MPHASE TECHNOLOGIES INC
Form 10-K
September 29, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10K

x **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, 2006**

COMMISSION FILE NO. 000-24969

mPHASE TECHNOLOGIES, INC.

(Name of issuer in its charter)

NEW JERSEY	**22-2287503**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

587 CONNECTICUT AVE., NORWALK, **CT 06854-1711**

(Address of principal executive offices) (Zip Code)

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

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

COMMON STOCK, $.01 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 o

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 September 18, 2006, there were 286,376,489 shares of common stock, .$01 par value, outstanding and the aggregate market price of shares held by non-affiliates was approximately $42,065,474 (Based upon a closing common stock price of $.18 on September 18, 2006) (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

FOR THE YEAR ENDED JUNE 30, 2006

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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," "potential," or 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 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.

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 New York, New York. The Company is a developer and seller of broadband communications products for telephone service providers. The Company s TV+ solution is an open-standards, carrier class solution of middleware/software enabling telephone service providers to deliver broadcast TV using internet protocol (IPTV), video on demand, voice and high-speed internet over such providers existing infrastructure. The Company also provides systems integration solutions for delivery of broadcast television (IPTV), video on demand, high-speed internet and voice using internet protocol over the existing infrastructure of a telephone service provider. The Company's TV+ solution is highly scalable and reliable middleware designed to operate with any IP based network. In addition the Company designs, manufacturers and sells DSL component products. In fiscal year 2004, the Company entered into the field of nanotechnology research and development of micro power cell batteries of various voltages. In 2005, the Company expanded its products in the field of nanotechnology research and development into electronic sensors or magnetometers using micro electrical mechanical systems.

In February of 2004, mPhase entered the business of nanotechnology that utilizes the latest scientific research in molecular engineering, quantum physics and electrochemistry to create new advances in products. In February of 2004, mPhase executed a $1.2 million 12 month Development Agreement with the Bell Labs division of Lucent Technologies, Inc. The Development Agreement is for exploratory devlelopment of battery and power cell products initially targeted for military applications. Such agreement was extended in March of 2005 for an additional 12 months and again in April of 2006 and currently runs through February of 2007. Under the terms of the current agreement, mPhase is obligated to pay the Bell Labs division of Lucent Technologies, Inc. $100,000 per month for a 12 month period.

In March of 2005, the Company entered into a second Development Agreement for 12 months for $1.2 million with the Bell Labs division of Lucent Technology to develop ultra sensitive magnetic sensor devices through the science of nanotechnology. Such agreement was renewed in April of 2006 for another 12 months requiring mPhase to pay Bell Labs the sum of $100,000 per month for exploratory research. The Company believes that such sensors may have significant applications in the area of military electronics, cell phones, the food industry and electronic security and detection devices. The family of magnetometers that mPhase is developing in collaboration with Lucent Bell Labs is based upon Micro Electrical Mechanical Systems (MEMS). This is a development technique using a combination of photolithography and etching with extremely small three dimensional structures, with the capabilities of movement, can be made on a wafer of Silicon. The processing of such devices is done in a semi-conductor clean room located at the New Jersey Nanotechnology Consortium facilities in Murray Hill, New Jersey. The discipline of developing new products utilizing nanotechnology fabrication is in its early stages of exploratory development making it difficult to predict the timing of product releases and future revenues. mPhase believes that these reserve batteries with exceptionally long shelf lives, very small size and high power density as well as electromagnetic sensors may be some of the first products resulting from nanotechnology research and development to achieve commercial viability.

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 over 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 innovative products and solutions designed to allow for the delivery of broadcast television by telephone service providers over their existing infrastructure and more recently two nanotechnology products. The Company believes that such expansion into nanotechnology product development is consistent with its strategy of being a pioneer of high growth technology products and potentially diversifies its product mix.

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. The DVDDS is a proprietary technology developed in conjunction with Georgia Tech Research Corporation (GTRC) and is one of the first systems of its kind developed. The Company has not earned any material revenues to date with respect to the DVDDS and has discontinued further development of the product and replaced it with its TV+ solution.

The Company believes that the demand for the TV+ system will be initially the greatest 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 and are therefore have less competitive solutions for the delivery of broadcast television. The Company s IPTV solution utilizes a communications framework based upon Internet Protocol (IP) instead of Asynchronous Transfer Mode (ATM) that was utilized in earlier releases of the product. ATM is an industry standard for transportation of data based upon a packaging of information into a fixed-size cell format for transportation across networks. Many telecommunications service providers currently deploy equipment that handles this protocol because it can support voice, video, data and multimedia applications simultaneously with a high degree of reliability. IP is another transport protocol that maintains network information and routes packets across networks. IP packets are larger and can hold more data than ATM cells. Historically, there have been concerns that service providers would be unable to provide the same quality of service with IP because it is not optimized for time-sensitive signals such as broadcast television and voice. Nevertheless, there is a greater demand by telecommunication service providers for IP systems for delivery of television, voice and high-speed data because such systems are significantly more cost effective to deploy based upon greater scalability.

The Company s TV+ solution consists of middleware/software that will operate with any IP based network including DSL, Ethernet, or fiber or any combination thereof. The solution is transport agnostic and may be deployed with any IP multicast router or DSLAM transportation method used for the delivery of television and high-speed data over an IP network.

In 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+ solution. In March of 2000, we established mPhase Television net., Inc. (mPhase TV), a joint venture between mPhase and Alphastar International, Inc. in which mPhase owns a 57% interest. Through such joint venture, mPhase has gained significant experience in negotiation of contracts with television programmers for delivery of television by telephone service providers. Such experience should prove useful in providing assistance especially to smaller U.S. telecommunications service providers in obtaining programming content necessary to enter into the delivery of broadcast television.

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.

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.

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 legacy Traverser DVDDS. GTRC is entitled to receive a royalty equal to 5% of gross sales of the Traverser DVDDS and 30% of any "lump sum payments" received in connection with revenues received by mPhase from the Traverser DVDDS product the under the terms of its license, as amended. The Traverser DVDDS has been replaced by the Company's IPTV solution.

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.

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 20 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 Broadcast Television Switch 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 mPhases' BTS.

Effective September 15, 2003, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. that has been extended through December of 2005 pursuant to additional Statements of Work under such Development Agreement for development of its IPTV solution.

Effective February 3, 2004, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. for the development of micro power source arrays fabricated using nanotextured superhydorphobic materials.

On November 28,2004, mPhase entered a Software License Agreement with Espial Group, Inc to be used in the set top box of its TV+ solution. Espial Group, Inc. is a leader in system operating software for set top boxes used to receive IPTV.

On January 3, 2005, mPhase entered into a work order with Magpie Telecom Insiders, Inc. pursuant to the terms of a Software Development Agreement dated September 2, 2004 for purposes of adding video on demand to its TV+ solution.

Effective March 5, 2005, mPhase extended its Development Agreement with Bell Labs for an additional 12 months for the development of micro power source power arrays.

Effective March 10, 2005, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies Inc. for the development of a new generation of magnetic field sensors using the science of nanotechnology.

In April of 2006, mPhase renewed each of the nanotechnology agreements with Bell Labs dated March 5, 2005 and March 10, 2005 , respectively, for an additional 12 months the cost of $100,000 per month each.

In May of 2006, the Development Agreement with the Bell Labs division of Lucent Technologies, Inc. covering the Company s TV+ solution was not renewed by the Company and Velankani, a software designer headquartered in India, assumed responsibilities for development of the system management software object code and system integration of the Company s TV+ solution. The Company has been working with Velankani for system integration testing since January of 2006.

On June 27, 2006, the Company entered into Amendment No. 4 to a Software License Agreement with Espial Group, Inc. which extended the term of its original development agreement through 2008 for Software development and support of the TV+ software in connection with multiple set top boxes of various vendors.

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 *iPOTS* and broadband loop products (which have been discontinued). We are currently exploring the development of VDSL (very fast DSL) CPE (customer premises equipment) Splitters as a new DSL component product line. Neither our TV+ solution or our nanotechnology products have generated to date any material revenues other than $280,000 of revenue with respect to the sale of 1000 set top boxes together with software for Release 2.0 (that uses asynchronous transfer mode protocol) of our TV+ solution in fiscal year 2005 to a major Russian telecommunications service provider. In our fiscal years ended June 30, 2006 and June 30, 2005 we generated approximately $1.0 million and $1.6 million in revenue, respectively, from the commercial sale of our component products and overall losses for such years of $24,450,650, and 11,234,324, respectively. These component products, including filters and Central Office POTS Splitter Shelves, marketed to other DSL equipment vendors. In addition on September 13, 2006, we announced the deployment of a 1,500 subscriber system for a 30 day trial deployment of our IPTV solution. Upon successful completion of such trial, it is anticipated that a 6,000 subscriber deployment would follow generating the Company s first revenues with respect to its IPTV solution.

Products & Services

IPTV Solution

Our primary business is to develop and market our TV+ solution that consists of a middleware/software designed for the delivery of television over any IP network. We believe our TV+ system is the most cost-effective, reliable, scaleable and easiest to operate platform for delivery of broadcast television, data and voice over IP networks on the market. MPhase is currently primarily marketing its IPTV product 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.

Our goal is to achieve wide acceptance of our TV+ solution in developing markets outside of the United States for multi-channel digital broadcast IP television at significant gross margins by creating an extremely cost-effective product. Our TV+ solution consists of highly scalable system management middleware/software designed to deliver IP television, video on demand, high speed internet and voice over any IP based network. The solution is carrier class and standards based designed to work with hardware of many different vendors that manufacture DSLAM's, IP Multicasters, set top boxes, as well as any backbone of hardware servers or topology that are key components that form part of a system for the delivery of IPTV. It is important to note that the Company has shifted its focus from a proprietary end to end hardware and software platform for the delivery of broadcast television over DSL to the development of middleware/software for carrier class delivery of IPTV over any IP network infrastructure of a telecommunications service provider. This shift has taken place over the past three years in response to advancements in IP deliver of television and the current requirements of telecommunications service providers for IPTV solutions.

Other DSL 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, located in the central offices of telecommunications service providers, allows for increased clarity of both voice and data information and decreased crosstalk or interference. Due to the intense global competition, pricing and margins for such product have eroded significantly and the Company is currently reexamining its product line. The Company is seeking to use the combination of capabilities of its own prior experience with respect to central office and customer premises POTS Splitters for ADSL with those of Microphase Corporation and Janifast Ltd. to develop a new line of VDSL customer premises splitters in what appears to be a new and evolving market.

Intelligent POTS Splitter

The mPhase *i* POTS (renamed the Broadband Loop Watch) are products for the DSL industry that enables remote 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 can be accomplished by use of these products. The advent of manufacturers of digital subscriber line access multiplexers (DSLAM s) building POTS splitters into DSLAM s, has made the Broadband Loop Watch, a less compelling solution in a more competitive market. As a result, the Company has discontinued its efforts with respect to the Broadband Loop Watch product.

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. These products are also subject to intense global price competition and reduced margins and are presently also being reexamined by the Company as part of its overhaul of its DSL product line to meet current market conditions.

Nanotechnology Products

Effective February 3, 2004, mPhase entered into a Research and Development Agreement with the Bell Labs division of Lucent Technologies, Inc. for exploratory development of micro power cell battery arrays employing nantextured superhydrophobic materials for $1.2 million. Under the terms of the contract, the Company will share in royalties from any licensing of the products developed with Lucent. In March of 2005 and again in April of 2006 mPhase extended such contract each for an additional 12 months at a total cost of $1.2 million . In March of 2005 mPhase also engaged the Bell Labs division of Lucent Technologies, Inc in a second 12 month $1.2 million contract to develop an ultra sensitive magnetometer designed initially for electronic military applications that was extended in

April of 2006 for an additional 12 months on the same terms.

Highly Sensitive Magnetometers - The enhanced sensitivity of these devices results from two scientific advances recently made researchers at Lucent Bell Labs. Presently, the highest sensitivity magnetometers commercially available require cooling to cryogenic temperatures. Called SQUIDs (for Superconducting Quantum Interference Devices) these devices only work at the temperature where liquid helium boils, -455 degrees below zero Fahrenheit, making such magnetometers expensive and bulky and therefore ill-suited for remote-sensing applications. Room temperature magnetometers, on the other hand, are less sensitive, and use technology that was developed in World War II for detecting submarines.

The new technology being developed by Bell Labs and mPhase employs a number of different designs based on Micro-Mechanical Systems (MEMS). These designs use the very high "Quality Factor (Q)" of the mechanical resonance in single crystals of silicon. A resonance is similar to the fundamental frequency of a tuning fork. When tapped, a tuning fork will vibrate for a length of time inversely proportional to the internal friction of vibration within the metal of the tuning fork. A comparable tuning fork made from single crystal silicon, which has less internal friction than the hardest metal, will vibrate almost a thousand times longer. Based on this principal, a device employing a high Q resonator will have enhanced amplitude of vibration at the resonance frequency, and hence will display a greater sensitivity to external perturbations that affect its resonance frequency. By coupling the mechanical motion of a bar or a paddle constructed from silicon to the ambient magnetic field, this high mechanical sensitivity can be converted to high magnetic field sensitivity. The technical approach that the team is developing can be achieved either statically with an integrated magnetic film, or dynamically through motion of the silicon bar or paddle.

The Benefits of MEMS - Commercial magnetometers using purely electronic detection, such as Hall, magneto-resistance or flux-gate devices, have sensitivities limited by their *electronic* Q-factor. This Q-factor depends on the natural electrical resistance, or electronic friction, of the metal in the circuit. For room-temperature operations it is therefore difficult to reduce the electrical Q-factor. Mechanical resonators made from semiconductor-grade silicon, on the other hand, exhibit mechanical Q-factors, approaching 100,000 at room temperature. In all, these new, smaller and less costly magnetometers should be 100-1000 times more sensitive than existing commercial devices, thus enabling a new class of sensor systems that mPhase plans on commercializing.

The mPhase and Lucent magnetometer team has successfully reached an early milestone and have produced a number MEM based sensor samples from the clean room facilities and are working on integrating them into the surrounding electronic circuitry so that measurement, characterization and sensitivity testing can be conducted.

Potential Spin Off of Magnetometer Technology- On August 17, 2006, the Company announced that its Board of Directors had approved the spinout of its ultra-sensitive magnetometer sensor product into a new publicly-held company. Such spinout is subject to future shareholder approval and is designed to unlock potential shareholder value in this product line by continuing its development and marketing in a separate company.

Target Markets

mPhase's primary target market for its IPTV+ solution is primarily large international telephone service providers and rural U.S. telephone service providers in areas in which an extensive fiver infrastructure has not been developed. We believe our IPTV solution is most competitive in markets that currently have limited access to multi-channel television services such as many parts of Eastern Europe, Russia, the Ukraine, Turkey and other countries in the Middle East. We believe that our IPTV solution will also be competitive in the United States as we continue to add features required by large American telecommunications service providers.

Our nanotechnology products have potential military and commercial applications. Our micro power cell has potential application for usage on credit cards as well as potential military applications as a power source with a much longer shelf life prior to activation, than conventional batteries. Our magnetometer has potential military and commercial applications including cell phones and the food industry for detection of needles used for injection of hormones in cattle and other animals consumed grown for meat products. Potential military applications could include electronic security devices and detection devices of enemy mines and soldiers.

Competitive Business Conditions

During the past 5 years, the market for the delivery of TV by telephone service providers has been marked by significant technological change. During the robust spending period in the late 1990's into the year 2000, the theme of convergence focused strictly on the last mile to the home in the United States. Telephone service providers were beginning to deliver high-speed internet over digital subscriber lines (DSL) using their copper infrastructure and examining methods to deliver broadcast television together with voice as a triple play to increase revenues and margins as traditional revenues and margins from wire line telephone services declined with the advent of wireless and voice over IP competition from cable providers. The industry has evolved from an initial focus on proprietary end to end systems such as the Traverser DVDDS developed by mPhase to the need for standards-based open architecture with carrier class quality and security which are features of mPhase s TV+ solution for the delivery of IP television. During such period, telephone service providers concluded that in order to achieve minimum cost of delivery and maximum scalability, any solution for delivery of broadcast television and video on demand would need to be based upon a transport mode utilizing the new Internet Protocol as opposed to the services provider's traditional asynchronous transfer mode (ATM protocol). The evolution of mPhase's TV+ solution is targeted to meet the new market realities and requirements of major telecommunications service providers for the delivery of a triple play of converged services.

Despite significant market noise and fanfare about IPTV, major deployments of true broadcast television by telecommunications service providers are relatively few but have increased during the past 12 months.. The complexity of designing the software/middleware solution of low cost, high reliability, scalability, security and open architecture to allow service providers to custom tailor and grow into a system based upon such provider's network topology, take rate among customers and specific feature requirements has proved to be a significant challenge for all of the major players in such market place including Microsoft. Alcatel, Minerva, Myrio and Motorola. In addition, the delivery of IPTV by telephone service providers with robust features may require a simultaneous investment in routers and servers to upgrade a system s backbone which may entail significant additional cost . It is estimated that the cost of the IPTV middleware sold by mPhase may constitute only 5% of the overall investment a telecommunications service provider will need to upgrade its overall system for IPTV delivery. The story is still being played out in the market with considerable uncertainty as to who the final dominant players will be on the middleware/software market which is the driving focus of mPhase s of its TV+ solution. In 2006, the telecommunications sector has continued its slow recovery began in 2004 from the significant downturn and weakness in capital spending by service providers globally that began at the end of calendar year 2000. The dramatic pull back in equipment purchased by service providers from its peak commencing at the end of calendar year 2000, 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 four years, has halted the growth of the sector. The Company remains optimistic about the future of the industry and the potential of its IPTV platform and solutions. The Company has responded to the market challenges in the past several years to reconfigure its video product line from a narrow, proprietary, DSL platform solution to an open systems standard for the delivery of Broadcast Television, high speed internet and voice over a medium agnostic and delivery agnostic solution. The Company's IPTV solution enables telephone service providers to deliver a triple play of services over both a fiber, coaxial or copper transport medium with a transport mode not tied to any particular DSLAM, multiplexer or other transport vendor of Broadcast TV but rather based upon an open standards system delivery and management system software. We anticipate an eventual upturn in capital spending by telephone service providers seeking to provide a triple play of voice, data and video delivery even though such upturn may be constrained by the fact that service providers still face significant challenges of overcapacity and declining margins for traditional services globally. The worldwide rollout of VDSL data delivery services should also provide a market for the Company's component products such as its newly designed VDSL Splitters necessary in customer premises of service providers.

As has been seen during the past several years, in addition to the very volatile economic climate, the telecommunications software and hardware equipment market is also characterized by swift technological change. Currently, communications service providers have the option to offer several broadband solutions for the last mile to the home , 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 it has broadened its competitive capabilities beyond the traditional DSL and copper market with the development of its IPTV product in its TV+ solution that operates over any form of IP network.

Where DLSAM (digital subscriber line access multiplexes) continue to be a key transport instrument for the delivery by telephone service providers of converged services, it should be noted that 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) and has announced a major joint

venture with Microsoft to develop middleware for IPTV deliver by telecommunications service providers. The recent merger of Alcatel and Lucent Technologies, Inc. reflects the continuing industry trend of consolidation of telecommunications equipment vendors.

There are a number of middleware providers competing in the IPTV solutions market including a number of competitors that are much larger, better known and with far greater financial resources than mPhase. Such competitors include Minverva, Orca Interactive, Siemens Corporation, VBrick Systems, Alcatel and Microsoft Corporation.

Bell South has recently awarded a major contract to the Alcatel/ Microphase joint venture to develop an IP network capable of delivering an IP TV solution with robust features.

To date, there are several deployments of IPTV worldwide including a deployment in Italy by Fastweb an Italian corporation. In Spain, Imagenio, operated by Telefonica has completed a significant deployment. Other major deployments of IPTV worldwide also include Yahoo BB/Softbank in Japan, Supersun in Hong Kong and Media on Demand in the Republic of China operated by Chunghwa Telecom.

Other vendors that offer complete platforms for delivery of IPTV hardware or software portions of such platforms that incorporate broadband solutions 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..

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 component DSL products that are produced by Janifast Ltd. By using contract manufacturers, mPhase will avoid the substantial capital investments required for internal production.

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 outsourced the digital engineering development for the legacy Traverser DVDDS to GTARC. It also out sources analog engineering development and certain administrative functions to Microphase Corporation. mPhase currently outsources to Latens., as well as Magpie Telecom Insiders, Inc., Velankani and Espial significant software development to be used as part of its new IPTV solution. The agreement with respect to development of portion of the TV+ system management being performed by Bell Labs expired in May of 2006 and has not been renewed. The Company has transferred the portions of software being developed by Bell Labs and systems integration to Velankani.

mPhase has also outsourced to the Bell Laboratories Division of Lucent Technologies its research and development efforts in the nanotechnology area aimed at developing power cells and batteries with enhanced shelf lives and other features not currently available in batteries. Such focus is initially upon the development of batteries for military applications using nanotextured materials. In addition, as noted above, mPhase expanded its efforts in product development using the science of nanotechnology extensions of its original Development Agreement with Bell Labs for power cell and battery development for another 12 months as well as extending its Development Agreement with Bell Labs originally entered into in March of 2005 to develop electronic magnetic sensors (the Magnetometer) product line that has also been extended for an additional 12 months.

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.

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.

The Company has recently decided not to incur the cost of maintaining patents originally obtained by Georgia Tech Research Corporation in connection with its Traverser DVDDS legacy product in which the Company was the exclusive worldwide licensee for a 5 % royalty. As previously noted, the TV+ solution has replaced the legacy product.

The Company had filed seven (7) additional patents that consist of a combination of (a) patents granted to mPhase from the Bell Labs division of Lucent Technologies, Inc. and (b) joint patents development by mPhase and employees of Bell Labs relating to the micro pwer cells and magnetometers currently under development by the Company. mPhase has obtained the licensing rights from Bell Labs to use the prior art patents after expiration of the development period for each of the nanotechnology products.

On July 12, 2005, mPhase announced that it had been granted a U.S. patent that covers a series of techniques for splitting different voice and data signals in DSL access networks that is used in its Broadband Loop Watch product. As previously noted, the Company is not currently pursuing further development and marketing of this product.

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 our TV+ platform, in particular, which is not currently the protected by any patents or the subject of any patents pending, 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.

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 TV+ is FCC Part 15 compliant.

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. As of June 30, 2006, we had been billed a cumulative total of approximately $13,563,000 for research and development conducted by GTARC.

mPhase originally contracted with Lucent in fiscal year 2002 to reduce the cost of its INI set top box used with the Traverser DVDDS platform. During fiscal year 2003, the Company engaged Lucent to develop an integrated system with the Lucent Stinger DSLAM and mPhase middleware for the delivery of Television, high speed internet and voice on an open standards system to replace the proprietary Traverser product. As previously noted, Releases 1.0 and 2.0 of

the TV+ solution are designed to be ATM systems that operate exclusively with the Lucent Stinger DSLAM to enable a telecommunications service provider to deliver broadcast television, voice and high speed internet over DSL.

Our TV+ system using internet protocol or IPTV product was completed during May of 2006 by the Bell Labs division of Lucent Technologies, Inc. under a contract extended in August of 2005, for an aggregate cost of approximately $1.6 million. We have not renewed our contract for software development of our TV+ product with Bell Labs. We have engaged and expect to continue to engage Velankani, Magpie Insiders,Inc. Espial and other software vendors and developments for future assistance with our development including product refinements and enhancements. As of June 30, 2006 we have been billed a cumulative total of approximately $4,882,345 for research and development conducted by Lucent for our TV+, of which we have paid approximately $4,568,745. We have aggregate capital commitments by contract for future development of the TV+ solution in the amount of $1,998,000.

In addition, our advanced battery and power cell technology research and development is being performed by the Bell Labs division of Lucent under the terms of a contract for a cost of approximately $1.2 million with payments over a 12 month period of $100,000 per months extending through February of 2007. From February of 2004 through February of 2006 the Company had paid a total of $2.4 million to Bell Labs under at the rate of $100,000 under its initial contract for development of advanced battery power cell technology. In March of 2005, the Company further engaged Bell Labs in a separate Development Agreement for the development of a new generation of ultra magnetic sensors using the science of nanotechnology with a total cost of $1.2 million also payable in monthly installments of $100,000 for a period of 12 months which was extended through March of 2007 at the cost of $100,000 per month .

Employees

mPhase presently has 23 full-time employees, two of whom are also employed by Microphase Corporation. See the description in the section entitled "Certain Relationships and Related Transactions."

In addition to the Risk Factors set forth herein it is important for you to consider the following:

mPhase was advised in April 2002 that following an investigation by the staff of the Securities and Exchange Commission, the staff intended to recommend that the Commission file a civil injunctive action against Packetport.com, Inc. (''Packetport'') and its Officer's and Directors. Such recommendation related 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 Exchanges Act of 1934. As noted in other public filings of mPhase, the Chief Executive Officer and Chief Operating Officer of mPhase also serve as Directors and Officers of Packetport. At that time these persons advised mPhase that they deny any violation of law on their part and intend to vigorously contest such recommendation or action, if any.

On November 15, 2005, the Commission filed a civil enforcement action 3:05 CV 1747 against 6 individuals and 4 companies as a result of its investigation in federal district court in the State of Connecticut alleging various violations of the Securities Act of 1933 including Sections 5, Section 17(a) and the Securities Exchange Act of 1934 including Sections 10b, Rule 10b-5, Sections, 12,Section 13, Section 16 in connection with the purchase and sale of stock of Packetport.com in the period on or about December 14, 1999 into February of 2000. The defendants include the Chief Executive Officer and Chief Operating Officer of mPase as well as Microphase Corporation, a privately held Connecticut corporation, that shares common management with mPhase. mPhase Technologies, Inc. is not named as a party in the enforcement action. The Chief Executive Officer and Chief Operating Officer of mPhase , and Microphase Corporation, each deny any violation of the law by each or any of them and intend to vigorously contest all charges set forth in such enforcement action by the Commission.

RISK FACTORS

RISKS RELATED TO FINANCIAL ASPECTS OF OUR BUSINESS

The Company has entered into the new and emerging business of nanotechnology, which entails significant exploratory development and commercial risk.

The Company has expended approximately $3 million pursuant to a contract commencing in February of 2004 with Lucent Technologies, Inc. to initially develop longer life battery cells for military applications. The Company expects to continue exploratory research with Lucent Technologies, Inc. and in March of 2005 and again in April of 2006 extended its original Development Agreement with Lucent for an additional 12 months through February of 2007 at a cost of $100,000 per month. Even though a feasibility prototype product has been successfully developed, pure research involves a high degree of risk with significant uncertainty as to whether a commercially viable product will result. On March 10, 2005 the Company undertook to have Lucent Technologies Inc develop a new product line at $100,000 per month using the science of nanotechnology that is an uncooled magnetic ultra sensor device or magnetometer. Such contract was renewed in April of 2006 through March of 2007 on the same economic terms. The Company does not expect significant revenues from either of its nanotechnology products for at least 3 years.

mPhase's stock price has suffered significant declines during the past six years and remains volatile.

The market price of our common stock closed at $7.56 on June 30, 2000 and closed at $.28 and $.19 on June 30, 2005 and June 30, 2006 respectively. During such period of time the shares of outstanding common stock of the Company increased from approximately 30 million to over 277 million shares (480 million shares fully diluted). Such increase of shares was done to finance company operations and were issued at prices that were depressed and substantially diluted shares held by shareholders acquiring shares prior to the second quarter of fiscal year 2002. Stocks in telecommunications equipment providers of DSL products have been very volatile and declined dramatically 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 through the fiscal year ended June 30, 2005 and may not be able to operate profitability in the future.

We have had substantial net losses since our inception in 1996 (including $24,450,650 and 11,234,324 for the fiscal year ended June 30, 2006 and fiscal year ended June 30, 2005, 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 $15 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 June 30, 2006 and we have incurred (a) accumulated losses of $151,460,057 and a stockholder's deficit of $606,085 and (b) cumulative negative cash flow from operations of $67,257,660. As of June 30, 2006 we have negative working capital of $1,093,785

Our independent auditor's report expresses 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, 2006, June 30, 2005, June 30, 2004, 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." Such opinion from our outside auditors makes it significantly more difficult and expensive for the Company to raise additional needed capital necessary to continue our operations.

Our common stock is subject to significant dilution upon issuance of shares we have reserved for future issuance.

As of June 30, 2006, we have warrants and options outstanding convertible into approximately 206 million shares of mPhase common stock, which, upon conversion, may adversely affect the future price of our common stock. As of June 30, 2006 we have warrants and options convertible into approximately 98 million shares of our common stock at $.20 per share or less that, upon exercise may result in significant dilution to many of our current shareholders and may adversely affect the future price of our common stock. On June 28, 2006, the Company at its Annual Meeting of Shareholders received authorization to increase its authorized shares of common stock from 500 million to 900 million shares to enable us to continue to finance development of its products and fund continued operations. 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. Certain warrants with key vendors are subject to cashless exercise and may be immediately exercised with no resulting proceeds to the Company.

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 any of our solutions for the delivery of broadcast television, high-speed internet and voice by a major telephone service provider.

We have had to date no material revenues derived from sales of either our legacy Traverser Digital Video Data Delivery System (DVDDS) or our TV+ solution or any of our nanotechnology related products. There has been to date only one sale of our TV+ software and Set Top Boxes for 1000 customers of a telecommunications service provider in Russia that is just commencing deployment of a small group of customers as a trial and no major deployments of our TV+ Solution by telephone service providers globally of our products and there currently is uncertainty as to