,800,000.

Net loss. mPhase recorded a net loss of \$11,245,361 for the year ended June 30, 2002 as compared to a loss of \$23,998,734 for the same period ended June 30, 2001. This represents a loss per common share of \$(.23) in 2002 as compared to \$(.72) in 2001, based upon weighted average common shares outstanding of 49,617,280 and 33,436,641 during the periods ending June 30, 2002 and June 30, 2001, respectively.

CURRENT PLAN OF OPERATIONS

RESEARCH AND DEVELOPMENT ACTIVITIES

mPhase throughout its history has outsourced its research and development activity with respect to both of its TV platforms as well as its POTS splitter products. GTARC has conducted a significant amount of research and development for mPhase pursuant to a research agreement comprised of a series of delivery orders, which outline the timing, necessary actions and form of payment for specific tasks related to the completion of certain components of the DVDDS legacy product. Microphase has performed research and development for mPhase with respect to certain component DSL products such as the iPOTS Splitter products, low pass filters and POTS Splitters and the legacy DVDDS product. Most recently, mPhase has engaged Lucent to cost-reduce its INI set top box and develop its new TV+ product.

For the years ended June 30, 2003, 2002 and 2001 and for the period since inception (October 2, 1996) to June 30, 2003, approximately \$100,00, \$450,000, \$3,813,683 and \$13,524,300, respectively, has been billed to mPhase for research and development conducted by GTARC. With the completion of the DVDDS legacy product, the Company has shifted its research and development from GATRC to Lucent Technologies Inc. Such new research and development was (a) initially for cost reduction of its INI set top box (b) development by Lucent of the new TV+ product (consisting of a newly designed television broadcast switch compatible with the Lucent Stinger data delivery system as well as equipment of other major vendors) . The Company incurred research and development expenses with Lucent for fiscal years ended June 30, 2003 and 2002 of \$1,112,500 and \$156,250, respectively.

In November of 2002, the Company and GTRC and GTARC entered into a Memorandum of Intention to convert approximately \$1.8 million in remaining payables outstanding to GTRC and exchange mutual releases in consideration for two term Notes totaling \$624,235 with varied payments through 2007 and warrants to purchase shares of the Company's common stock through 2007, at a price and formula to be agreed upon. Such Memorandum of Intention is subject to a final written agreement between mPhase and GTRC requiring approval of each company's board of directors. Under the terms of its license from GTRC mPhase is the sole, worldwide licensee of the technology developed by GTARC in conjunction with the legacy DVDDS product line. Upon completion of the legacy DVDDS product, GTRC may receive a royalty of up to 5% of product sales.

The amount of research and development costs the Company has expended from October 2, 1996, its inception date, through June 30, 2003 is \$34,347,079. During the year ended June 30, 2003, the Company incurred research and development expenses of \$3,538,305 related to the continued development of its current TV platforms and other DSL products and services as compared to \$3,819,583 for the same period ended June 30, 2002.

STRATEGIC ALLIANCES IMPLEMENTED

mPhase Technologies, Inc. has signed a worldwide distribution agreement with Corning Cable Systems, an industry-leading manufacturer of fiber optic and copper communications network solutions and pioneer of DSL

POTS splitter applications. This agreement enables Corning Cable Systems to resell mPhase's line of "intelligent" DSL component products including the recently released iPOTS3, as well as its other "intelligent" products. This relationship expands mPhase's distribution network extensively via Corning Cable Systems' worldwide sales force. Based on this agreement, mPhase will act as the original equipment manufacturer for Corning Cable Systems, jointly manufacturing the iPOTS product set, as well as providing sales support and continuing product design and development work. mPhase continues to aggressively directly market these product since the current agreement with Corning is non-exclusive in scope.

In addition, the Company has entered into a Co-Branding Agreement with Lucent for its redesigned cost reduced Traverser INI set top box. In addition, pursuant to a Systems Integration Agreement with Lucent, the Company has been designated as the exclusive worldwide reseller of the Lucent Stinger when bundled as part of the mPhase TV+ product.

CRITICAL ACCOUNTING POLICIES

REVENUE RECOGNITION

All revenue included in the accompanying consolidated statements of operations for all periods presented relates to sales of mPhase's POTS Splitter Shelves and DSL component products.

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As required, mPhase has adopted the Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements, which provides guidelines on applying generally accepted accounting principals to revenue recognition based upon the interpretations and practices of the SEC. The Company recognizes revenue for its POTS Splitter Shelf and other DSL component products at the time of shipment, at which time, no other significant obligations of the Company exist, other than normal warranty support.

The deferred revenues balance recorded on the Balance Sheet for the fiscal year ended June 30, 2003 is made up of three customer deposits consisting of \$156,180 in the aggregate for the POTS product and of \$58,000 for final customer acceptance of the Traverser product which will occur upon commercial production of such product.

RESEARCH AND DEVELOPMENT

Research and development costs are charged to operations as incurred in accordance with Statement of Financial Accounting Standards (SFAS), No.2, Accounting for Research and Development Cost.

INCOME TAXES

mPhase accounts for income taxes using the asset and liability method in accordance with SFAS No.109 Accounting for Income Taxes. Under this method, deferred tax assets and liabilities are measured using currently enacted tax rates. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in results of operations in the period that includes the enactment date. Because of the uncertainty as to their future realizability, net deferred tax assets, consisting primarily of net operating loss carryforwards, have been fully reserved for. Accordingly, no income tax benefit for the net operating loss has been recorded in the accompanying financial statements.

Utilization of net operating losses generated through June 30, 2003 may be limited due to changes in control of our common stock that occurred.

STOCK-BASED COMPENSATION

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Financial Accounting Statement No. 123, Accounting for Stock Based Compensation, encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation for grants to employees using the intrinsic method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock. The Company has adopted the disclosure only alternative described in SFAS 123 and SFAS 148, which require pro forma disclosures of net income and earnings per share as if the fair value method of accounting had been applied.

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The Company accounts for non-employee stock based awards in which goods or services are the consideration received for the equity instruments issued based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more readily determinable.

INVENTORY RESERVE AND VALUATION ALLOWANCE

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The Company carries its inventory at the lower of cost, determined on a first-in, first-out basis, or market. Inventory consists mainly of the Company's POTS Splitter Shelf and Filters. In determining the lower of cost or

market, the Company periodically reviews and estimates a valuation allowance to reserve for technical obsolescence and marketability. The allowance represents management's assessment and reserve for the technical obsolescence based upon the inter-operability of its component products, primarily filters and splitters, with presently deployed and next generation DSL infrastructures as well as a reserve for marketability based upon current prices and the overall demand for the individual inventory items. Material changes in either the technical standards of future DSL deployments or further erosion in the demand for deployments of DSL infrastructures could affect the estimates and assumptions resulting in the amounts reported. The allowance is estimated as the difference between inventory at historical cost, on a first in first out basis, and market based upon assumptions about future demand, current prices and product liability, and charged to the provision for inventory, which is a component of cost of sales. At the point the historical cost is adjusted, a lower cost-basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

During the fiscal years ended June 30, 2003, 2002 and 2001, the Company reserved approximately \$302,000, approximately \$928,000, and approximately \$315,000, respectively, for technical obsolescence and marketability based upon current prices and overall demand and charged a like amount to expense, representing 8.4% of average inventory, at cost, of approximately \$3,588,000 on hand during the period in fiscal 2003; 20.2% of average inventory, at cost, of approximately \$4,602,000 on hand during the period in fiscal 2002; and 13.6% of average inventory, at cost, of approximately \$2,309,000 on hand during fiscal 2001. The reserve and corresponding charges in fiscal 2002 were increased as the Company experienced a dramatic decrease, along with the entire telephonic industry, in demand for our component products in addition to the decision to table the production of certain product line items built on certain European standards and which the Company does not expect to pursue in the near future. As of June 30, 2003, the Company recorded a cost adjustment of approximately \$1,059,000, recognizing permanent cost reductions due to price adjustments approximating \$318,000 and reductions due to obsolescence resulting from a lack of inter-operability of certain components in inventory with the Company's present product line approximating \$741,000. As a result on June 30, 2003 the Company had a total inventory valuation reserve of \$486,500 against its inventory with a total balance, at cost, of \$2,589,678, or 18.8%. If there was to be a sudden and significant decrease in demand for our products, or if there were a higher incidence of inventory obsolescence because of rapidly changing technology and customer requirements, we could be required to increase our inventory allowances and our gross margins could be adversely affected.

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MATERIAL RELATED PARTY TRANSACTIONS

The Company records material related party transactions. The Company incurs costs for engineering, design and production of prototypes and certain administrative functions from Microphase Corporation and the purchase of finished goods, primarily consisting of DSL splitter shelves and filters, from Janifast Limited. The Company has incurred costs for obtaining transmission rights. This enabled the Company to obtain re-transmission accreditation to proprietary television content that the Company plans to provide with its flagship product, the Traverser within its incorporated joint venture mPhase Television.Net, in which the Company owns a 56.5% interest.

The Company has also incurred charges for beta testing and on-site marketing, including the display of a live working model at Hart Telephone. In addition, the Company has entered into a supply agreement with Hart Telephone, which is scheduled to commence upon the commercial production of the Traverser. In addition the Company has tested its TV+ platform in July of 2003 with 3 customers of Hart Telephone. A member of mPhase's Board of Directors is employed by Lintel, Inc., the parent corporation of Hart Telephone.

Directors that are significant shareholders of Janifast Limited include Messrs Ronald A. Durando, Gustave T. Dotoli, and Necdet F. Ergul.

Mr. Michael McInerney, an outside Director, is employed by Lintel, Inc. and Mr. Abraham Biderman was employed until September 30, 2003 by our former investment banking firm Lipper & Company.

Messrs, Biderman, McInerney and Mr. Anthony Guerino own a relatively small amount of stock, warrants and options in mPhase Technologies, Inc.

Mr. Durando, the President and CEO of mPhase, owns a controlling interest and is a director of Janifast Limited. Mr. Durando is Chief Operating Officer and Mr. Dotoli is an officer of Microphase Corporation. Mr. Ergul, the chairman of the board of mPhase, owns a controlling interest and is a director of Microphase Corporation. Microphase, Janifast, Hart Telephone and Lintel Corporation are significant shareholders of mPhase. Microphase, Janifast and Hart Telephone have converted significant liabilities to equity in fiscal years June 30, 2001, 2002 and in the current fiscal year. Management believes the amounts charged to the Company by Microphase, Janifast, mPhase Television.Net and Hart Telephone are commensurate to amounts that would be incurred if outside parties were used. The Company believes Microphase, Janifast and Hart Telephone have the ability to fulfill their obligations to the Company without further support from the Company.

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Significant charges from related parties are summarized for the periods enumerated as follows:

| <i>Charges and Expenses with Related Parties</i> | For the Years Ended June 30, | | |
|--|-------------------------------------|--------------|-------------|
| | 2001 | 2002 | 2003 |
| Charges incurred with Janifast included in: | | | |
| Cost of sales and ending inventory | \$ 8,932,378 | \$ 1,759,308 | \$ 178,959 |
| Total Janifast | \$ 8,932,378 | \$ 1,759,308 | \$ 178,959 |
| Charges incurred with Microphase Corp. included in: | | | |
| Cost of sales and ending inventory (including Royalties) | \$ 335,777 | \$ 200,440 | \$ 86,468 |
| Research and development | 1,660,606 | 876,074 | 428,434 |
| General and administrative | 132,600 | 136,080 | 133,200 |
| Total Microphase Corp. | \$ 2,128,983 | \$ 1,212,594 | \$ 648,102 |
| Charges incurred with Lintel & Affiliates included in: | | | |
| Research and development | \$ 192,000 | \$ 0 | \$ 0 |
| General and administrative | 285,000 | 0 | 0 |
| Total Lintel & Affiliates | \$ 477,000 | \$ 0 | \$ 0 |
| Charges incurred with Joint Venture Partners & Affiliates included in: | | | |
| Research and development | \$ 949,420 | \$ 64,039 | \$ 0 |
| General and administrative | 60,000 | 0 | 0 |
| Total Joint Venture Partners & Affiliates | \$ 1,009,420 | \$ 64,039 | \$ 0 |
| Total Charges with Related Parties included in: | | | |
| Cost of sales and ending inventory | \$ 9,268,155 | \$ 1,959,748 | \$ 2,65,427 |
| Research and development | 2,802,026 | 940,113 | 428,434 |
| General and administrative | 477,600 | 136,080 | 133,200 |
| Total Charges with Related Parties | \$ 12,547,781 | \$ 3,035,941 | \$ 827,061 |

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LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2003 mPhase had a working capital deficit of \$1,405,331 as compared to working capital of \$399,321 as of June 30, 2002. The Company's working capital position improved significantly in July of 2003 as a result of a major order for POTS Splitters as reflected in its 8k filings of July 2, 2003 and July 23, 2003, respectively. The Company believes this will be sufficient for its short-term liquidity. During fiscal year ending June 30, 2004 it is estimated that the Company will need to raise approximately \$2,000,000 to meet longer term liquidity needs through June 30, 2004. Such monies would be necessary primarily to fund future capital expenditures for research and development of enhanced features for its TV+ product and the manufacturing of inventory necessary to complete any significant order for DSL component products. Additional capital will need to be raised to build inventory for any significant order of the TV+ platform, the legacy Traverser DVDDS platform or the new Traverser INI set top box that might occur in fiscal year 2004. Finally, (depending upon sales and margins in fiscal year 2004) additional capital may be required to fund a portion of any growth necessary in operations.

Included in the Company's working capital position at June 30, 2003, were the conversions of approximately \$1.9 million of accounts payable and accrued expenses due to related parties and strategic vendors to equity, \$360,000 of accounts payable and accrued expenses due to related parties and approximately \$625,000 accrued payables and accrued expenses into Notes payable and \$1.2 million of accounts payable and accrued expenses due to a strategic vendor expected to be converted to equity in fiscal 2004. Through June 30, 2003, the Company has incurred development stage losses totaling approximately \$108,016,497. At June 30, 2003, the Company had cash and cash equivalents of \$396,860 compared to \$47,065 at June 30, 2002. Historically, mPhase had funded its operations and capital expenditures primarily through private placements of common stock. Management expects that its ongoing financial needs will be provided by financing activities and believes that the sales of its line of POTS Splitter products and other related DSL component products will provide some offset to cash flow used in operations, although there can be no assurance as to the level and growth rate of such sales in future periods as seen with quarter to quarter fluctuations in component sales. At June 30, 2003, the Company had accounts receivable of \$287,135 and inventory of approximately \$2.1 million. This compared to \$273,780 of accounts receivable and approximately \$3.3 million of inventory at June 30, 2002.

Cash used in operating activities was \$1,212,718 million during the twelve months ending June 30, 2003. For fiscal 2003 the cash used by operating activities principally consists of the net loss plus the slight increase in accounts receivable, offset by the decrease in inventory and by the increases in accounts payable, accrued expenses and increases in the amounts due to related parties; further offset by non cash expenses for depreciation and amortization, and by non-cash charges for common stock options and warrants issued for services.

In the year ended June 30, 2003, net cash of approximately \$73,305 was used in investing activities for the purchase of fixed assets.

The Company has entered into various agreements with GTARC, pursuant to which the Company receives technical assistance in developing the Digital Video and Data Delivery System. The Company has incurred expenses in connection with technical assistance from GTARC totaling approximately \$3,813,683, \$450,000 and \$100,000 for the years ended 2001, 2002 and 2003, respectively, and \$13,524,300 from the period from inception through June 30, 2003. As noted above, in November of 2002, the Company and GTRC and GTARC entered into a Memorandum of Intent to convert all amounts outstanding and exchange mutual Releases in consideration for two term Notes totaling \$624,235 with varied payments through 2007 and warrants to purchase shares of the Company's common stock through 2007, at a price and formula to be agreed upon. mPhase is the sole, worldwide licensee of the technology developed by GTARC in conjunction with the Traverser product line. Upon completion of the commercial product, GTRC may receive a royalty of up to 5% of product sales.

During the fiscal year ended, June 30, 2003, certain officers, directors and related parties were issued restricted shares of the Company's common stock and warrants for aggregate investments totaling \$116,000 in cash in one of the private placements listed below.

During the twelve-month period ended June 30, 2003, the Company raised capital through private placements with accredited investors, whereby the Company issued 4,296,680 shares of the Company's common stock together with 4,296,680 warrants, each to purchase one share of the Company's common stock at an exercise price of \$.30 per share, generating gross proceeds of \$1,289,005. The Company incurred \$124,687 of cash expenses and issued 313,669 warrants, each to purchase one share of its common stock at \$.30 per share to finders, consultants and investment banking firms in connection with these private placements.

Effective June 30, 2001 the Company converted \$2,420,039 of liabilities due to directors and related parties into 4,840,077 shares of the Company's common stock pursuant to debt conversion agreements.

During the fiscal year ended June 30, 2002 certain strategic vendors and related parties converted approximately \$2.7 million of accounts payable and accrued expenses into 7,492,996 shares of the Company's common stock and 5,953,490 warrants. Such vendors include Microphase Corporation, Janifast, Ltd., and Piper Rudnick LLP, mPhase's outside counsel.

During the fiscal year ended June 30, 2003, certain strategic vendors and related parties converted approximately \$1.9 million of accounts payable and accrued expenses into 5,923,333 shares of the Company's common stock and 3,706,800 warrants. Such vendors include Microphase Corporation and Janifast Ltd. In addition, Messrs. Durando and Dotoli, converted \$468,756 in back salary obligations into warrants to purchase 2,491,800 shares of common stock of the Company.

The Company has no commitments from affiliates or related parties to provide additional financing. The Company has, from time to time, been able to obtain financing from affiliates when conditions in the capital markets make third party financing difficult to obtain or when external financing is available only upon very unattractive terms to the Company, and when such capital has been available from the affiliates.

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As a result, conversion of debt with related parties and strategic vendors during the periods enumerated is as follows:

| <i>Equity Conversions of Debt With Related Parties and Strategic Vendors</i> | For the Years Ended June 30, | | |
|---|-------------------------------------|--------------|--------------|
| | 2001 | 2002 | 2003 |
| Related Party Conversions | | | |
| Number of shares | 4,840,077 | 6,546,550 | 5,533,333 |
| Number of warrants | 0 | 3,733,334 | 3,491,800 |
| Amount converted to equity | \$ 2,420,038 | \$ 1,594,628 | \$ 1,748,756 |
| Strategic Vendor Conversions | | | |
| Number of shares | 0 | 999,662 | 390,000 |
| Number of warrants | 0 | 870,000 | 205,000 |
| Amount converted to equity | \$ 0 | \$ 529,503 | \$ 198,032 |
| Total Related Party and Strategic Party Conversions | | | |
| Number of shares | 4,840,077 | 7,546,212 | 5,923,333 |
| Number of warrants | 0 | 4,603,334 | 3,696,800 |
| Amount converted to equity | \$ 2,420,038 | \$ 2,124,131 | \$ 1,946,788 |
| Gain on Extinguishment of Debt | \$ 0 | \$ 142,236 | \$ 61,226 |

As of June 30, 2003, mPhase had commitments of approximately \$700,000 for capital expenditures with respect to its new TV+ product with Lucent Technologies, Inc.

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LOSSES DURING THE DEVELOPMENT STAGE AND MANAGEMENT'S PLANS

Through June 30, 2003, the Company incurred development stage losses totaling approximately \$108,016,497, and at June 30, 2003 had a working capital deficit of \$1,405,331. The primary reason for the deterioration in the Company's working capital position at June 30, 2003, was the continued weakness in sales necessary to fund continuing expenses of operations as well as difficult capital markets funding conditions and the desire of management of the Company to avoid unnecessary dilution by issuing large amounts of equity at depressed prices to raise larger sums of cash. As noted above, during the fiscal year ended June 30, 2003 the Company's efforts to maintain a manageable working capital position included conversions of approximately \$1.9 million of accounts payable and accrued expenses due to related parties and strategic vendors to equity, \$360,000 of accounts payable and accrued expenses due to a related party into a note payable and continued negotiations to convert up to approximately \$1.8 million of accounts payable and accrued expenses due to strategic vendor into notes payable and equity, of which a minimum of approximately \$1.2 million is expected to be converted to equity in fiscal 2004. At June 30, 2003, the Company had \$396,860 of cash and cash equivalents and \$287,135 of trade receivables to fund short-term working capital requirements. The Company's ability to continue as a going concern and its future success is dependent upon its ability to raise capital in the near term to: (1) satisfy its current obligations, (2) continue its research and development efforts, and (3) the successful market and sell its products.

During the fiscal years ended June 30, 2002 and 2003 the Company was able to negotiate extended payment terms for overdue accounts payable with strategic vendors. These obligations are now classified as notes payable and included in current and long-term portions of notes payable in the accompanying balance sheets, based upon the revised payment terms. The company believes they can maintain its present repayment schedule, or otherwise renegotiate such terms that are satisfactory to the Company and these vendors.

On December 31, 2003, the Company became in arrears with respect to \$420,872 of a balloon payment on a Note payable to its outside Law Firm, Piper & Rudnick LLC. The Company is in discussion with respect to such law firm to extend and/or cancel all or portions of this debt. It should be noted that Piper & Rudnick hold warrants received in March of 2001 in exchange for cancellation of certain payables. Such warrants have conversion rights into our common stock for 2,233,490 shares that are being registered hereunder (see Selling Shareholders list - page 65 hereof) and are cashless. Such warrants could be exercised shares of our common stock which could then be sold in the open market upon the effectiveness of this Registration Statement on Form S-1 in the open market to recover our outstanding payable. See also Risk Factors Section on Page 8 hereof.

The Company believes that it will be able to complete the necessary steps in order to meet its cash flow requirements throughout fiscal 2004 and continue its development and commercialization efforts. Management's plans in this regard include, but are not limited to, the following:

We intend to continue to invest in technology and telecommunications hardware and software necessary to keep our products. We continue to operate on an austerity budget with sharply reduced administrative and marketing expenses.

We continue our efforts to raise additional funds through private placements of our common stock, the proceeds of which are required to fund continuing development stage expenditures and the commercial roll-out of our TV+ platform. However, there can be no assurances that we will generate sufficient revenues to provide positive cash flows from operations or that sufficient capital will be available when needed or at terms that we deem to be reasonable.

We have evaluated our cash requirements for fiscal year 2004 based upon certain assumptions, including our ability to raise additional financing and increased sales of our POTS splitter. The Company anticipates that it will need to raise approximately \$2 million additional monies primarily in private placements of its common stock with accredited investors, or alternatively we will need to curtail certain expenses as incurred at the present levels including marketing and research and development expenses. We have no commitments from affiliated or third parties to provide additional financing. In the event that we do not receive any proceeds from additional financings, we will attempt to further reduce expenditures and continue to operate the Company from sales revenue and any funding that may be available from affiliated companies. Additional investment in technology

design to reduce the cost of the Traverser□ will be necessary over the next 12 months. In the long term, the Company may continue to invest additional funds annually on research and development of the Traverser□ product line based upon sales levels, changes to technology and the overall success of the Company attaining sufficient financing until such time as it achieves profitable operations.

Should these cash flows not be available to us, we believe we would have the ability to revise our operating plan and make certain further reductions in expenses, so that our resources available at June 30, 2003, plus financing to be secured during fiscal year 2004, and expected POTS splitter revenues, will be sufficient to meet our obligations until the end of fiscal year 2004. We have continued to experience operating losses and negative cash flows. To date, we have funded our operations with a combination of component sales, debt conversions with related parties and strategic vendors and private equity offerings. Management believes that we will be able to secure the necessary financing in the short term to fund our operations into our next fiscal year. However, failure to raise additional funds, or generate significant cash flows through revenues, could have a material adverse effect on our ability to achieve our intended business objectives.

ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISKS

The Company is not exposed to changes in interest rates as the Company has no floating rate debt arrangements and no investments in certain held-to-maturity securities. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. A hypothetical 100 basis point adverse move in interest rates along the interest rate yield curve would not materially affect the fair value of any financial instruments at June 30, 2003. We believe that interest rate risks for our accounts receivable are insignificant. Sales to customers are denominated in dollars. Accordingly, we are not directly exposed to market risks from currency fluctuations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

d warrants received in March of 2001 in exchange for cancellation of certain payables. The information required by this item is set forth commencing on page F-1 attached hereto.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

[Back to Contents](#)**PART III****ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS**

Executive officers are selected by the Board of Directors. No family relationships exist between any of the executive officers or directors. The following table sets forth certain information with respect to each person, who is an executive officer or director. mPhase's executive officers and directors as of June 30, 2003 are as follows:

| <u>NAME</u> | <u>AGE</u> | <u>POSITION(S)</u> |
|---------------------------|------------|---|
| Necdet F. Ergul | 79 | Chairman of the Board and Director |
| Ronald A. Durando | 46 | Chief Executive Officer and Director |
| Gustave T. Dotoli (2) | 67 | Chief Operating Officer and Director |
| David Klimek | 49 | Chief Technology Officer and Director Executive Vice President, General Counsel and Chief Financial Officer |
| Martin Smiley | 56 | Officer |
| OUTSIDE DIRECTORS | | |
| Michael McInerney | 46 | Director |
| Anthony H. Guerino (1)(2) | 57 | Director |
| Abraham Biderman (1)(2) | 55 | Director |

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

All of the directors were elected by the shareholders on May 15, 2002. The current executive officers and directors, along with their backgrounds, are set forth below:

NECDET F. ERGUL has served as mPhase's Chairman of the Board since October 1996 with the exception of a three-month period when he temporarily resigned due to the press of personal business. Mr. Ergul also currently serves as the Chairman of the Board of Directors, President and Chief Executive Officer of Microphase Corporation, a leading developer of military electronic defense and telecommunications technology, which he founded in 1955. In addition to his management responsibilities at Microphase, he is active in engineering design and related research and development. Mr. Ergul holds a Masters Degree in Electrical Engineering from the Polytechnic Institute of Brooklyn, New York.

RONALD A. DURANDO is a co-founder of mPhase and has served as the Company's President, Chief Executive Officer and Director since its inception in October 1996. Since 1994, Mr. Durando has been an Officer of Microphase Corporation. Mr. Durando is not a Director of Microphase Corporation. >From 1986-1994, Mr. Durando was President and Chief Executive Officer of Nutley Securities, Inc., a registered broker-dealer. In addition, Mr. Durando is also Chairman of the Board of Janifast, Ltd., a Hong Kong company, for operational and manufacturing companies in China. Mr. Durando is also President and a Director of PacketPort.com, Inc. (Packet Port).

GUSTAVE T. DOTOLI has served as mPhase's Chief Operating Officer since October 1996 and has been a Director since October 1996. Prior to joining the Company, Mr. Dotoli was President and CEO of State Industrial Safety, Inc. from 1986-1996. In addition, Mr. Dotoli currently serves as the Vice President of Corporate Development of Microphase Corporation. Mr. Dotoli is also a Director and Vice President of Packet Port. He is formerly the President and Chief Executive Officer of the following corporations: Imperial Electro- Plating, Inc., World Imports USA, Industrial Chemical Supply, Inc., SISCO Beverage, Inc. and Met Pack, Inc. Mr. Dotoli received a B.S. in Industrial Engineering from Fairleigh Dickenson University in 1959.

DAVID KLIMEK is a co-founder of mPhase and has served as the Company's Chief Technology Officer since June 1997 and as Director of Engineering since its inception in October 1996. Mr. Klimek joined the Board of Directors in October 1996. From 1990-1996, Mr. Klimek owned and operated Mashiyach Design, Inc., an engineering consulting firm. He has more than 18 years of technical engineering and design expertise and presently holds 14 individual or co- authored U.S. patents. From 1982 to 1990, Mr. Klimek was the R&D manager of Digital Controls, Inc. Mr. Klimek holds a B.S. in Electrical Engineering from Milwaukee School of Engineering, Milwaukee, Wisconsin.

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MICHAEL P. MCINERNEY is President of Lintel, Inc. subsidiaries; Hart Telephone Company, a 10,000-line local exchange carrier in Northeast Georgia, Hart Communications, a telecommunications company, Hart Cable, a cable television company and Diversified Golf. Mr. McInerney was Executive Vice President of Lintel, Inc. from 1994 until he became President in 2001. >From 1991 to 1994, Mr. McInerney was Executive Director of Standard Telephone Company. In the period from 1980-1991, Mr. McInerney was a regional manager, state manager and an account executive with AT&T. Mr. McInerney earned a Masters of Business Administration degree at Winthrop College and a B.S. degree at the University of Vermont.

ANTHONY H. GUERINO has been a member of the Board since February 23, 2000. Since December 1997, Mr. Guerino has been an attorney in private practice in New Jersey. Prior thereto, Mr. Guerino served as a judge of the Newark Municipal Courts for over twenty (20) years, periodically sitting in the Essex County Central Judicial Processing Court at the Essex County Courthouse. Mr. Guerino has been a chairperson for and member of several judicial committees and associations in New Jersey, and has been an instructor for the Seton Hall School of Law's Trial Moot Court Program.

ABRAHAM BIDERMAN has been a member of the Board since August 3, 2000. Since 1990, Mr. Biderman has been employed by Lipper & Co. as Executive Vice President; Executive Vice President, Secretary and Treasurer of the Lipper Funds; and Co-Manager of Lipper Convertibles, L.P. Prior to joining Lipper & Co. in 1990, Mr. Biderman was Commissioner of the New York City Department of Housing, Preservation and Development from 1988 to 1989 and Commissioner of the New York City Department of Finance from 1986 to 1987. He was Chairman of the New York City Retirement System from 1986 to 1989. Mr. Biderman was Special Advisor to former Mayor Edward I. Koch from 1985 to 1986 and assistant to former Deputy Mayor Kenneth Lipper from 1983 to 1985. Mr. Biderman is a Director of the Municipal Assistance Corporation for the City of New York. Mr. Biderman graduated from Brooklyn College and is a certified public accountant.

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MARTIN SMILEY joined mPhase as Executive Vice President, Chief Financial Officer and General Counsel in August 2000. Mr. Smiley has over twenty years experience as a corporate finance and securities attorney and as an investment banker. Prior to joining the company, Mr. Smiley served as a Principal at Morrison & Kibbey, Ltd., a mergers and acquisitions and investment banking firm from 1998 to 2000, and as a Managing Director for CIBC Oppenheimer Securities from 1994 to 1998. He served as a Vice President of Investment Banking at Chase Manhattan Bank from 1989 to 1994, and as a Vice President and Associate General Counsel for Chrysler Capital Corporation from 1984 to 1989. Mr. Smiley graduated with a B.A. in Mathematics from the University of Pennsylvania and earned his law degree from the University of Virginia School of Law.

At each annual meeting of stockholders, the newly elected directors' terms begin on the date of election and qualification, and continue through the next annual meeting following election. Terms may differ in the case where a director resigns, is removed from office, or until the time when a successor director is elected and qualified.

SECTION 16 (A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Directors, executive officers, and individual owning more than 10 percent of mPhase common stock are required to file initial reports of ownership and changes in ownership with the SEC under Section 16(a) of the Securities Exchange Act of 1934, as amended. The SEC regulations also require those persons to provide copies of all filed Section 16(a) reports to the Company. mPhase has reviewed the report copies filed in fiscal year 2003, and based also on written representations from those persons, the Company believes that there was compliance with Section 16(a) filing requirements for fiscal year 2003. All the officers and directors filed all of the required forms in a timely manner.

[Back to Contents](#)**ITEM 11. EXECUTIVE COMPENSATION**

The following table sets forth, for the fiscal year ended June 30, 2003 and the two previous fiscal years, the compensation earned by mPhase's chief executive officer and the four other executive officers, whose compensation was greater than \$100,000 for services rendered in all capacities to the Company for the year ended June 30, 2003.

SUMMARY COMPENSATION TABLE**LONG-TERM COMPENSATION**

| | <u>YEAR</u> | <u>ANNUAL COMPENSATION</u> | | <u>RESTRICTED STOCK AWARD(S)</u> | <u>SECURITIES UNDERLYING OPTIONS/SARS</u> |
|---|-------------|--------------------------------|--------------|--|---|
| | | <u>SALARY</u> | <u>BONUS</u> | | |
| Ronald A. Durando (1) (2) Chief Executive Officer and President | 2003 | \$234,504 | □ | | 450,000 |
| | 2002 | \$388,504 | □ | | 1,850,000 |
| | 2001 | \$395,004 | □ | □ | 1,225,000 |
| Gustave Dotoli (1) (2) Chief Operating Officer | 2003 | \$193,254 | | | 350,000 |
| | 2002 | \$313,504 | □ | □ | 1,225,000 |
| | 2001 | \$342,917 | □ | □ | 860,000 |
| David Klimek Chief Technology Officer | 2003 | \$ 90,958 | | | 75,000 |
| | 2002 | \$106,606 | □ | □ | 162,500 |
| | 2001 | \$175,577 | □ | □ | 110,000 |
| Martin Smiley Executive Vice President | 2003 | \$109,583 | | | 200,000 |
| | 2002 | \$158,712 | | | 540,000 |
| Chief Financial Officer and General Counsel | 2001 | \$163,435 | □ | □ | 670,000 |

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(1) Includes \$7,500 annual stipend as a director for fiscal years ended June 30, 2001 and June 30, 2002. No such stipend was recorded for fiscal year ended June 30, 2003.

(2) Does not include 1,395,400 and 1,096,400 warrants to Messrs. Durando and Dotoli, respectively, to cancel previously unpaid compensation. Such warrants relate to \$234,362 and \$35,000 of unpaid cash compensation to Mr. Durando for fiscal years 2002 and \$84,105 and \$27,500 of unpaid cash compensation to Mr. Dotoli for fiscal years 2002 and 2003, respectively, the amounts of which are included in □Annual Compensation□ in the above table.

No individual named above received prerequisites or non-cash compensation during the years indicated which exceeded the lesser of \$50,000 or an amount equal to 10% of such person's salary. No other executive officer received compensation and bonuses that exceeded \$100,000 during any year.

Compensation of Directors

During fiscal year 2003 mPhase compensated each of the inside directors with Warrants to purchase 75,000 shares of common stock at a price of \$.40 per share. The outside directors were each compensated with Warrants to purchase 35,000 shares of common stock at \$.40 per share. There was no cash stipend paid to any directors during the fiscal year 2003. A cash stipend was paid to each director in the amount of \$7,500 for fiscal years 2002 and 2001.

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STOCK OPTIONS

The following table contains information regarding options granted in the fiscal year ended June 30, 2003 to the executive officers named in the summary compensation table above. For the fiscal year ended June 30, 2003, mPhase granted options and compensatory warrants to acquire up to an aggregate of 1,615,000 shares to employees and directors.

**OPTION GRANTS IN LAST FISCAL YEAR
(INDIVIDUAL GRANTS)**

| Name | Number of% Securities Underlying Option/SARS Granted (#) | of Total Option/SARS Granted to Employees in Fiscal Year | Exercise or Base Price (\$/Share) | Market Price on Grant Dates | Expiration Dates | Potential Realizable Value of Assumed Annual Rates of Stock Price Appreciation for 5 Year Option Term | | |
|----------------------|--|--|---|---|---------------------|---|-----------|------------|
| | | | | | | <u>0%</u> | <u>5%</u> | <u>10%</u> |
| Ronald A. Durando | 450,000 | 27.9% | \$.40 | \$.31 | 2008 | \$0 | \$0 | \$ 44,665 |
| Gustave T. Dotoli | 350,000 | 21.7% | \$.40 | \$.31 | 2008 | \$0 | \$0 | \$ 34,740 |
| David Klimek | 75,000 | 4.6% | \$.40 | \$.31 | 2008 | \$0 | \$0 | \$ 7,445 |
| Martin Smiley | 200,000 | 12.4% | \$.40 | \$.31 | 2008 | \$0 | \$0 | \$ 19,850 |

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The following table sets forth information with respect to the number and value of outstanding options held by executive officers named in the summary compensation table above at June 30, 2003. During the fiscal year ended June 30, 2003, No options were exercised. The value realized is the difference between the closing price on the date of exercise and the exercise price. The value of unexercised in-the-money options is based upon the difference between the closing price of mPhase's common stock on June 30, 2003, and the exercise price of the options.

**AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND
FISCAL YEAR-END OPTION VALUES**

| Shares Acquired on Exercise | Value Realized \$ | NUMBER OF SECURITIES (1) UNDERLYING UNEXERCISED OPTIONS AT YEAR END (#) | | VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT YEAR END (\$) | | |
|-----------------------------------|-------------------------|---|---------------|--|---------------|---|
| | | EXERCISABLE | UNEXERCISABLE | EXERCISABLE | UNEXERCISABLE | |
| Ronald A. Durando | □ | □ | 4,225,000 | □ \$ | 59,000 | □ |
| Gustave T. Dotoli | □ | □ | 2,860,000 | □ \$ | 39,000 | □ |
| David Klimek | □ | □ | 547,500 | □ \$ | 4,650 | □ |
| Martin Smiley | □ | □ | 1,285,000 | □ \$ | 18,400 | □ |

(1) Includes compensatory warrants granted during the year ended June 30, 2003.

Compensation of Directors

During fiscal year 2003 mPhase compensated each of the directors with Warrants to purchase 75,000 shares of common stock at a price of \$.40 per share. The outside directors were each compensated with Warrants to purchase 35,000 shares of common stock at \$.40 per share. There was no cash stipend paid to any directors during fiscal year 2003. A cash stipend was paid to each director in the amount of \$7,500 for fiscal years 2002 and 2001.

Employment Agreements

All employment agreements with officers of mPhase have expired and are currently being renegotiated.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The members of the Compensation Committee during fiscal 2003 were Messrs. Dotoli, Biderman and Guerino. Mr. Dotoli is the Chief Operating Officer. Neither Messrs. Biderman nor Guerino has been one of mPhase's officers or employees. None of the Company's directors or executive officers served as a member of the Compensation Committee (or other board committee performing equivalent functions or, in the absence of such committee, the entire Board of Directors) of another entity during fiscal 2003 that has a director or executive officer serving also as a director on mPhase's Board of Directors, except that Mr. Dotoli is also a member of the Board of Directors of PacketPort, a company in which Mr. Durando serves as Chief Executive Officer. Mr. Dotoli, together with Mr. Durando and Mr. Ergul, are collectively controlling shareholders of Janifast and Mr. Dotoli and Mr. Ergul are also Directors of Janifast. Janifast has produced components for the Traverser and has and continues to produce the POTS splitter product for mPhase. MPhase plans to use Janifast to produce certain portions of orders for its Television platforms in the future.

[Back to Contents](#)**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth as of June 30, 2003, certain information regarding the beneficial ownership of our shares:

- by each person who is known by us to be the beneficial owner of more than five percent (5%) of its outstanding common stock;
- each of our directors;
- by each executive officer named in the Summary Compensation Table; and,
- by all of our directors and executive officers as a group.

| Name and Address of Beneficial Owner(1) | Number of [Shares] of Common Stock Beneficially Owned | Percentage Ownership of Common Stock(2) |
|---|--|--|
| Necdet F. Ergul(7)(9) | 16,477,451 | 21.0% |
| Ronald A. Durando(3)(7) | 15,584,548 | 19.9% |
| Gustave T. Dotoli(7)(10) | 4,596,100 | 6.1% |
| J. Lee Barton(4)(6)(7)(8) | 3,589,000 | 5.0% |
| David Klimek(7) | 715,000 | 1.0% |
| Intel, Inc.(6) | 4,114,219 | 5.7% |
| Abraham Biderman(5)(7) | 312,733 | * |
| Anthony Guerino(7) | 302,500 | * |
| Michael McInerney(7)(8) | 168,900 | * |
| Martin Smiley(11) | 3,841,050 | 5.2% |
| Microphase Corp,(12) | 14,169,535 | 18.2%(12) |
| Janifast(13) | 8,550,000 | 11.7%(13) |
| All executive Officers & Directors as a group (eight people) (8) | 49,701,501 | 53.1% |

* Less than 1%

(1) Unless otherwise indicated, the address of each beneficial owner is 587 Connecticut Avenue, Norwalk, Connecticut 06854-1711.

(2) Unless otherwise indicated, mPhase believes that all persons named in the table have sole voting and investment power with respect to all shares of the Company shares beneficially owned by them. The percentage for each beneficial owner listed above is based on 72,086,186 shares outstanding on October 27, 2003, and, with respect to each person holding options or warrants to purchase shares that are exercisable within 60 days after October 27, 2003, the number of options and warrants are deemed to be outstanding and beneficially owned by the person for the purpose of computing such person's percentage ownership, but are not deemed to be outstanding for the purpose of computing the percentage ownership of any other person. The number of shares indicated in the table include the following number of shares issuable upon the exercise of warrants or options:

| | |
|-------------------|-----------|
| Necdet F. Ergul | 6,541,250 |
| Ronald A. Durando | 6,142,067 |
| Gustave Dotoli | 3,513,067 |
| J. Lee Barton | 295,000 |
| Intel, Inc. | □ |

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| | |
|-------------------|-----------|
| David Klimek | 322,500 |
| Martin Smiley | 2,443,007 |
| Michael McInerney | 155,500 |
| Abraham Biderman | 307,500 |
| Anthony Guerino | 302,500 |

- (3) Includes 1,396,148 shares held by Durando Investment LLC, and 7,350,000 shares and 1,200,000 warrants held by Janifast which Mr. Durando controls and 230,000 shares owned by Karen and Ronald Durando Foundation; and 95,000 shares owned by Durando Charitable Remainder Trust.
- (4) Includes 100,000 shares owned by Kim Barton, his wife and 100,000 shares owned by Betty Barton, his daughter. Mr. Barton resigned from the Board of Directors in March 2002.
- (5) Includes 5,233 shares of common stock, options and warrants for 272,500 shares of common stock. Does not include 1,103,225 shares held by Lipper & Co, where Mr. Biderman is a director.
- (6) The address for Lintel, Inc. and J. Lee Barton, who is Chief Executive Officer of Lintel, Inc. is 196 North Forest Avenue, P.O. Box 388, Hartwell, GA 30643.
- (7) Includes options for 25,000 shares of common stock received as compensation for participation on the Board of Directors.
- (8) Mr. Michael P. McInerney, President of Lintel, Inc. subsidiaries, was appointed to the Board at the 2002 Annual Shareholders meeting.
- (9) Includes 200,000 shares owned by Berrin Snyder, his daughter and 150,000 owned by Eda Peterson, his daughter. Also includes 8,244,667 shares and 3,200,000 warrants and 1,200,000 shares and warrants to purchase 1,200,000 shares issuable pursuant to the terms of a convertible note held by Microphase Corporation, a company in which Mr. Ergul is the President and Chief Executive Officer.
- (10) Includes 195,000 shares owned by Patricia and Gustave Dotoli Foundation; and 30,000 shares owned by Dotoli Charitable Remainder Trust.
- (11) Includes 333,334 shares and warrants to purchase 333,334 shares issuable pursuant to the terms of a convertible note.
- (12) Includes 8,244,667 shares and 3,200,000 warrants and 1,200,000 shares and warrants to purchase 1,200,000 shares issuable pursuant to the terms of a convertible note held by Microphase Corporation, the totals of which are included in the total beneficially owned shares of Necedet F. Ergul.
- (13) Includes 7,350,000 shares and 1,200,000 warrants, the totals of which are included in the total beneficially owned shares of Ronald A. Durando.

[Back to Contents](#)**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

mPhase's President and Chairman of the Board of the Company and Chief Operating Officer are also officers of Microphase. (See Footnote 11 to Financial Statement entitled "Related Party Transactions".) On May 1, 1997, the Company entered into an agreement with Microphase, whereby it will use office space as well as the administrative services of Microphase, including the use of accounting personnel. This agreement was for \$5,000 per month and was on a month-to-month basis. In July 1998, the office space agreement was revised to \$10,000 and in January 2000 to \$11,050 per month. In July, 2002 this was increased to \$12,200 per month and as of January 1, 2003 such rent was reduced to 10,000 per month. Additionally, in July 1998, mPhase entered into an agreement with Microphase, whereby mPhase reimburses Microphase \$40,000 per month for technical research and development assistance. Such agreement was amended as of January 1, 2002 to reduce such payment to \$20,000 per month. Microphase also charges fees for specific projects on a project-by-project basis. During the years ended June 30, 2001, 2002, and 2003 and for the period from inception (October 2, 1996) to June 30, 2003, \$2,128,983, \$1,212,594, \$648,102 and \$7,224,526, respectively, have been charged to expense or inventory under these Agreements and is included in operating expenses in the accompanying consolidated statements of operations.

The Company is obligated to pay a 3% royalty to Microphase on revenues from its proprietary Traverser Digital Video and Data Delivery System and DSL component products. During the years ended June 30, 2001, 2002 and 2003 mPhase recorded royalties to Microphase totaling \$297,793, \$78,762 and \$47,304, respectively. Pursuant to a debt conversion agreement between the Company and Microphase for the year ended June 30, 2001, Microphase received 1,278,000 shares of mPhase common stock. For the year ended June 30, 2002, in consideration for a direct investment of \$100,000 and pursuant to debt conversion agreements, Microphase received 2,900,000 shares of mPhase common stock and 2,200,000 warrants to purchase mPhase common stock. During the fiscal year ended June 30, 2003 Microphase received 4,033,333 shares of common stock plus 1,000,000 five year warrants to purchase shares of common stock of mPhase at \$.30 per share in exchange for the cancellation of accounts payable totaling \$920,000. As of June 30, 2002, the Company had \$92,405 included in other liabilities related parties in the accompanying consolidated balance sheet and as of June 30, 2003 \$360,000 in notes payable related parties. Additionally, at June 30, 2003, approximately \$142,000 of undelivered purchase orders remain outstanding with Microphase.

Directors that are significant shareholders of the Company include Messrs Ronald A. Durando, Gustave T. Dotoli, Necdet F. Ergul and Mr. David Klimek. Mr. Michael McInerney, an outside Director, is employed by Lintel, Inc. and Mr. Abraham Biderman was employed until September 30, 2003 by our former investment banking firm Lipper & Company. Messrs. Biderman, McInerney and Mr. Anthony Guerino own a relatively small amount of stock, warrants and options in mPhase Technologies, Inc.

During the year ended June 30, 2000, mPhase advanced money to Janifast Ltd., which is a related party of which three directors of mPhase are significant shareholders, in connection with the manufacturing of POTS Splitter Shelves and DSL component products. As of June 30, 2000 the amount advanced to Janifast Ltd. was approximately \$1,106,000, which is included in production advances-related parties on the accompanying balance sheet. There were no such advances as of June 30, 2001 and June 30, 2002.

Pursuant to a debt conversion agreement between the Company and Janifast Ltd., for the year ended June 30, 2001, Janifast Ltd. received 1,200,000 shares of the Company's common stock. For the year ended June 30, 2002 pursuant to debt conversion agreements, Janifast Ltd. received 3,450,000 shares of mPhase common stock and 1,200,000 warrants to purchase mPhase common stock. During the year ended June 30, 2003 Janifast Ltd. was issued 1,500,000 shares of mPhase common stock in connection with the cancellation of \$360,000 of outstanding liabilities of mPhase, the value of which was based upon the price of the Company's common stock on the effective date of the settlement. No gain or loss was recognized in connection with conversions by Janifast Ltd. for the fiscal year ended June 30, 2003. During the years ended June 30, 2001, 2002 and 2003 and the period from inception (October 2, 1996) to June 30, 2003 \$8,932,378, \$1,759,308 and \$10,691,686 respectively, of invoices for products and services have been charged to inventory or expense-other liabilities related parties as long term liabilities in the accompanying consolidated balance sheet and as of June 30, 2003 no amounts remain payable to Janifast Ltd. Additionally, at June 30, 2003, approximately \$1,435,000 of undelivered purchase orders remain outstanding with Janifast Ltd.

In July 2000, mPhase added a member to the Board of Directors who is employed by an investment-banking firm that has assisted and is expected to continue to assist the Company in raising capital through private financing. During the year ended June 30, 2001, the Company issued 140,350 shares of common stock for investment banking services rendered during the period and recorded an additional \$69,000 of fees which is included in accrued expenses at June 30, 2001. A member of mPhase's Board of Directors is employed by Lintel, Inc, the parent corporation of Hart Telephone. The Company has installed its prototype product and commenced beta testing at Hart Telephone. In addition, the Company has entered into a supply agreement with Hart Telephone upon the commencement of commercial production of the Traverser. As consideration for the execution of the agreement with Hart Telephone, in May 2000, mPhase issued Hart Telephone 125,000 options each to purchase one share of common stock at an exercise price of \$1.00 (valued at \$1,010,375), which is included in research and development expenses in the accompanying statement of operations for the year ended June 30, 2000. Mr. J. Lee Baron the president and chief executive officer of Lintel Inc., (Lintel is the parent of Hart Telephone Company), and at that time a Director of the Company, received a \$285,000 bonus, a stock award of 140,000 shares and 100,000 options in addition to the 125,000 granted to Hart for beta testing services in the year ended June 30, 2000 and 120,000 options for services as a Director for the year ended June 30, 2001.

Effective June 30, 2001 the Company converted \$2,420,039 of liabilities due to directors and related parties into 4,840,077 shares of the Company's common stock pursuant to debt conversion agreements.

Effective March 31, 2002, the Company converted \$420,872 of liabilities due to Piper Rudnick LLP, outside legal counsel to mPhase into a warrant to purchase up to a total of 1,683,490 shares of the Company's common stock which pursuant to EITF 96-18, has an approximate value of \$.30 per share; and a warrant to purchase 550,000 shares of the Company's common stock at an exercise price of \$.30 per share pursuant to the terms of payment agreement. In addition, Piper agreed to accept a promissory note for \$420,872 of current payables at an interest rate of 8% with payments of \$5,000 per month commencing June 1, 2002 and continuing through December 1, 2003, with a final payment of principal plus accrued interest due at maturity on December 31, 2003. As of August 11, 2003 the Company is \$35,000 in arrears with respect to the \$5,000 per month payment on the promissory note.

During the year ended June 30, 2002 the Company converted \$2,738,658 of accounts payable and accrued expenses strategic vendors and related parties (of which \$1,460,000 was to such related parties) into 7,492,996 shares of common stock and 5,953,490 warrants to purchase additional shares of common stock.

During the year ended June 30, 2002 certain officers directors and related parties were issued 8,150,000 shares of common stock and 3,400,000 warrants to purchase additional shares of common stock in exchange for an aggregate cash investment of \$1,000,000 plus the conversion of accounts payable equal to \$1,460,000.

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On November 11, 2002 and November 12, 2002, the Company issued warrants to purchase 2,491,080 shares of common stock of the Company which were valued at \$480,917 or \$.193 per share pursuant to EITF 96-18, for the cancellation of unpaid compensation to two officers of the Company as of October 14, 2002. In addition the Company issued 4,533,333 shares of its common stock to related parties in exchange for the cancellation of an aggregate of \$980,000 of accounts payable as October 14 and October 15, 2002. The Company's Board of Directors ratified and approved these transactions on October 30, 2002. For accounting purposes these debt conversions were reflected on the Company's balance sheet dated September 30, 2002.

On October 14, 2002, the Company entered into a memorandum on intention with Georgia Tech Research Corporation (GTRC) and its affiliate, Georgia Tech Applied Research Corporation (GTARC), which memorandum was revised on November 12, 2002 and is subject to the approval of the respective board of directors of the parties thereto and the exchange of mutual releases. The memorandum provides for the settlement of any and all amounts outstanding to GTRC and GTARC through September 30, 2002 in consideration of the issuance of warrants to purchase shares of the Company's common stock at a price and quantity to be determined in exchange for cancellation of accounts payable of \$1,211,249. In addition the Company would issue two term promissory notes totaling \$624,235 with interest at 7% and varied payments through 2007 in exchange for the cancellation of an account payable by the Company in an equal principal amount. The non-current amount of such Notes is reflected on the balance sheet dated June 30, 2003 as long-term debt and other liabilities for the amounts expected to be converted to the two promissory notes payable and the warrants respectively.

Effective December 31, 2002, the Company issued to Janifast Ltd. 1,200,000 shares of common stock and a warrant to purchase 1,200,000 additional shares of common stock at \$.30 per share (good for 5 years) in exchange for cancellation of \$360,000 of accounts payable due from the Company.

In March of 2003, Messrs. Durando the CEO and President and Smiley the CFO and General Counsel of the Company lent the Company \$30,000 and \$100,000 respectively evidenced by two promissory notes bearing interest at 12% per annum due in September of 2003. As of June 30, 2003 the Company prepaid Mr. Durando's promissory note in full together with accrued interest. In June 2003, Mr. Smiley agreed to extend his note until July, 2004. Also in June, 2003, Microphase agreed to convert \$360,000 of accounts payable to a note payable, interest at 12%, due in July, 2004. The notes have provisions for prepayment by the Company, and, at the option of the holder, provide for the conversion of unpaid principal and interest into units valued at \$.30 each, each unit consisting of one share of the Company's common stock and a one warrant to purchase the Company's common stock at \$.30 per share for a period of 5 years.

Effective March 31, 2003, the Company issue to Microphase Corporation 1,000,000 shares of its common stock plus a 5 year warrant to purchase an additional 1,000,000 shares of common stock at \$.30 per share in exchange for cancellation of accrued payables owed by mPhase to Microphase Corporation totaling \$3,666,667 in the aggregate.

Our management is affiliated by employment at and/or ownership of a related group of companies, including Microphase Corporation, Complete Telecommunications, Inc. (which was dissolved subject to a settlement dated August 16, 1999), Packetport.com, Inc. and Janifast Ltd., which may record material transactions with us. As a result of such affiliations, our management in the future may have conflicting interests with these affiliated companies.

Necdet F. Ergul and Ronald A. Durando, our Chairman and Chief Executive Officer, respectively, are executive officers and shareholders of Microphase. In addition, Ronald Durando and Gustave T. Dotoli are president and vice-president of PacketPort.com., respectively. Gustave T. Dotoli is an officer of Microphase.

During the fiscal year ended June 30, 2003 we reimbursed Microphase \$7,455 per month for research and development services and administrative expenses incurred for the use of Microphase's office space, lab facilities and administrative staff. Such amount was reduced to \$6,000 per month starting January 1, 2003.

One of our former directors, J. Lee Barton, is Chairman of the Board of Lintel, Inc. Lintel is the parent corporation of Hart Telephone Company, our beta customer located in Hartwell, Georgia, where we installed our prototype product and commenced beta testing. In December 1998, we issued 3,115,000 shares in a private placement to J. Lee Barton, several members of his family, Lintel, several employees of Lintel and two employees of Microphase for a purchase price of approximately \$1.03 per share, or an aggregate purchase price of

\$3,197,416. In addition, Mr. Barton received a \$285,000 payment plus an award of 140,000 shares of mPhase common stock for the fiscal year ended June 30, 2000 for assisting the Company in making available the facilities and resources of Hart Telephone as its beta testing site. During Mr. Barton's tenure as a Director of the Company through March of 2001, he received options to purchase 295,000 shares of mPhase common stock at varying prices which includes options to Hart Telephone to purchase 125,000 shares of common stock at an exercise price of \$1.00 per share valued at \$1,013,375 which was included as a non-cash portion of research and development expenses for the fiscal year ended June 20, 2000.

Michael McInerney, one of our directors, is the president of Lintel, Inc. Prior to becoming a Director of mPhase, Mr. McInerney received options to purchase 25,000 shares of mPhase common stock for the fiscal year ended June 30, 1999, of which 5,000 options were exercised during the fiscal year ended June 30, 2000. Mr. McInerney received options for 23,000 shares of common stock in the fiscal year ended June 30, 2001 and 15,000 options for consulting and beta testing services in the fiscal year ended June 30, 2002. In addition for the fiscal years ended June 30, 2002 and June 30, 2003 Mr. McInerney received options and warrants to purchase a total of 62,500 shares and for 35,000 shares of mPhase common stock respectively.

Janifast Ltd., a Hong Kong corporation manufacturer, which has produced components for our prototype Traverser's DVDDS product, and has in the past and continues to produce our POTS splitter product. In addition, Janifast may manufacture, based upon mPhase receiving firm orders, certain portions of our Television+ platform in the future. Necdet F. Ergul, Ronald A. Durando and Gustave T. Dotoli are controlling shareholders of Janifast Ltd. with an aggregate ownership interest of greater than 75% of Janifast Ltd. Mr. Durando is Chairman of the Board of Directors and Mr. Ergul is a Director of Janifast.

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Abraham Biderman became a member of our Board in August 2000. Mr. Biderman is the Executive Vice President of Lipper & Company, L.P., which received a total of 265,125 shares of common stock for its services as a placement agent for our May 2000, September 2000 and January 2001 private placements. In July, 2001 and November, 2001 Lipper and Company received 138,000 shares and 300,000 shares in additional common stock in mPhase for services rendered to the Company as placement agent in a Private Placement and for general investment banking and financial advice services.

[Back to Contents](#)**ITEM 14A. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K**

(a)(1) The following is a list of the financial statements, financial statement schedules and exhibits, which are included in this Annual Report on Form 10-K. Where so indicated by footnote, exhibits, which were previously filed, are incorporated by reference.

FINANCIAL STATEMENT SCHEDULES:**EXHIBITS****EXHIBITS****NUMBER****REFERENCE****DESCRIPTION**

| | |
|------|---|
| 2.1* | Exchange of Stock Agreement and Plan of Reorganization (incorporated by reference to Exhibit 2(a) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)). |
| 2.2* | Exchange of Stock Agreement and Plan of Reorganization dated June 25, 1998 (incorporated by reference to Exhibit 2(b) to our registration statement on Form 10SB-12G filed on May 6, 1999 (file no. 000-24969)). |
| 3.1* | Certificate of Incorporation of Tecma Laboratory, Inc. filed December 20, 1979 (incorporated by reference to Exhibit 3(a) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)). |
| 3.2* | Certificate of Correction to Certificate of Incorporation of Tecma Laboratory, Inc. dated June 19, 1987 (incorporated by reference to Exhibit 3(b) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)). |
| 3.3* | Certificate of Amendment of Certificate of Incorporation of Tecma Laboratory, Inc. filed August 28, 1987 (incorporated by reference to Exhibit 3(c) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)). |
| 3.4* | Certificate of Amendment of Certificate of Incorporation of Tecma Laboratories, Inc. filed April 7, 1997 (incorporated by reference to Exhibit 3(d) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)). |
| 3.5* | Certificate of Amendment of Certificate of Incorporation of Lightpaths TP Technologies, Inc. filed June 2, 1997 (incorporated by reference to Exhibit 3(e) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)). |
| 3.6* | Certificate of Amendment of Certificate of Incorporation of mPhase Technologies, Inc. filed September 15, 2000 (incorporated by reference to Exhibit 3i to our quarterly report on Form 10Q filed on November 13, 2000 (file no. 000-24969)). |
| 3.7* | Bylaws of the Company (incorporated by reference to Exhibit 3(g) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)). |
| 4.1* | Form of Registration Rights Agreement, dated January 26, 2001, by and among the Company and the purchasers listed on Schedule A attached thereto (incorporated by reference to Exhibit 4.1 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 4.2* | Form of Registration Rights Agreement, dated February 9, 2001, by and among the Company and the purchasers listed on Schedule A attached thereto (incorporated by reference to Exhibit 4.2 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |

10.1*

License Agreement, dated March 26, 1998, between the Company and Georgia Tech Research Corporation (incorporated by reference to Exhibit 10(e) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000- 24969)).

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EXHIBITS

NUMBER

REFERENCE

DESCRIPTION

| | |
|-----------|--|
| 10.2* | First Amendment to the License Agreement, dated January 8, 2001, between the Company and Georgia Tech Research Corporation (incorporated by reference to Exhibit 10.2 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 10.3* | Employment Agreement between Ronald A. Durando and the Company (incorporated by reference to Exhibit 10.8 to our registration statement on Form SB-2 filed on August 13, 1999 (file no. 333-85147)). |
| 10.4* | Employment Agreement between Gustave T. Dotoli and the Company (incorporated by reference to Exhibit 10.9 to our registration statement on Form SB-2 filed on August 13, 1999 (file no. 333-85147)). |
| 10.5* | Employment Agreement between Martin S. Smiley and the Company, dated as of August 15, 2000 (incorporated by reference to Exhibit 10.5 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 10.6* | Employment Agreement between David C. Klimek and the Company, dated as of April 1, 2001 (incorporated by reference to Exhibit 10.6 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 10.7* | Manufacturing Services Agreement, dated March 14, 2001, by and between the Company and Flextronics International USA, Inc (incorporated by reference to Exhibit 10.7 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 10.8* | Supply Agreement by and between the Company and Hart Telephone Company, Inc., date of August 19, 1998 (incorporated by reference to Exhibit 10.8 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 10.9* | Facilities/Services Agreement between the Company and Microphase Corporation, dated as of July 1, 1998. (incorporated by reference to Exhibit 10.9 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 10.10* | Company's 2001 Stock Incentive (incorporated by reference to Exhibit C to our preliminary proxy statement on Form Pre 14A filed on March 21, 2001 (file no.000-30202)). |
| 10.11* | License Agreement, dated July 31, 1996, by and between AT&T Paradyne Corporation and Microphase Corporation. (incorporated by reference to Exhibit 10.11 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 10.12(a)* | Assignment Agreement, dated February 17, 1997, by and between the Company and Microphase Corporation. (incorporated by reference to Exhibit 10.12 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33- 63262)). |
| 10.12(b)* | Distribution Agreement effective May 15, 2002 by and between Corning Cable System and the Company. |
| 10.13.** | Development Agreement between Lucent Technologies, Inc. and mPhase Technologies, Inc., effective as of December 1, 2002, relating to Video Services Switch and Statement of Work, dated December 9, 2002. |

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EXHIBITS

NUMBER

REFERENCE

DESCRIPTION

| | |
|-----------|---|
| 10.14. ** | Purchase Order between the Company and Lucent Technologies, Inc., dated December 15, 2002, for cost reduction of the mPhase Traverser INI□ set box. |
| 10.15. | Co-Branding Agreement, dated as of January 21, 2003, between the Company and Lucent Technologies, Inc. |
| 10.16** | Systems Integrator Agreement, dated as of April 4, 2003, between the Company and Lucent Technologies, Inc. |
| 21* | List of Subsidiaries (incorporated by reference to Exhibit 21 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 23.1* | Consents of Schuhalter, Coughlin & Suozzo, LLC dated August 31, 1998 and Mauriello, Franklin & LoBrace, P.C. dated August 31, 1998 (incorporated by reference to Exhibit 23 to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)). |
| 23.2* | Consents of Schuhalter, Coughlin & Suozzo, LLC dated April 23, 1999 and Mauriello, Franklin & LoBrace, P.C. dated April 23, 1999 (incorporated by reference to Exhibit 23 to our registration statement on Form 10SB-12G filed on May 6, 1999 (file no. 000-24969)). |
| 23.3* | Consent of Schuhalter, Coughlin & Suozzo, LLC dated August 13, 1999 (incorporated by reference to Exhibit 23.1 to our registration statement on Form SB-2 filed on August 13, 1999 (file no. 333-85147)). |
| 23.4* | Consent of Arthur Andersen LLP (incorporated by reference to our registration statement, Amendment No. 2 filed on Aug. 15, 2001.) |
| 23.5* | Consent of Schuhalter, Coughlin & Suozzo, LLC (incorporated by reference to our registration statement, Amendment No. 2 filed on Aug. 15, 2001.) |
| 23.6* | Consent of Piper Marbury Rudnick & Wolfe LLP (incorporated by reference to our registration statement, Amendment No. 2 filed on Aug. 15, 2001.) |
| 23.7* | Consent of Rosenberg, Rich , Baker, Berman and Company (incorporated by reference to our registration statement, Amendment No. 1/A filed on August 1 2002 .) |
| 23.8* | Consent of Schuhalter, Coughlin & Suozzo, LLC (incorporated by reference to our registration statement, Amendment No 1/A filed on August 2, 2002.) |
| 23.9* | Consent of Piper&Rudnick LLP. (incorporated by reference to our registration statement, Amendment No. 1/A filed on August 2, 2002) |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Incorporated by reference.

** All or portions of such Agreements have been omitted and the Company has requested that the omitted sections be treated as Confidential Information pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended and has been filed with the Securities and Exchange Commission separately.

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FINANCIAL STATEMENTS

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| Consolidated Balance Sheets as of June 30, 2002 and 2003 | F-4 |
| Consolidated Statements of Operations for the years ended June 30, 2001, 2002 and 2003 and for the period from inception (October 2, 1996) through June 30, 2003. | F-5 |
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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of mPhase Technologies, Inc.:

We have audited the accompanying consolidated balance sheets of mPhase Technologies, Inc. (a New Jersey corporation in the development stage) and subsidiaries as of June 30, 2003 and June 30, 2002, and the related consolidated statements of operations, changes in stockholders' equity (deficit), cash flows and Schedule II (Valuation and Qualifying Accounts, Item 14B) for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of mPhase Technologies, Inc. for the period from inception to June 30, 2001. Such amounts are included in the cumulative from inception to June 30, 2001 totals of the statements of operations, changes in stockholders' equity and cash flows and reflect total net loss of 83 percent of the related cumulative totals. Those statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to amounts for the period from inception to June 30, 2001, included in the cumulative totals, is based solely upon the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of mPhase Technologies, Inc. and subsidiaries as of June 30, 2003 and 2002 and the results of their operations and their cash flows for each of the two years in the period ended June 30, 2003 and for the period from inception to June 30, 2003, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has suffered recurring losses from operations and is in a working capital deficit position that raises substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 14 to the consolidated financial statements, management has expanded certain disclosures in the accompanying consolidated financial statements. The resulting changes from these expanded disclosures and additional schedules have no effect on the financial position and results of operations for the year ended June 30, 2003. As a result of these expanded disclosures, management has reissued the June 30, 2003 consolidated financial statements to reflect these expanded disclosures.

Rosenberg Rich Baker Berman & Company
Bridgewater, NJ

September 10, 2003, except for Note 14 as to which the date is December 5, 2003.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of mPhase Technologies, Inc.:

We have audited the accompanying consolidated statements of operations, and cash flows and for the period from inception to June 30, 2001 of mPhase Technologies, Inc. (a New Jersey corporation in the development stage) and subsidiaries for the year ended June 30, 2001, and changes in stockholders' equity for each of the three years in the period ended June 30, 2001 and for the period from inception (October 2, 1996) to June 30, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of mPhase Technologies, Inc. for the period from inception to June 30, 1998. Such amounts are included in the cumulative from inception to June 30, 2001 totals of the statements of operations, changes in stockholders' equity and cash flows and reflect total net loss of 6 percent of the related cumulative totals. Those statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to amounts for the period from inception to June 30, 1998, included in the cumulative totals, is based solely upon the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of mPhase Technologies, Inc. and subsidiaries as of June 30, 2001, and the results of their operations and their cash flows for the year ended June 30, 2001 and for the period from inception to June 30, 2001, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has suffered recurring losses from operations and is in a working capital deficit position that raises substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Arthur Andersen LLP

Stamford, Connecticut

October 12, 2001

PURSUANT TO SEC RELEASE NO. 33-8070 AND RULE 437A UNDER THE SECURITIES ACT OF 1933, AS AMENDED, MPHASE TECHNOLOGIES, INC. HAS NOT RECEIVED WRITTEN CONSENT AFTER REASONABLE EFFORT TO USE THIS REPORT. THIS REPORT IS A COPY OF A PREVIOUSLY ISSUED ARTHUR ANDERSEN LLP REPORT. THIS REPORT HAS NOT BEEN REISSUED BY ARTHUR ANDERSEN LLP. WITH RESPECT TO THIS INSTANT 10K/A, YOU WILL NOT BE ABLE TO RECOVER AGAINST ARTHUR ANDERSEN LLP UNDER SECTION 11 OF THE SECURITIES ACT FOR ANY UNTRUE STATEMENTS OF A MATERIAL FACT CONTAINED IN THE FINANCIAL STATEMENTS AUDITED BY ARTHUR ANDERSEN LLP OR ANY OMISSIONS TO STATE A MATERIAL FACT REQUIRED TO BE STATED THEREIN.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of mPhase Technologies, Inc.:

We have audited the statements of operations, changes in stockholders' equity, and cash flows for the period October 2, 1996 (date of inception) through June 30, 1998 of mPhase Technologies, Inc. (a development stage company). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the results of its operations and its cash flows for the period of October 2, 1996 (date of inception) through June 30, 1998 in conformity with generally accepted accounting principles.

Schuhalter, Coughlin & Suozzo, PC

Raritan, New Jersey
January 28, 1999

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED BALANCE SHEETS

| | JUNE 30, | |
|--|-----------------|--------------|
| | 2002 | 2003 |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 47,065 | \$ 396,860 |
| Accounts receivable, net of bad debt reserve of \$2,906 and \$0 respectively | 273,780 | 287,135 |
| Stock subscription receivable | □ | 110,000 |
| Inventory | 3,342,716 | 2,103,328 |
| Prepaid expenses and other current assets | 830,589 | 100,329 |
| | 4,494,150 | 2,997,652 |
| | | |
| Property and equipment, net | 1,742,186 | 581,890 |
| Patents and licenses, net | 685,349 | 184,587 |
| | | |
| Other assets | 20,830 | 17,250 |
| | 6,942,515 | 3,781,649 |
| | \$ 6,942,515 | \$ 3,781,649 |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | |
| Current liabilities: | | |
| Accounts payable | \$ 2,819,245 | \$ 2,352,961 |
| Accrued expenses | 673,065 | 885,735 |
| Due to related parties | 35,000 | 187,372 |
| Note payable, current | 353,339 | 762,735 |
| Deferred revenue | 214,180 | 214,180 |
| | 4,094,829 | 4,402,983 |
| | | |
| Other liabilities | 1,211,249 | 1,561,249 |
| Other liabilities, related parties | 665,068 | □ |
| Notes payable-related parties | □ | 460,000 |
| Long-term debt, net of current portion | 1,014,218 | 586,303 |
| | 1,211,249 | 1,561,249 |
| | 1,211,249 | 1,561,249 |

COMMITMENTS AND CONTINGENCIES (Note 13)

STOCKHOLDERS' EQUITY (DEFICIT):

Common Stock, stated value \$.01, 150,000,000

shares authorized; 60,807,508 and 71,453,521 shares issued and
outstanding, in 2002 and 2003, respectively

| | | |
|--|-----------------------------|-----------------------------|
| | 608,075 | 714,535 |
| Additional paid-in capital | 100,751,284 | 104,081,049 |
| Deferred compensation | (23,923) | □ |
| Deficit accumulated during development stage | (101,366,286) | (108,016,497) |
| Unrecognized capital losses | (4,026) | □ |
| Less-treasury stock, 13,750 shares, at cost | (7,973) | (7,973) |
| | <u> </u> | <u> </u> |

| | | |
|--------------------------------------|-----------------------------|-----------------------------|
| Total stockholders' equity (deficit) | (42,849) | (3,228,886) |
| | <u> </u> | <u> </u> |

| | | |
|--|-----------------------------|-----------------------------|
| Total liabilities and stockholders' equity (deficit) | \$ 6,942,515 | \$ 3,781,649 |
| | <u> </u> | <u> </u> |

The accompanying notes are an integral part of these consolidated balance sheets.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF OPERATIONS

| | For the Years Ended June 30, | | | From Inception (October 2, 1996) to June 30, 2003 |
|--|------------------------------|-----------------|----------------|--|
| | 2001 | 2002 | 2003 | |
| TOTAL NET REVENUES | \$ 10,524,134 | \$ 2,582,446 | \$ 1,581,639 | \$ 14,967,695 |
| COSTS AND EXPENSES: | | | | |
| Cost of Sales (see also note 11 Related Party Transactions) | 5,804,673 | 2,415,129 | 1,493,394 | 9,844,952 |
| Research and development (including non-cash stock related charges of \$0, \$267,338, \$385,495 and \$2,045,669 respectively, see also note 11 Related Party Transactions) | 10,779,570 | 3,819,583 | 3,538,305 | 34,347,079 |
| General and administrative (including non-cash stock related charges of \$7,398,455, \$2,994,111, \$748,840, and \$46,090,349 respectively, see also note 11 Related Party Transactions) | 17,321,614 | 7,038,923 | 2,683,534 | 74,877,136 |
| Depreciation and Amortization | 660,372 | 670,183 | 515,417 | 2,767,029 |
| Total costs and expenses | 34,566,229 | 13,943,818 | 8,230,650 | 121,836,196 |
| Loss from operations | (24,042,095) | (11,361,372) | (6,649,011) | (106,868,501) |
| OTHER INCOME (EXPENSE): | | | | |
| Gain On Extinguishments | □ | 142,236 | 61,226 | 203,462 |
| Minority interest loss in consolidated subsidiary | □ | □ | □ | 20,000 |
| Loss from unconsolidated subsidiary | □ | □ | □ | (1,466,467) |
| Loss on sale of securities | □ | □ | (11,258) | (11,258) |
| Interest income (expense), net | 43,361 | (26,225) | (51,168) | 106,267 |
| Total other income (expense) | 43,361 | 116,011 | (1,200) | (1,147,996) |
| NET LOSS | \$ (23,998,734) | \$ (11,245,361) | \$ (6,650,211) | \$ (108,016,497) |
| Unrealized holding (loss) gain on securities | □ | (4,026) | 4,026 | □ |

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| | | | | |
|--|----------------------|------------------------|-----------------------|-------------------------|
| COMPREHENSIVE LOSS | <u>\$ 23,998,734</u> | <u>\$ (11,249,387)</u> | <u>\$ (6,646,185)</u> | <u>\$ (108,016,497)</u> |
| LOSS PER COMMON SHARE, basic and diluted | <u>\$ (0.72)</u> | <u>\$ (.23)</u> | <u>\$ (.10)</u> | |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING, basic and diluted | <u>33,436,641</u> | <u>49,617,280</u> | <u>65,217,088</u> | |

The accompanying notes are an integral part of these consolidated financial statements.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF CHANGES IN
STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)
TO JUNE 30, 1997 AND FOR EACH OF THE SIX YEARS
IN THE PERIOD ENDED JUNE 30, 2003

| | <u>Common Stock</u> | | | | | TOTAL STOCKHOLDERS' EQUITY (DEFICIT) | |
|---|---------------------|-----------------------------------|---------------------------|---|----------------------------------|---|--------------------------------|
| | <u>Shares</u> | <u>\$.01 Stated Value</u> | <u>Treasury Stock</u> | <u>Additional Paid-In Capital</u> | <u>Deferred Compensation</u> | | <u>Accumulated Deficit</u> |
| BALANCE, OCTOBER 2, 1996 (date of inception). | 1,140,427 | \$ 11,404 | \$ | \$ 459,753 | \$ | \$ (537,707) | (66,550) |
| Issuance of common stock of Tecma Laboratories, Inc., for 100% of the Company. | 6,600,000 | 66,000 | □ | (537,157) | □ | 537,707 | 66,550 |
| Issuance of common stock, in private placement, net of offering costs of \$138,931 | 594,270 | 5,943 | □ | 752,531 | □ | □ | 758,474 |
| Net loss | □ | □ | □ | □ | □ | (781,246) | (781,246) |
| BALANCE, JUNE 30, 1997 | 8,334,697 | 83,347 | □ | 675,127 | □ | (781,246) | (22,772) |
| Issuance of common stock with warrants, in private placement, net of offering costs of \$84,065 | 999,502 | 9,995 | □ | 791,874 | □ | □ | 801,869 |
| Issuance of common stock for services | 300,000 | 3,000 | □ | 147,000 | □ | □ | 150,000 |
| Issuance of common stock in connection with investment in unconsolidated subsidiary | 250,000 | 2,500 | □ | 122,500 | □ | □ | 125,000 |
| Repurchase of 13,750 shares of common stock | □ | □ | (7,973) | □ | □ | □ | (7,973) |
| Issuance of common stock with warrants in private placement, net of offering costs of \$121,138 | 1,095,512 | 10,955 | □ | 659,191 | □ | □ | 670,146 |
| Issuance of common stock for financing services | 100,000 | 1,000 | □ | (1,000) | □ | □ | □ |
| Issuance of common stock in consideration for 100% of the common stock of Microphase Telecommunications, Inc. | 2,500,000 | 25,000 | □ | 1,685,000 | □ | □ | 1,710,000 |
| Net loss | □ | □ | □ | □ | □ | (4,341,059) | (4,341,059) |
| BALANCE, JUNE 30, 1998 | 13,579,711 | \$ 135,797 | (7,973) | \$ 4,079,692 | □ | \$ (5,122,305) | (914,789) |

The accompanying notes are an integral part of these consolidated financial statements.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF CHANGES IN
STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)
TO JUNE 30, 1997 AND FOR EACH OF THE SIX YEARS
IN THE PERIOD ENDED JUNE 30, 2002

| | <u>Common Stock</u> | | | | | | TOTAL STOCKHOLDERS' EQUITY (DEFICIT) |
|---|---------------------|-----------------------------------|---------------------------|---|----------------------------------|--------------------------------|---|
| | <u>Shares</u> | <u>\$.01 Stated Value</u> | <u>Treasury Stock</u> | <u>Additional Paid-In Capital</u> | <u>Deferred Compensation</u> | <u>Accumulated Deficit</u> | |
| BALANCE, JUNE 30, 1998 | 13,579,711 | \$ 135,797 | \$ (7,973) | \$ 4,079,692 | \$ | \$ (5,122,305) | \$ (914,789) |
| Issuance of common stock with warrants in private placements, net of offering costs of \$107,000 | 3,120,000 | 31,200 | □ | 2,981,800 | □ | □ | 3,013,000 |
| Issuance of common stock for services | 1,599,332 | 15,993 | □ | 8,744,873 | □ | □ | 8,760,866 |
| Issuance of common stock with warrants in private placement, net of offering costs of \$45,353 | 642,000 | 6,420 | □ | 1,553,227 | □ | □ | 1,559,647 |
| Issuance of common stock in private placement, net of offering costs of \$679,311 | 4,426,698 | 44,267 | □ | 10,343,167 | □ | □ | 10,387,434 |
| Issuance of stock options for services | □ | □ | □ | 7,129,890 | □ | □ | 7,129,890 |
| Issuance of warrants for services | □ | □ | □ | 16,302 | □ | □ | 16,302 |
| Deferred employee stock option compensation | □ | □ | □ | □ | (140,000) | □ | (140,000) |
| Net loss | □ | □ | □ | □ | □ | (22,838,344) | (22,838,344) |
| BALANCE, JUNE 30, 1999 | 23,367,741 | 233,677 | \$ (7,973) | \$ 34,848,951 | \$ (140,000) | \$ (27,960,649) | \$ 6,974,006 |
| Issuance of common stock and options in settlement | 75,000 | 750 | □ | 971,711 | □ | □ | 972,461 |
| | 4,632,084 | 46,321 | □ | 5,406,938 | □ | □ | 5,453,259 |

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| | | | | | | | | |
|--|------------|------------|------------|---------------|----------------|-----------------|----|--------------|
| Issuance of common stock upon exercise of warrants and options | | | | | | | | |
| Issuance of common stock in private placement, net of cash offering costs of \$200,000 | 1,000,000 | 10,000 | □ | 3,790,000 | □ | □ | | 3,800,000 |
| Issuance of common stock in private placement, net of cash offering costs of \$466,480 | 1,165,500 | 11,655 | □ | 9,654,951 | □ | □ | | 9,666,606 |
| Issuance of common stock for services | 1,164,215 | 11,642 | □ | 8,612,265 | □ | □ | | 8,623,907 |
| Issuance of options for services | □ | □ | □ | 9,448,100 | □ | □ | | 9,448,100 |
| Deferred employee stock option compensation | □ | □ | □ | 1,637,375 | (1,637,375) | □ | | □ |
| Amortization of deferred employee stock option compensation | □ | □ | □ | □ | 551,707 | □ | | 551,707 |
| Net loss | □ | □ | □ | □ | □ | (38,161,542) | | (38,161,542) |
| <hr/> | | | | | | | | |
| BALANCE, JUNE 30, 2000 | 31,404,540 | \$ 314,045 | \$ (7,973) | \$ 74,370,291 | \$ (1,225,668) | \$ (66,122,191) | \$ | 7,328,504 |
| <hr/> | | | | | | | | |

The accompanying notes are an integral part of these consolidated financial statements.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF CHANGES IN
STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)
TO JUNE 30, 1997 AND FOR EACH OF THE SIX YEARS
IN THE PERIOD ENDED JUNE 30, 2003

| | Common Stock | | | | | | TOTAL STOCKHOLDERS' EQUITY (DEFICIT) |
|---|---------------------|-----------------------------------|---------------------------|---|----------------------------------|--------------------------------|---|
| | Shares | \$.01 Stated Value | Treasury Stock | Additional Paid-In Capital | Deferred Compensation | Accumulated Deficit | |
| BALANCE, JUNE 30, 2000 | 31,404,540 | \$ 314,045 | \$ (7,973) | \$ 74,370,291 | \$ (1,225,668) | \$ (66,122,191) | \$ 7,328,504 |
| Issuance of common stock upon exercise of options | 320,000 | 3,200 | □ | 324,300 | □ | □ | 327,500 |
| Issuance of common stock with warrants in private placements, net of cash offering costs of \$512,195 | 4,329,850 | 43,298 | □ | 7,766,547 | □ | □ | 7,809,845 |
| Issuance of common stock for services | 450,000 | 4,500 | □ | 1,003,125 | □ | □ | 1,007,625 |
| Issuance of options and warrants for services | □ | □ | □ | 5,849,585 | □ | □ | 5,849,585 |
| Deferred employee stock option compensation | □ | □ | □ | 607,885 | (607,885) | □ | □ |
| Amortization of deferred employee stock option compensation | □ | □ | □ | □ | 1,120,278 | □ | 1,120,278 |
| Issuance of common stock in settlement of debt to directors and related parties | 4,840,077 | 48,402 | □ | 2,371,637 | □ | □ | 2,420,039 |
| Net Loss | □ | □ | □ | □ | □ | (23,998,734) | (23,998,734) |
| BALANCE, JUNE 30, 2001 | 41,344,467 | \$ 413,445 | \$ (7,973) | \$ 92,293,370 | \$ (713,275) | \$ (90,120,925) | \$ 1,864,642 |

The accompanying notes are an integral part of these consolidated financial statements

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mPHASE TECHNOLOGIES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN
SHAREHOLDERS' EQUITY (DEFICIT)
FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)
TO JUNE 30, 1997 AND FOR EACH OF THE SIX YEARS
IN THE PERIOD ENDED JUNE 30, 2003

| | <u>Shares</u> | <u>\$.01 Stated Value</u> | <u>Treasury Stock</u> | <u>Additional Paid-in Stock</u> | <u>Deferred Compensation</u> |
|--|-------------------|---------------------------|-----------------------|---------------------------------|------------------------------|
| Balance June 30, 2001 | 41,344,467 | \$ 413,445 | \$ (7,973) | \$ 92,293,370 | \$ (713,275) |
| Sale of Common stock with warrants in private placement | 6,980,643 | 69,807 | □ | 1,903,943 | □ |
| Issuance of Common stock for services | 2,976,068 | 29,760 | □ | 1,169,241 | □ |
| Issuance of options and warrants for services | □ | □ | □ | 1,877,937 | □ |
| Cancellation of unearned options to former employees | □ | □ | □ | (140,802) | 140,802 |
| Amortization of deferred employee stock option compensation | □ | □ | □ | □ | 548,550 |
| Issuance of common stock and warrants in settlement of debt to related parties and strategic vendors | 7,492,996 | 74,930 | □ | 2,663,728 | □ |
| Sale of Common stock to certain Officers and Directors in private placement | 2,000,000 | 20,000 | □ | 980,000 | □ |
| Issuance of Common stock upon exercise of options | 13,334 | 133 | □ | 3,867 | □ |
| Net Loss | □ | □ | □ | □ | □ |
| Other comprehensive loss | □ | □ | □ | □ | □ |
| Balance, June 30, 2002 | 60,807,508 | \$ 608,075 | \$ (7,973) | \$ 100,751,284 | \$ (23,923) |
| Sale of Common stock with warrants in private placement, net of Cash offering costs of \$124,687 | 4,296,680 | 42,967 | □ | 1,121,351 | □ |
| Issuance of Common stock for services | 426,000 | 4,260 | □ | 107,985 | □ |
| Issuance of options and warrants for services | □ | □ | □ | 274,100 | □ |
| Amortization of deferred employee stock option compensation | □ | □ | □ | □ | 23,923 |
| Issuance of common stock and warrants in settlement of debt to related parties and strategic vendors | 5,923,333 | 59,233 | □ | 1,826,329 | □ |
| Net Loss | □ | □ | □ | □ | □ |
| Other comprehensive loss | □ | □ | □ | □ | □ |
| Balance, June 30, 2003 | 71,453,521 | \$ 714,535 | \$ (7,973) | \$ 104,081,049 | \$ 0 |

The accompanying notes are an integral part of these consolidated financial statements

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mPHASE TECHNOLOGIES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN
SHAREHOLDERS' EQUITY (DEFICIT)
FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)
TO JUNE 30, 1997 AND FOR EACH OF THE SIX YEARS
IN THE PERIOD ENDED JUNE 30, 2003

| | Accumulated Deficit | Comprehensive Loss | TOTAL STOCKHOLDERS EQUITY (DEFICIT) |
|--|------------------------|-----------------------|--|
| Balance June 30, 2001 | \$ (90,120,925) | | \$ 1,864,642 |
| Issuance of Common stock with warrants in private placement | | | 1,973,750 |
| Issuance of Common stock for services | | | 1,199,001 |
| Issuance of options and warrants for services | | | 1,877,937 |
| Cancellation of unearned options to former employees | | | □ |
| Amortization of deferred employee stock option compensation | | | 548,550 |
| Issuance of common stock and warrants in settlement of debt to related parties and strategic vendors | | | 2,738,658 |
| Sale of Common stock to certain Officers and Directors in private placement | | | 1,000,000 |
| Issuance of Common stock upon exercise of options | | | 4,000 |
| Net Loss | (11,245,361) | | (11,245,361) |
| Other comprehensive loss | | (4,026) | (4,026) |
| Balance, June 30, 2002 | \$ (101,366,286) | \$ (4,026) | \$ (42,849) |
| Issuance of Common stock with warrants in private placement, net of cash offering costs of \$124,687 | | | 1,164,318 |
| Issuance of Common stock for services | | | 112,245 |
| Issuance of options and warrants for services | | | 274,100 |
| Amortization of deferred employee stock option compensation | | | 23,923 |
| Issuance of common stock and warrants in settlement of debt to related parties and strategic vendors | | | 1,885,562 |
| Net Loss | (6,650,211) | | (6,650,211) |
| Other comprehensive (loss) gain | | 4,026 | 4,026 |
| Balance, June 30, 2003 | \$ (108,016,497) | \$ (0) | \$ (3,228,886) |

The accompanying notes are an integral part of these consolidated financial statements.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For the Years Ended June 30, | | | Inception (October 2, 1996) to June 30, 2003 |
|---|---------------------------------|--------------------|--------------------|--|
| | 2001 | 2002 | 2003 | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | | |
| Net loss | \$ (23,998,734) | \$ (11,245,361) | \$ (6,650,211) | \$ (108,016,497) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | | |
| Depreciation and amortization | 1,235,213 | 1,653,346 | 1,425,952 | 5,594,140 |
| Book value of fixed assets disposed | 61,414 | □ | □ | 74,272 |
| Loss on unconsolidated subsidiary | □ | □ | □ | 1,466,467 |
| Provision for doubtful accounts | 29,218 | 2,906 | □ | 32,124 |
| Impairment of note receivable | 212,500 | 20,250 | □ | 232,750 |
| Loss on securities | □ | □ | 11,258 | 11,258 |
| Gain on Extinguishments | □ | (142,236) | (61,226) | (203,462) |
| Non-cash common stock, common stock option and warrant expense | 7,398,455 | 3,261,449 | 1,134,335 | 48,144,097 |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | (170,466) | 15,748 | (13,355) | (319,259) |
| Inventory | (4,303,895) | 961,179 | 1,449,628 | (1,893,088) |
| Prepaid expenses and other current assets | 88,280 | 173,649 | (29,652) | (596,449) |
| Production advances-related parties | 1,109,641 | □ | | |
| Other assets | (150,000) | 146,420 | 3,580 | □ |
| Receivables from subsidiary | □ | □ | □ | (150,000) |
| Due from officer | (100,000) | 100,000 | □ | □ |
| Accounts payable | 2,802,008 | (340,057) | 174,939 | 4,157,395 |
| Accrued expenses | (5,394) | 332,819 | 273,986 | 1,812,571 |
| Deferred revenue | □ | 214,180 | □ | 214,180 |
| Due to related parties: | | | | |
| Microphase | 709,832 | 864,555 | 721,544 | 2,295,949 |
| Janifast | 1,272,709 | 907,450 | 99,841 | 2,280,000 |
| Officers | (412,400) | 312,504 | 246,835 | 559,339 |
| Accrued expense, Lintel | 477,000 | □ | □ | 477,000 |
| Due to Others | 59,566 | 25,794 | □ | 211,972 |
| Net cash used in operating activities | (13,685,053) | (2,735,405) | (1,212,546) | (43,615,241) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | | |
| Investment in patents and licensing rights | (148,127) | (74,649) | □ | (375,720) |
| Purchase of property and equipment | (705,577) | (31,445) | (73,305) | (2,537,105) |
| Net cash used in investing activities | (853,704) | (106,094) | (73,305) | (2,912,825) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | | |

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| | | | | |
|--|------------------|------------------|-------------------|-------------------|
| Net proceeds from private placement of common stock and exercise of options and warrants | 8,137,345 | 2,977,750 | 1,090,474 | 46,507,918 |
| Repurchase of treasury stock at cost | □ | □ | □ | (7,973) |
| Advances from Microphase | □ | □ | 527,840 | 527,840 |
| Proceeds from notes payable officers | □ | □ | 130,000 | 130,000 |
| Repayment of notes payable □ officers | □ | □ | (30,000) | (30,000) |
| Repayment of notes payable | □ | (120,191) | (82,668) | (202,859) |
| | <u>8,137,345</u> | <u>2,857,559</u> | <u>1,635,646</u> | <u>46,924,926</u> |
| Net cash provided by financing activities | 8,137,345 | 2,857,559 | 1,635,646 | 46,924,926 |
| Net increase (decrease) in cash | (6,401,412) | 16,060 | 349,623 | 396,688 |
| CASH AND CASH EQUIVALENTS, beginning of period | 6,432,417 | 31,005 | 47,065 | □ |
| | <u>6,432,417</u> | <u>31,005</u> | <u>47,065</u> | <u>□</u> |
| CASH AND CASH EQUIVALENTS, end of period | \$ 31,005 | \$ 47,065 | \$ 396,860 | \$ 396,860 |
| | <u>\$ 31,005</u> | <u>\$ 47,065</u> | <u>\$ 396,860</u> | <u>\$ 396,860</u> |

The accompanying notes are an integral part of these consolidated financial statements.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2003

1. ORGANIZATION AND NATURE OF BUSINESS

mPhase Technologies, Inc. (the "mPhase" or the "Company") was organized on October 2, 1996. The primary business of mPhase is to design, develop, manufacture and market high-bandwidth telecommunications products incorporating digital subscriber line (DSL) technology. The present activities of the Company are focused on the deployment of its proprietary Traverser System, which delivers MPEG2, non-Internet Protocol-based television, high-speed Internet and voice over copper wire. Additionally, the Company sells a line of DSL component products.

On February 17, 1997, mPhase acquired Tecma Laboratories, Inc., (Tecma) in a transaction accounted for as a reverse merger.

On June 25, 1998, the Company acquired Microphase Telecommunications, Inc. (MicroTel) a Delaware corporation, through the issuance of 2,500,000 shares of its common stock in exchange for all the issued and outstanding shares of MicroTel (Note 4). The assets acquired in this acquisition were patents and patent applications utilized in the Company's proprietary Traverser Digital Video and Data Deliver System (Traverser).

On August 21, 1998, the Company incorporated a 100% wholly-owned subsidiary called mPhaseTV.net, Inc., a Delaware corporation, to market interactive television and e-commerce revenue opportunities. This subsidiary is dissolved.

On March 2, 2000 the Company acquired a 50% interest in mPhaseTelevision.Net, Inc., an incorporated joint venture with AlphaStar International, Inc. (Note 8) for \$20,000. The Company acquired an additional interest in the joint venture of 6.5% in April of 2000 for \$1.5 million. Based on its controlling interest in mPhaseTelevision.Net, the operating results of mPhaseTelevision.Net are included in the consolidated results of the Company since March 2, 2000.

The Company is in the development stage and its present activities are focused on the commercial deployment of its legacy Traverser DVDDS and TV+ products for delivery of broadcast television over ADSL and associated DSL component products which include POTS splitters and a line of intelligent POTS splitter products. Since mPhase is in the development stage, the accompanying consolidated financial statements should not be regarded as typical for normal operating periods.

2. LOSSES DURING THE DEVELOPMENT STAGE AND MANAGEMENT'S PLANS

Through June 30, 2003, the Company had incurred development stage losses totaling \$108,016,497, and at June 30, 2003 had a stockholders' deficit of \$3,228,886. At June 30, 2003, the Company had \$396,860 of cash and cash equivalents and \$287,135 of trade receivables to fund short-term working capital requirements.

The Company's ability to continue as a going concern and its future success is dependent upon its ability to raise capital in the near term to: (1) satisfy its current obligations, (2) continue its research and development efforts, and (3) the successful wide scale development, deployment and marketing of its products.

The Company believes that it will be able to complete the necessary steps in order to meet its cash flow requirements throughout fiscal 2004 and continue its development and commercialization efforts. Management's plans in this regard include, but are not limited to, the following:

During the fiscal year ended June 30, 2003, the Company converted certain payables and accrued expenses with officers, related parties and strategic vendors aggregating approximately \$1.9 million into 5,923,333 restricted shares of the Company's common stock and 5 year warrants to purchase an additional 3,706,800 restricted shares of the Company's common stock.

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In addition, in October of 2002, GTRC executed a Memorandum of Intention to convert a total of approximately \$1.8 million in payables to promissory notes and equity.

Management estimates that the Company will need additional minimum capital of \$2.0 million by June 30, 2004 to continue its operations either through revenues from sales, external independent or related party funding further expense reductions some combination thereof. The Company presently has ongoing discussions and negotiations with a number of additional financing alternatives, one or more of which it believes will be able to successfully close to provide necessary working capital, while maintaining sensitivity to shareholder dilution issues. However, the Company has no definitive agreements to provide funding at this time.

In addition to the above financing activities, the following business initiatives are also ongoing and are expected to provide additional working capital to the Company.

The Company is currently negotiating with several organizations for the commencement of field trials which would lead to commercial sales of its broadcast television platform products. The Company has had an upturn in sales of its POTS splitter products since the close of its fiscal year ended June 30, 2003, including sales to one customer of approximately \$1.6 million through August 21, 2003.

Management believes that actions presently being taken to complete the Company's development stage through the commercial roll-out of its broadcast television platforms will be successful. However, there can be no assurance that mPhase will generate sufficient revenues to provide positive cash flows from operations or that sufficient capital will be available, when required, to permit the Company to realize its plans. The accompanying financial statements does not include any adjustments that might result from the outcome of this uncertainty.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2003

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of mPhase, its wholly-owned and majority owned subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

USE OF ESTIMATES

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

RECLASSIFICATIONS

Certain reclassifications have been made in the prior period consolidated financial statements to conform to the current period presentation.

CASH AND CASH EQUIVALENTS

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

STOCK BASED COMPENSATION

Financial Accounting Statement No. 123, Accounting for Stock Based Compensation, encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation using the intrinsic method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock. The Company has adopted the "disclosure only" alternative described in SFAS 123 and SFAS 148, which require pro forma disclosures of net income and earnings per share as if the fair value method of accounting had been applied.

PROPERTY AND EQUIPMENT

Property and equipment is recorded at cost. Depreciation is provided on the straight-line method over the estimated useful lives of three to five years.

SHORT-TERM INVESTMENTS

Short-term investments principally consist of highly-liquid shares of corporate securities. The Company classifies all these short-term investments as available-for-sale securities. Unrealized gains and losses on these investments are recorded in accumulated other comprehensive income (loss) as a separate component of shareholders' equity. Any decline in market value judged to be other than temporary is recognized in determining net income. Realized gains and losses from the sale of these investments are included in determining net income (loss).

REVENUE RECOGNITION

All revenue included in the accompanying consolidated statements of operations for all periods presented relates to sales of mPhase's POTS Splitter Shelves and DSL component products.

As required, mPhase has adopted the Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements, which provides guidelines on applying generally accepted accounting principles to revenue recognition based on the interpretations and practices of the SEC. The Company recognizes revenue for its POTS Splitter Shelf and other DSL component products at the time of shipment, at which time, no other significant obligations of the Company exist, other than normal warranty support.

SHIPPING AND HANDLING CHARGES

The Company includes costs of shipping and handling billed to customers in revenue and the related expense of shipping and handling costs is included in cost of sales.

BUSINESS CONCENTRATIONS AND CREDIT RISK

To date the Company's products have been sold to a limited number of customers, primarily in the telecommunications industry. The Company had revenues from two customers representing 64% and 19% of total revenues during the year ended June 30, 2001. The Company had revenues from two customers representing 39% and 21% of total revenues during the year ended June 30, 2002. The Company had revenue from two customers of 31% and 25% during the fiscal year ended June 30, 2003.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2003

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES □ (Continued)

ADVERTISING COSTS

Advertising costs are expensed as incurred.

COMPREHENSIVE INCOME (LOSS)

In addition to net loss, comprehensive income (loss) includes all changes in equity during a period, except those resulting from investments by and distributions to owners. Items of comprehensive income include foreign currency exchanges and unrealized gains and losses on investments classified as available for sale.

In 1998, the Company adopted SFAS No. 130, Reporting Comprehensive Income, which establishes rules for the Reporting of Comprehensive Income and its components. For each of the years ended June 30, 2001 and 2000, there was no difference between the Company's net income and comprehensive income.

PATENTS AND LICENSES

Patents and licenses are capitalized when mPhase determines there will be a future benefit derived from such assets, and are stated at cost. Amortization is computed using the straight-line method over the estimated useful life of the asset, generally five years.

Amortization expense was \$460,121, \$471,629 and \$468,495 for the years ended June 30, 2001, 2002, and 2003, respectively.

Effective July 1, 2002, the Company adopted SFAS Nos. 141 and 142. SFAS 142 eliminates amortization of goodwill and certain other intangible assets, but requires annual testing for impairment (comparison of fair market value to carrying value). Fair value is estimated using the present value of expected future cash flows and other measures. The transitional impairment test for the Company's patents and license rights resulted in the Company concluding that no impairment in addition to amortization previously recorded was necessary during the year ended June 30, 2003, however, the Company will continue its amortization policy of five years.

INVENTORIES

Inventory consists mainly of the Company's POTS Splitter Shelf and Filters. Inventory is comprised of the following:

| | June 30 | |
|--------------------------------|----------------|-------------|
| | 2002 | 2003 |
| Raw materials | \$ 266,748 | \$ 131,797 |
| Work in Progress | 1,045,679 | 728,537 |
| Finished goods | 3,273,644 | 1,729,344 |
| | 4,586,071 | 2,589,678 |
| Total | | |
| Less: Reserve for obsolescence | (1,243,355) | (486,350) |
| | | |

\$ 3,342,716 \$ 2,103,328

LONG-LIVED ASSETS

The Company accounted for long-lived assets for the years ended June 30, 2001 and 2002 in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." The Company reviewed its long-lived assets for impairment when changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Such changes in circumstances may include, among other factors, a significant change in technology that may render an asset or an asset group obsolete or noncompetitive, a significant change in the extent or manner in which an asset is used, evidence of a physical defect in an asset or asset group or an operating loss.

In June 2001, the FASB issued Statement No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"), which became effective for the Company July 1, 2002 for the fiscal year ended June 30, 2003. As a result of this new standard, goodwill will no longer be amortized, but will be tested annually for impairment beginning in fiscal year ending June, 2003. Goodwill impairment testing will require that the Company make judgments concerning future cash flows and appropriate discount rates (see Patents and Licenses below).

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2003

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES □ (Continued)

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts reported in the consolidated balance sheets for mPhase's cash, accounts receivable, accounts payable, and accrued expenses approximate their fair values due to the short maturities of these financial instruments.

The carrying amounts reported in the consolidated balance sheets for mPhase's notes payable, long-term debt, amounts due to related parties approximate their fair values as they represent the amount the Company expects to liquidate these obligations with cash or cash equivalents, and the amounts recorded as other liabilities and other liabilities □ related parties approximate their fair values based on current rates at which the Company could borrow funds with similar maturities.

LOSS PER COMMON SHARE, BASIC AND DILUTED

mPhase accounts for net loss per common share in accordance with the provisions of SFAS No. 128, □Earnings per Share□ (□EPS□). SFAS No. 128 requires the disclosure of the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Common equivalent shares have been excluded from the computation of diluted EPS since their effect is anti-dilutive.

WARRANTY RESERVE

The Company warrants that all equipment manufactured by it will be free from defects in material and workmanship under normal use for a period of one year from the date of shipment. Through June 30, 2003, substantially all sales by the Company have been from component telephone equipment parts, primarily the Company's POTS Splitter Shelves. The Company's □ actual experience for cost and expenses in connection with such warranties have been nominal and through June 30, 2003, an additional amount of \$10,000 has been added to reserve for future warranty costs which the Company estimates aggregate \$40,000 at this time.

RECENT ACCOUNTING PRONOUNCEMENTS

In April 2002, the FASB issued SFAS No. 145 □Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.□ This statement rescinds SFAS No. 4, □Reporting Gains and Losses from Extinguishment of Debt,□ and an amendment of that statement, SFAS No. 44, □Accounting for Intangible Assets of Motor Carriers,□ and SFAS No. 64, □Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements.□ This statement amends SFAS No. 13, □Accounting for Leases,□ to eliminate inconsistencies between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. Also, this statement amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. Provisions of SFAS No. 145 related to the rescission of SFAS No. 4 were effective for the Company on November 1, 2002 and provisions affecting SFAS No. 13 were effective for transactions occurring after May 15, 2002. The adoption of SFAS No. 145 did not have a material impact on our financial statements.

In June 2002, the FASB issued SFAS No. 146, □Accounting for Costs Associated with Exit or Disposal Activities.□ This statement covers restructuring type activities beginning with plans initiated after December 31, 2002. Activities covered by this standard that are entered into after that date will be recorded in accordance with the provisions of SFAS No. 146. The adoption of SFAS No. 146 did not have a significant impact on our consolidated financial position or results of operations.

In December 2002, the FASB issued SFAS 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," which provides alternative methods of transition for a voluntary change to fair value based method of accounting for stock-based employee compensation as prescribed in SFAS 123, "Accounting for Stock-Based Compensation." Additionally, SFAS 148 required more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The provisions of this Statement are effective for fiscal years ending after December 15, 2002, with early application permitted in certain circumstances. The Company has adopted the disclosure provisions in these consolidated financial statements as disclosed above under Stock Based Compensation.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"). FIN 45 requires a company, at the time it issues a guarantee, to recognize an initial liability for the fair value of obligations assumed under the guarantee and elaborates on existing disclosure requirements related to guarantees and warranties. The initial recognition requirements of FIN 45 are effective for guarantees issued or modified after December 31, 2002 and adoption of the disclosure requirements are effective for the Company during the first quarter ending January 31, 2003. The adoption of FIN 45 did not have a significant impact on our consolidated financial position or results of operations.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES □ (Continued)

In January 2003, the FASB issued FASB Interpretation No. 46 (□ FIN 46□), □Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51.□ FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The adoption of FIN 46 did not have a significant impact on our consolidated financial position or results of operations.

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In May 2003, the FASB issued SFAS Statement No. 150, □Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity□. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities, if applicable. It is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. The adoption of this statement is not expected to have a significant impact on the Company□s results of operations or financial position.

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STATEMENT OF CASH FLOW SUPPLEMENTAL INFORMATION

| | JUNE 30 | JUNE 30 |
|--|----------------|----------------|
| | 2002 | 2003 |
| Interest paid | \$ 21,760 | \$ 14,512 |
| Taxes paid | \$ □ | \$ □ |
| Schedule of Non-Cash Investing and Financing Activities: | | |
| Conversion of accounts payable and accrued expenses to equity | \$ 2,738,658 | \$ 1,931,788 |

Conversion of accounts payable and accrued expenses

| | | |
|---|-----------------------------|-----------------------------|
| to notes payable | \$ 1,487,747 | \$ 360,000 |
| | <u> </u> | <u> </u> |
| Research and development fixed assets transferred to Work in process inventory | \$ | \$ 210,239 |
| | <u> </u> | <u> </u> |
| Investments in Patents and Licenses paid with equity | \$ 43,750 | \$ |
| | <u> </u> | <u> </u> |

4. ACQUISITION OF MICROTTEL

In June 1998, mPhase issued 2,500,000 shares of common stock in exchange for all of the issued and outstanding shares of MicroTel, a wholly-owned subsidiary of Microphase, Inc. (Microphase). The transaction was accounted for as a purchase pursuant to APB Opinion No. 16 Accounting for Business Combinations. The total purchase price of approximately \$1,870,000, which was based on the fair market value of the shares issued, was allocated to the patents acquired and is being amortized over an estimated useful life of five years. Pursuant to the agreement of merger, MicroTel has become a wholly-owned subsidiary of mPhase.

5. NOTE RECEIVABLE

As consideration for a letter of settlement with a former consultant of mPhase, the Company had loaned the former consultant \$250,000 in the form of a Note (the Note) secured by 75,000 shares of the former consultants common stock of mPhase. The Note was due April 7, 2001. The Company decreased the Note to \$37,500, representing the estimated value of the underlying stock at June 30, 2001. The Company charged \$212,500 to administrative expense as a result of this impairment. The Company has included the \$37,500, in long-term assets in the accompanying consolidated balance sheet for the year ended June 30, 2001. The Company decreased the Note to \$17,250, representing the estimated value of the underlying stock at June 30, 2002. The Company charged \$20,250 to administrative expenses as a result of the further impairment of the underlying stock value at June 30, 2002 and has maintained the same balance for the Note throughout the fiscal year ended June 30, 2003. The Company has included the \$17,250 in long-term assets in the accompanying consolidated balance sheet for the year ended June 30, 2003.

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mPHASE TECHNOLOGIES, INC.
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6. PROPERTY AND EQUIPMENT

Property and equipment, at cost, consist of the following:

| | June 30 | |
|--------------------------------|----------------|--------------|
| | 2002 | 2003 |
| Equipment | \$ 3,593,418 | \$ 2,572,031 |
| Office and marketing equipment | 482,464 | 482,464 |
| | 4,075,882 | 3,054,495 |
| Less-Accumulated depreciation | (2,333,696) | (2,472,605) |
| | \$ 1,742,186 | \$ 581,890 |

Depreciation expense for the years ended June 30, 2001, 2002, and 2003, was \$775,092, \$1,181,717, and \$957,457, respectively, of which \$501,676, \$983,163 and \$442,040, respectively, is included in research and development expense.

7. ACCRUED EXPENSES

Accrued expenses consist of the following:

| | June 30 | |
|---------------------------|----------------|-------------|
| | 2002 | 2003 |
| Lucent Projects (Note 13) | \$ 81,250 | \$ 370,795 |
| Other General Expenses | 591,815 | 514,940 |
| | \$ 673,065 | \$ 885,735 |

8. JOINT VENTURE

In March 2000, mPhase acquired a 50% interest in mPhaseTelevision.Net (formerly Telco Television Network, Inc.), an incorporated joint venture, for \$20,000. The agreement provided for the grant of warrants to the joint venture partner in consideration of the execution of the Joint Venture Agreement, to purchase 200,000 shares of the Company's common stock for \$4.00 per share (valued at \$2,633,400). This non-cash charge is included in general and administrative expenses in the accompanying statement of operations for the year ended June 30, 2000. The fair value of the warrants granted to the joint venture partner as of the date of grant was based on the Black-Scholes stock option pricing model, using the following weighted average assumptions: annual expected rate of return of 0%, annual volatility of 115%, risk free interest rate of 5.85% and an expected option life of 3 years.

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The agreement stipulates for mPhase's joint venture partner, AlphaStar International, Inc., (AlphaStar), to provide mPhaseTelevision.Net right of first transmission for its transmissions of MPEG-2 digital satellite television. In addition, in March 2000, mPhase loaned the joint venture \$1,000,000 at 8% interest per annum. The loan is repayable to the Company from equity infusions to the subsidiary, no later than such time that mPhaseTelevision.Net qualifies for a NASDAQ Small Cap Market Listing. During April 2000, the Company acquired an additional 6.5% interest in mPhaseTelevision.Net for \$1,500,000.

As of June 30, 2003 mPhase owns a 56.5% interest in mPhaseTelevision.net. The Company terminated the lease of the earth station for business reasons, and there was no material impact on mPhaseTelevision.net's operating activities.

Pursuant to an agreement dated as of June 18, 2002, mPhaseTelevision.Net has terminated its lease of the earth station and Alphastar and its affiliated entity have converted certain accounts payable into shares of the Company's common stock. Additionally, under this Agreement, mPhase is obligated to pay Alphastar and its affiliates \$35,000, which is included in amounts due to related parties in the accompanying consolidated balance sheet.

During the fiscal year ended June 30, 2002 and ended June 30, 2003, the joint venture was charged \$64,039 and \$0, respectively for fees and costs by its joint venture partner and its affiliates.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2003

9. LONG TERM DEBT

Long-term debt is comprised of the following:

| | <u>June 30, 2002</u> | <u>June 30, 2003</u> |
|---|--------------------------|--------------------------|
| Settlement Agreements: | | |
| Accounts payable expected to be converted to Note payable to GTRC bearing 7% interest, amortized in equal monthly payments of \$4,167 and a lump sum payment of \$75,000 due twelve months from issuance (see also Note 13-Commitments and Contingencies) | \$ 150,000 | \$ 150,000 |
| Accounts payable expected to be converted to Note payable to GTRC bearing 7% interest, amortized in average monthly payments of \$0 in 2004, \$39,568 in 2005, \$56,085 in 2006 \$60,140 in 2007, \$64,488 in 2008, and a lump sum payment of \$253,955 due at maturity in September 2008 (see also Note 13 Commitments and Contingencies)) | 474,235 | 474,235 |
| Note payable to law firm bearing 8% interest, monthly installments of \$5,000 per month commencing in June 2002 and continuing through December 1, 2003 with a final payment of principal plus accrued interest due at maturity on December 31, 2003 | 415,887 | 405,022 |
| Note payable to vendor bearing 8% interest due in weekly payments of \$5,000 including accrued interest. These payments commenced in January 2002 and continue until June 2004 | 237,169 | 210,558 |
| Note payable to vendor non interest bearing average monthly payments of \$4,167 in 2003 and \$3,660 in 2004. These payments commenced in April 2002 and continue until May 2004 | 90,266 | 79,765 |
| Note payable, vendor, interest at 8%, with average monthly payments of \$2,000 through March, 2004 | □ | 29,458 |
| Total | <u>1,367,557</u> | <u>1,349,038</u> |
| Less: Current portion | <u>(353,339)</u> | <u>(762,735)</u> |
| Long-term Debt, non-current portion | <u>\$ 1,014,218</u> | <u>\$ 586,303</u> |

At June 30, 2003 total maturities of long-term debt are as follows:

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| | | |
|---------------------|----|-----------|
| 2004 | \$ | 762,735 |
| 2005 | | 151,637 |
| 2006 | | 56,085 |
| 2007 | | 60,140 |
| 2008 | | 64,487 |
| 2009 and thereafter | | 253,954 |
| | | <hr/> |
| TOTAL | \$ | 1,349,038 |
| | | <hr/> |

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2003

10. STOCKHOLDERS' EQUITY

mPhase initially authorized capital of 50,000,000 shares of common stock with no par value. On February 23, 2000, the Board of Directors proposed and on May 22, 2000 the shareholders approved an increase in the authorized capital to 150,000,000 shares of common stock.

On January 26, 2000 the Board of Directors of mPhase resolved that the stated value of the common stock was \$.01 for accounting purposes and, as such, the financial statements have been retroactively restated to reflect this change.

Tecma issued 6,600,000 shares of common stock for all of the issued and outstanding shares of the Company in the reverse acquisition (Note 1).

In October 1997, mPhase issued 250,000 shares of its common stock in connection with its investment in Complete Telecommunications Inc.

During the year ended June 30, 1998, mPhase sold, pursuant to private placements, 2,095,014 shares of its common stock together with 1,745,179 warrants for proceeds to the Company of \$1,472,015, net of offering costs of \$205,203. The warrants were issued to purchase one share each of common stock at an exercise price of \$0.75, and exercised during the year ended June 30, 2000 generating proceeds to the Company of \$1,308,884. Included in offering costs are 100,000 shares of common stock issued for services provided by a third party valued at \$0.50 per share, the fair market value on the date of grant.

During the year ended June 30, 1998, mPhase issued 300,000 shares of common stock to consultants for services at \$0.50 per share, its fair market value. The Company recorded a charge to operations of \$150,000 included in cumulative from inception in the accompanying consolidated statement of operations.

On June 25, 1998, mPhase issued 2,500,000 shares of its common stock for all of the outstanding stock of MicroTel (Note 4) for approximately \$1,870,000, the fair market value.

In November 1998, mPhase sold, 3,120,000 shares of its common stock at \$1.00 per share, together with 1,000,000 warrants, with an exercise price of \$1.00 per share, for \$3,013,000 net of offering costs of approximately \$107,000 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors. On June 2, 2000 these warrants were exercised, generating proceeds to the Company of \$1,000,000.

During the year ended June 30, 1999, mPhase issued 1,599,332 shares of common stock to employees and consultants for services performed. The Company recognized a charge to operations of \$8,760,866, based upon the fair market value of the shares.

In April, May and June of 1999, mPhase sold a total of 642,000 shares of common stock at \$2.50 per share, together with 642,000 warrants for \$1,559,647, net of offering costs of \$45,353 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors.

The warrants expire in June 2004. By June 30, 2000, 148,000 of these warrants were exercised, generating proceeds to the Company of \$370,000.

In June 1999, mPhase sold 4,426,698 shares of its common stock at a price of \$2.50 per share for \$10,387,434, net of offering costs of \$679,311, in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors.

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In December 1999 and January 2000, mPhase sold, pursuant to private placements, 1,000,000 shares of common stock at a price of \$4.00 per share, net of cash offering costs of \$200,000, generating net proceeds to the Company of \$3,800,000 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors. In connection with the private placements, the Company issued 200,000 and 50,000 warrants to purchase common stock to the respective investors. The warrants had an exercise price of \$4.00 and \$5.00, respectively. During February 2000, these warrants were exercised, generating \$1,050,000 of proceeds to the Company.

In March 2000, mPhase sold 832,500 shares of common stock at a price of \$10.00 per share, net of cash offering costs of \$466,480, and issued 124,875 shares to a transaction advisor for services, generating net proceeds to the Company of \$7,858,520 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors. On May 5, 2000 the Company issued an additional 208,125 shares to these investors due to a market value adjustment. These shares were valued at \$1,808,086, which is included in general and administrative expenses in the accompanying statement of operations for the year ended June 30, 2000.

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mPHASE TECHNOLOGIES, INC.
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10. STOCKHOLDERS' EQUITY (Continued)

During the year ended June 30, 2000, mPhase issued 1,164,215 shares of common stock to employees and consultants for services performed. The Company recognized a charge to operations of \$8,623,907, based upon the fair market value of the common stock on the dates of grant.

In September 2000, mPhase issued 510,000 shares of its common stock, generating net proceeds of \$2,532,120, net of cash offering costs of \$17,880 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors. In connection with the private placement, the Company issued 105,750 shares of its common stock to transaction advisors.

In February 2001, mPhase issued 2,342,500 shares of its common stock and a like amount of warrants to purchase one share each of the Company's common stock generating gross proceeds of \$4,685,000 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended with accredited investors. The attached warrants permit the investor to purchase one share each of common stock at an exercise price of \$3.00 per share. The Company incurred cash offering costs of \$425,315 and also issued 284,600 shares of its common stock and 162,600 warrants to purchase one share each at an exercise price of \$3.00 to transaction advisors.

In May and June 2001, mPhase issued 1,087,000 shares of its common stock and a like amount of warrants to purchase one share each of the Company's common stock generating gross proceeds of \$1,087,000 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended with accredited investors. The attached warrants permit the investor to purchase one share each of common stock at an exercise price of \$3.00. The Company incurred offering costs of \$69,000.

During the year ended June 30, 2001, the Company issued 450,000 shares of common stock to consultants for services performed and to be performed. The Company recognized a charge to operations of \$886,534 and deferred \$121,091 for services to be performed in the fiscal year ending June 30, 2002. Total expense of \$1,007,625, based upon the fair market value of the common stock on the date of the grant and the balance of \$121,091 was charged to operations for the year ended June 30, 2002.

Effective June 30, 2001 the Company issued 4,840,077 shares of the Company's common stock in settlement of debt totaling \$2,420,039 to directors and related parties, based upon the fair market value of the common stock issued which approximated the debt settled on the measurement date on September 6, 2001, such date was determined pursuant to EITF00-19 as to when all contingent terms of the conversion agreement were set. The shares are reflected as outstanding as of June 30, 2001, pursuant to A9566 and SFAS 128.

In July 2001, the Company issued 75,000 shares of its common stock and a like amount of warrants to purchase one share each of the Company's common stock at an exercise price of \$3.00 generating proceeds of \$75,000 in a private transaction with accredited investors.

In December 2001, the Company issued 3,474,671 shares of its common stock and a like amount of warrants to purchase one share each of the Company's common stock at an exercise price of \$.30 generating gross proceeds of \$1,042,000 in a private transaction pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended with accredited investors, which included a subscription receivable of \$440,200, which was collected in January 2002.

In January 2002, the Company issued 2,754,503 shares of its common stock and a like amount of warrants to purchase one share each at an exercise price of \$.30 generating gross proceeds of \$826,351 and June 2002, the Company issued 100,000 shares of its common stock and a like amount of warrants to purchase one share each at an exercise price of \$.30, generating gross proceeds of \$30,000 in a private placements pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors.

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In connection with the December 2001, January 2002, and June 2002, private placements, the Company issued 576,469 shares of its common stock and a like amount of warrants to purchase one share each at an exercise price of \$.30 to finders and consultants whom assisted in the transaction.

During the year ended June 30, 2002 the Company issued 7,492,996 shares of its common stock, and 5,953,490 warrants to related parties and strategic vendors, in connection with the conversion of \$2,738,658 of accounts payable and accrued expenses, of which 6,150,000 shares of common stock and 3,400,000 warrants were issued in settlement of \$1,460,000 of accounts payable to related parties as follows:

Conversions Concurrent with Private Placements

Included in this total for the year ended June 30, 2002, related parties and strategic vendors converted debt aggregating approximately \$1,020,000 and \$96,000 respectively into:

- (a) 3,400,000 shares and of common stock plus warrants to purchase another 3,400,000 shares of common stock at \$.30 for a term of 5 years (2,200,000 units with Microphase for \$660,000 and 1,200,000 units with Janifast for \$360,000) and;
- (b) 320,000 shares of common stock plus warrants to purchase another 320,000 shares of common stock at \$.30 for a term of 5 years, respectively, were issued to strategic vendors.

Such conversions were upon the same terms of a concurrent private placement of common stock by the Company of approximately \$1.8 million in cash received for 6 million shares of common stock plus warrants to purchase another 6 million shares of Company's common stock for 5 years at \$.30 per share. No gain or loss was recognized in connection with conversions by related parties and strategic vendors of the above total of \$1,116,000 of debt.

Conversions, Settlements and Gain on Extinguishments

In addition this total for the year ended June 30, 2002 includes 3,772,996 shares of common stock and warrants to purchase 2,233,490 shares of the Company's common stock which were issued as follows:

- (a) 2,750,000 shares of common stock were issued to related parties, the value of which was based upon the price of the Company's common stock on the measurement date, such date was determined pursuant to EITF00-1 as to when all contingent terms of conversion agreements were met, in which no gain or loss was recognized on the conversion of \$440,000 of debt; and
- (b) 1,022,996 shares of common stock were issued to strategic vendors, the value of which was based upon the price of the Company's common stock on the effective date of settlement with each party, and, two warrants to purchase 2,233,490 shares of the Company's common stock were issued the Company's outside counsel to settle outstanding indebtedness of approximately \$450,000 as of March 15, 2002. The aggregate value of such warrants was estimated using the Black Scholes options pricing model, assuming an annual expected return of 0%, annual Beta volatility of 125.4 and a risk free interest rate of 5.9% pursuant to EITF 96-18, for the conversion of \$1,182,658 of such liabilities which, together with gains from cash settlements of \$27,860 resulted in an aggregate gain on extinguishments of \$142,236.

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mPHASE TECHNOLOGIES, INC.
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10. STOCKHOLDERS' EQUITY (Continued)

During the year ended June 30, 2002, certain officers, directors and related parties were issued 2,000,000 and 6,150,000 shares of mPhase common stock and 3,400,000 warrants in consideration of the investment of \$1,000,000 cash and the conversion of \$1,460,000 accounts payable. (see Note 11).

During the year ended June 30, 2002, certain officers, directors and related parties were issued 2,000,000 and 6,150,000 shares of mPhase common stock and 3,400,000 warrants in consideration of the investment of \$1,000,000 cash and the conversion of \$1,460,000 accounts payable. (see Note 11).

Also, during the fiscal year ended June 30, 2002, the Company granted 2,923,000 shares of its common stock and 1,675,000 warrants to consultants for services performed valued at \$1,199,001 for common stock and \$504,657 for warrants based upon the fair market value of the Company's common stock on the date of the grant using the Black-Scholes option premium model. These totaled \$1,703,658 and the Company recorded a charge to operations of \$955,668 for the year ended June 30, 2002 and the balance of \$747,990 was charged to operations for the year ended June 30, 2003.

During the year ended June 30, 2003, the Company issued 426,000 shares of its common stock valued at \$112,245 and 1,690,000 warrants, valued at \$203,150 based upon the fair market value of the Company's common stock on the date of the grant using the Black-Scholes option pricing model. The Company recorded these changes, totaling \$318,395 to operations for the year ended June 30, 2003.

During the fiscal year ended June 30, 2003, the Company converted certain payables and accrued expenses with officers, related parties and strategic vendors aggregating approximately \$1.9 million into 5,923,333 restricted shares of the Company's common stock and 5 year warrants to purchase an additional 3,706,800 restricted shares of the Company's common stock, of which 5,533,333 shares of common stock and 3,491,800 warrants were issued in settlement of \$1,748,756 of debt to related parties as follows:

Conversions Concurrent with Private Placements

Included in this total for the year ended June 30, 2003, related parties and strategic vendors converted debt aggregating approximately \$300,000 and \$15,000 respectively into:

- (a) 1,000,000 shares and 5 year warrants to purchase at \$.30 a share 1,000,000 shares of mPhase common stock by Microphase, a related party, which converted \$300,000 of liabilities;
- (b) 50,000 shares and 5 year warrants to purchase at \$.30 a share 50,000 shares of mPhase common stock by a strategic vendor which converted \$15,000 of liabilities.

Such conversions were upon the same terms of a concurrent private placement of common stock by the Company and no gain or loss was recognized in connection with these conversions.

Conversions, Settlements and Gain on Extinguishments

In addition this total for the year ended June 30, 2003 includes 3,772,996 shares of common stock and warrants to purchase 2,233,490 shares of the Company's common stock which were issued as follows:

- (a) During the year ended June 30, 2003, these included transactions with related parties whereby the Company and the counter parties respective board of director[s] approved, entering into an agreement in principle with the Company's officers and affiliates, including Janiafst Ltd. and Microphase Corporation, to convert up to an amount equal to accounts payable through September 30, 2002. Such approval was received by the respective boards of directors authorizing conversions of such payables

effective September 30, 2002 resulting in the conversion of \$620,000 on and \$360,000 on of liabilities due to Microphase corporation, and Janifast Ltd. into 3,033,000 shares and 1,500,000 shares of stock, respectively. The value attributable to the shares was based upon the market price of the Company's common stock on the measurement date, such date was determined pursuant to EITF00-1, as to when all the contingent terms of the conversion agreement were met, in which no gain or loss was recognized on the conversion of \$980,000 of debt and,

- (b) Also included in such conversions during the year ended June 30, 2003, were transactions whereby the Company converted \$513,756 of liabilities due to the Company's president, vice president and a sales manager who is also concurrently employed by Microphase, for unpaid management compensation and sales commissions due from mPhase into warrants to purchase up to a total of 2,656,500 shares of the Company's common stock. The aggregate value of such warrants was estimated using the Black-Scholes options pricing model, pursuant to EITF 96-18, having an approximate value of \$.21 per share, or \$525,962. The Company recorded a settlement expense of approximately \$12,206 with respect to these three individuals.
- (c) Strategic vendors converted \$117,486 of payables into 340,000 shares of the Company's common stock on the measurement date the value of which was based upon the price of the Company's common stock on the effective date of settlement with each party. This resulted in a gain of \$37,383, which, when combined with all the conversions and gains from cash settlements of \$36,049 for the fiscal year 2003, resulted in a net gain on extinguishments in the statements of operations of \$61,226 for the year ended June 30, 2003.

As a result of the preceding, during the three years ended June 30, 2003, extinguishments, cancellations and conversions of debt for issuance of the Company's common stock to related parties is summarized in Note 11 and amounts relating to strategic investors is summarized as follows:

| | For the Years Ended June 30, | | |
|---|-------------------------------------|-------------|-------------|
| | 2001 | 2002 | 2003 |
| Equity Conversions of Debt with Strategic Vendors | | | |
| Strategic Vendors | | | |
| Number of shares | 0 | 999,662 | 390,000 |
| Number of warrants | 0 | 870,000 | 215,000 |
| Amount converted to equity | \$ 0 | \$ 529,503 | \$ 198,032 |
| Gain on Extinguishment of Debt | \$ 0 | \$ 142,236 | \$ 73,432 |

The Company has no commitments from affiliates or related parties to provide additional financings. The Company has, from time to time, been able to obtain financings from affiliates when conditions in the capital markets make third party financing difficult to obtain or when external financing is available only upon very unattractive terms to the Company, and when such capital has been available from the affiliates. (See also Note 11 Related Party Transactions)

STOCK INCENTIVE PLANS

On August 15, 1997, mPhase established its Long Term Stock Incentive Plan. Included as part of the Long Term Stock Incentive Plan, is the Stock Option Plan (the "Plan"), in which incentive stock options and nonqualified stock options may be granted to officers, employees and consultants of the Company. On February 23, 2000 the Board of Directors proposed and on May 22, 2000 the stockholders approved an increase in the total shares

eligible under this plan to 15,000,000 shares. Vesting terms of the options range from immediately to two years and generally expire in five years.

On May 30, 2001, mPhase established the 2001 Stock Incentive Plan (the "2001 Plan"), in which incentive stock options and non-qualified stock options may be granted to officers, employees and consultants of the Company. The total shares eligible under the 2001 Plan is 20,000,000 shares, in addition to the shares previously authorized for issuance under the prior plan. Vesting terms of the options range from immediately to two years and options generally expire in five years. The maximum number of shares that may be granted during any one fiscal year to any one individual under the 2001 Plan is limited to 2,500,000 shares.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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10. STOCKHOLDERS' EQUITY (Continued)

A summary of the stock option activity for the years ended June 30, 2001, 2002, 2003 pursuant to the terms of both plans, which include incentive stock options and non-qualified stock options, is set forth on the below:

| | <u>NUMBER OF OPTIONS</u> | <u>WEIGHTED AVERAGE EXERCISE PRICE</u> |
|------------------------------|------------------------------|--|
| Outstanding at June 30, 2001 | 12,580,500 | \$ 1.94 |
| Granted | 6,570,000 | .43 |
| Exercised | □ | □ |
| Canceled | (43,500) | (4.26) |
| | <u>19,107,000</u> | <u>1.27</u> |
| Outstanding at June 30, 2002 | 19,107,000 | 1.27 |
| Granted | 625,000 | .30 |
| Exercised | □ | □ |
| Canceled/Expired | (2,565,000) | (1.00) |
| | <u>17,167,000</u> | <u>\$ 1.24</u> |
| Outstanding at June 30, 2003 | 17,167,000 | \$ 1.24 |
| | <u>17,092,006</u> | <u>\$ 1.28</u> |

The fair value of options granted in 2001 and 2002 and options and compensatory warrants granted in 2003 was estimated as of the date of grant using the Black-Scholes stock option pricing model, based on the following weighted average assumptions: annual expected return of 0%, annual volatility of 113% in 2001, 125.4% in 2002 and 144.4% in 2003 based upon a risk-free interest rate ranging from 2.4% to 5.8% and expected option life of 3 years.

The per share weighted average fair value of stock options granted during 2001, 2002 and 2003 was \$1.16, \$.26, and \$.21, respectively. The per share weighted average remaining life of the options outstanding at June 30, 2001, 2002, and 2003 is 3.66, 3.29 and 2.80 years, respectively.

mPhase has elected to continue to account for stock-based compensation under APB Opinion No. 25, under which no compensation expense has been recognized for stock options and certain compensating warrants granted to employees at fair market value. Had compensation expense for stock options granted under the Plan and certain warrants granted to employees in 2003, been determined based on fair value at the grant dates, mPhase's net loss for 2001, 2002 and 2003 would have been increased to the pro forma amounts shown below.

| <u>JUNE 30</u> | | |
|----------------|-------------|-------------|
| <u>2001</u> | <u>2002</u> | <u>2003</u> |

| | | | |
|---------------------|---------------|---------------|--------------|
| Net Loss: | | | |
| As reported. | \$ 23,998,734 | \$ 11,245,361 | \$ 6,650,211 |
| Proforma | \$ 25,243,270 | \$ 11,673,091 | \$ 6,866,271 |
| Net Loss Per Share: | | | |
| As reported. | \$ (.72) | \$ (.23) | \$ (.10) |
| Pro forma | \$ (.75) | \$ (.24) | \$ (.11) |

For the year ended June 30, 2001, mPhase recorded non-cash charges and deferred compensation totaling \$2,955,964 and \$607,885, respectively, in connection with the grant of 5,618,000 options to employees and options to consultants for services rendered or to be rendered.

For the year ended June 30, 2002, the Company recorded non-cash charges and deferred compensation totaling \$927,420 and \$0, respectively, in connection with the grant of 6,570,000 options to employees and options to consultants for services rendered or to be rendered. Such charges are the result of the differences between the quoted market value of the Company's common stock on the date of grant and the exercise price for options issued to employees and Black-Scholes stock option pricing calculations for options issued to consultants.

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mPHASE TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2003

10. STOCKHOLDERS' EQUITY (Continued)

For the year ended June 30, 2003, the Company recorded non-cash charges and deferred compensation totaling \$70,950 and \$0, respectively, in connection with the grant of 625,000 options to employees and consultants and the Company recorded non-cash charges of \$203,155 in connection with the grant of 1,690,000 compensating warrants to employees and consultants for services rendered or to be rendered. Such charges are the result of the differences between the quoted market value of the Company's common stock on the date of grant and the exercise price for option and warrants issued to employees and Black-Scholes stock option pricing calculations for options and warrants issued to consultants.

The following summarizes information about stock options outstanding at June 30, 2003:

**RANGE OF
EXERCISE PRICE**

**NUMBER
OUTSTANDING**