MPHASE TECHNOLOGIES INC
Form 10-K
September 24, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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, 2012**

COMMISSION FILE NO. **000-30202**

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 if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act.

Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes [ ] No [X]

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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

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. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]
Non-accelerated filer [X] Smaller reporting company [X]
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act)

Yes [ ] No [X]

As of December 31, 2011, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant was $4,993,904 the closing sale price as of that date. As of July 26, 2012, there were 4,071,051,851 shares of common stock, $.001 par value, outstanding.

Documents Incorporated by Reference

None.

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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 1A 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.

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ITEM 1. BUSINESS

General Description of the Business

mPhase Technologies, Inc. is a publicly-held New Jersey corporation founded in 1996. The Company has approximately 23,000 shareholders and approximately 4 billion shares of common stock outstanding as of June 30, 2012. The Company's common stock is traded on the Over the Counter Bulletin Board under the ticker symbol XDSL. The Company has offices in Little Falls, New Jersey as well as Norwalk, Connecticut.

mPhase is a development-stage company specializing in developing smart surfaces using materials science engineering, nanotechnology science and the principles of microfluidics and microelectromechanical systems (MEMS). The Company develops products for both commercial and military applications. The Company's flagship product is its Smart NanoBattery providing Power On Command . The new patent pending and patented battery technology, based on the phenomenon of electrowetting, offers a unique way to store energy and manage power. Features of the Smart NanoBattery include potentially infinite shelf life, environmentally friendly design, fast ramp to power, programmable control, and direct integration with microelectronic devices. The platform technology behind the Smart NanoBattery is a porous nanostructured material used to repel and precisely control the flow of liquids. The material has a *Smart Surface* that can potentially be designed for other innovative products such as medical devices including heart pacemakers and pumping devices.

mPhase has completed a Phase II Small Business Technology Transfer Program (STTR) grant, part of the Small Business Innovation Research (SBIR) program, with the U.S. Army for continued development of a reserve Smart NanoBattery for a critical computer memory application. Such reserve battery can be activated by an electronic pulse. The Army has also successfully tested the Smart NanoBattery as an energy source activated by g forces for a guidance system for small munitions.

In a separate effort, mPhase has also developed a mechanically- activated reserve battery. As a result of a unique combination of battery and mechanical engineering, such reserve battery also has a potentially infinite shelf-life. The battery was part of the Company's pilot program for a new emergency flashlight product line that has been designed by and co-branded with Porsche Design Studio, a premiere world-class company specializing in high-end accessory products for the luxury automotive manufacturer. The Company is developing a second automotive product with Porsche Design studio.

Description of Operations

Microfluidics, MEMS, and Nanotechnology

In February of 2004, mPhase entered the business of developing new products based on materials whose properties and behavior are controlled at the micrometer and nanometer scales. (For reference, a micrometer or micron is equal one millionth (10^{-6}) of a meter and a nanometer is one billionth (10^{-9}) of a meter the scale of atoms and molecules. A human hair is approximately 50 microns in diameter, or 50,000 nanometers thick.)

The Company has expertise and capabilities in microfluidics, microelectromechanical systems (MEMS), and nanotechnology. Microfluidics refers to the behavior, precise control and manipulation of fluids that are geometrically constrained to a small, typically micrometer scale. MEMS is the integration of mechanical elements, sensors, actuators, and electronics on a common silicon substrate through microfabrication technology. Nanotechnology is the creation of functional materials, devices and systems through control of matter (atoms and molecules) on the nanometer length scale (1-100 nanometers), and exploitation of novel phenomena and properties (physical, chemical, biological, mechanical, electrical) at that length scale.

In its Smart NanoBattery, mPhase exploits the physical phenomenon of electrowetting by which a voltage is used to change the wetting properties of a liquid/solid interface at the nanometer scale. Consider water as the liquid. Through electrowetting, mPhase can change a surface from what is referred to as a hydrophobic ("water repelling") state to a hydrophilic ("water attracting") state. In the hydrophobic state, the water beads up or is repelled by the surface. In the hydrophilic state, the water spreads out or is absorbed by the surface. The ability to electronically control the wetting characteristics of a surface at the nanometer scale forms the basis of mPhase's nanotechnology operations and intellectual property portfolio.

In the Smart NanoBattery application, mPhase uses electrowetting as a new technique to activate or literally "turn on" a battery once it is ready to be used for the first time. At the heart of the Smart NanoBattery is a porous, nanostructured superhydrophic or superlyophobic membrane designed and fabricated by mPhase. The so-called superhydrophobic membrane applies to water and the superlyophobic membrane applies to nonaqueous or organic liquids such as ethanol or mineral oil. The difference between the two membrane types lies in the nanoscale architecture at the surface. By virtue of its superhydrophobic or superlyophobic character, the membrane, although porous, is able to physically separate the liquid electrolyte from the solid electrodes so that the battery remains dormant or inactive, thus providing no voltage, or current until called upon. This electrolyte-electrode separation gives the battery the feature of potentially unlimited shelf life and the benefit of being always ready when needed, which is not necessarily the case for conventional batteries. Electrowetting alters the liquid/membrane interface so that the liquid is now able to flow over the membrane's surface and rapidly move through the pores where it is able to contact the solid electrode materials located on the other side of the membrane.

mPhase uses MEMS, to precisely control the machining of silicon-based materials at the micrometer and nanometer scales. This ability has led to the Company's proprietary membrane design that controls the wetting and movement of liquids on a solid surface. mPhase uses microfluidics to control the flow of liquid electrolyte through the porous membrane and is also the basis for other possible applications such as self-cleaning surfaces, filtration and separation and liquid delivery systems.

mPhase has also developed a manually-activated lithium reserve battery using an innovative industrial and mechanically-engineered design. The battery is activated by a unique triggering mechanism that rapidly releases and distributes the liquid electrolyte held in a glass sealed reservoir inside the battery. By twisting a screw-like mechanism outside the battery the glass seal is broken and the electrolyte immediately contacts the battery's solid electrodes to produce electric power. Unlike conventional batteries that have relatively short shelf lives prior to initial use of the flashlight, the mPhase reserve battery has a shelf life of over 20 years.

History of Nanotechnology Operations

Smart NanoBattery

mPhase Technologies, along with Bell Labs, jointly conducted research from February 2004 through April of 2007 that demonstrated control and manipulation of fluids on superhydrophobic and superlyophobic surfaces to create a new type of battery or energy storage device with power management features obtained by controlling the wetting behavior of a liquid electrolyte on a solid surface. The scientific research conducted set the ground work for continued development of the Smart NanoBattery and formed a path to commercialization of the technology for a broad range of market opportunities. The Company began its efforts by entering into a $1.2 million 12 month Development Agreement in February of 2004 with the Bell Labs division of Alcatel/Lucent for exploratory research of control and manipulation of fluids on superhydrophobic surfaces to create power cells (batteries) by controlling wetting behavior of an electrolyte on nanostructured electrode surfaces. The goal was to develop a major breakthrough in battery technology creating batteries with longer shelf lives as the result of no direct electrode contact (meaning no power drain prior to activation). During 2005 and 2006, the battery team tested modifications and enhancements to the internal design of the battery to optimize its power and energy density characteristics, as well as making engineering improvements that were essential in moving the battery from a zinc-based chemistry to a commercial lithium-based chemistry that can be manufactured on a large scale. The Company extended its development effort twice for an additional 2 year period ending in March of 2007 and for two additional periods thereafter through July 31, 2007. During this time, the technical focus shifted from trying to separate the liquid electrolyte from nanostructured electrodes to developing a nanostructured membrane that could physically separate the liquid electrolyte from the solid electrodes.

mPhase also began working with the Rutgers University Energy Storage Research Group (ESRG) in July of 2005 to conduct contract research in advanced battery chemistries involving lithium. This work involved characterizing and testing materials that could be used in the mPhase battery. In July of 2007, the relationship shifted to a collaboration focused on developing a memory backup battery needed by the U.S. Army. The work was funded through a Phase I Small Business Technology Transfer Program (STTR) grant.

In July of 2007, mPhase formed a new wholly-owned subsidiary, AlwaysReady, Inc., to focus on the development of its nanotechnology products. The Company has used this subsidiary as a division of the Company in order to develop increasing brand recognition of its battery products. The Company decided in September of 2007 to transfer its development work out of Bell Labs (Alcatel/Lucent) in order to accelerate and broaden its nanotechnology product commercialization efforts. Bell Labs had engaged in its battery research and development for the Company for zinc-based batteries and was limited since it did not have facilities capable of handling lithium chemistry. mPhase has continued to work with Rutgers ESRG which has facilities capable of handling lithium based batteries and has also engaged in work with foundries and other companies to supply essential components, fabricate prototypes, and plan manufacturing approaches. These companies currently include Silex, a well-respected silicon foundry in Sweden, and

Eagle Picher, a well-known battery designer and manufacturer that focuses on high-end batteries for military applications located in Joplin, Missouri.

In February of 2008, the Company announced that a prototype of its Smart NanoBattery was successfully deployed in a gun-fired test at the Aberdeen Proving Ground at Maryland. The test was conducted by the U.S. Army Armament Research and Development and Engineering Center (ARDEC) of Picatinny, New Jersey. The battery not only survived the harsh conditions of deployment at a gravitational force in excess of 45,000 g, but was also flawlessly activated in the process.

In March of 2008, mPhase announced that it had been invited to submit a proposal for a Phase II STTR grant based upon the successful work it had performed on the Phase I grant to develop a version of the Smart NanoBattery referred to as the multi-cell, micro-array reserve battery for a critical memory backup application. The Phase II grant in the gross amount of $750,000 (net $500,000) was granted to the Company in the middle of September of 2008. In March of 2008, the Company also announced the successful transfer to a commercial foundry of certain processes critical to the manufacturing of its Smart NanoBattery. This will enable fabrication of the porous membranes for the multi-cell, micro-array reserve battery mentioned above. The Company successfully manufactured nanostructured membranes at the foundry that are essential to commercial production of the battery. By achieving a series of delayed activations, the shelf-life and continuous run-time of such battery is increased to a period of time in excess of twenty years. In April of 2008, the Company announced that it had successfully activated it first Smart NanoBattery prototype by electrowetting using a hard-wired configuration and a remotely-activated device. Remote activation plays a key role in providing power to wireless sensors systems and radio frequency identification tags.

Also, in April of 2008, the Company announced that it had successfully produced its first lithium-based reserve battery with a soft or pouch package and breakable separator (in place of the electrowettable membrane) that relies on mechanical rather than electrical activation to provide Power On Command . The Company believes this to have been a significant milestone in moving from a low energy density zinc-based battery to a higher energy density lithium-based battery towards proving that this mechanically-activated reserve battery would become economically and commercially viable.

In fiscal years ended June 30, 2009 and June 30, 2010, the Company focused upon further development of its Smart Nano Battery under a Phase II STTR grant from the U.S. Army as a potential reserve battery for a back-up computer memory application for a weapons system. The Company has recently completed such Phase II Army grant. On November 12, of 2010, the Company announced that it had successfully triggered and activated its first functional multi-cell smart nano battery. Triggering and activation of the cells of the battery were achieved by using the technique of electrowetting or programmable triggering. Triggering was accomplished by applying a pulse of electrical energy to a porous, smart surface membrane located inside each cell in the battery causing the electrolyte to come in contact with the cell s electrodes, creating the chemical reaction to produce voltage inside of the multi-cell battery. The multi-cell battery consists of a matrix of 12 individual cells populated with an electrode stack consisting of lithium and carbon monofluoride materials with each rated at 3.0 volts. Using a custom designed circuit board for testing, each of the cells in the battery were independently triggered and activated without affecting any of the non-activated cells in the multi-cell configuration. Each cell in the battery has a very long shelf-life prior to triggering.

On February 9, 2011, the Company announced that it had signed a 3 year Cooperative Research and Development Agreement (CRADA) with the U.S. Army Armament Research, Development, and Engineering Center (ARDEC) at Picatinny, New Jersey, to continue to cooperatively test and evaluate the mPhase Smart NanoBattery, including new design features functionally appropriate for DoD based systems requiring portable power sources. The army researchers are evaluating the prototypes using the Army s testing facilities at Picatinny Arsenal in New Jersey in order to determine applicability of the technology to gun fired munitions and potentially to incorporate the technologies into research and development and other programs sponsored by Picatinny. The Research Agreement is supported by the Fuze & Precision Armaments Technology Directorate.

During fiscal year ended June 30, 2011, the Company completed work on its Phase II STTR grant for the U.S. army for a nano-reserve battery for a back-up computer memory application. In addition the Company engaged First Principals, Inc to perform an evaluation or each of its patents in order to identify a strategic partner whose products line will need the Company s SmartNanoBattery as a compelling solution.

On March 6, 2012, the Company announced that it is exploring the printing of its Smart NanoBattery on graphene and other new advanced materials. Graphene is a very strong material that has been described as the most conductive material known, making it a vast improvement over silicon. Graphene has the potential to lead to faster, cheaper and more flexible devices including power sources.

Emergency Flashlight

On December 5, 2008, mPhase Technologies, Inc. signed a contract with Porsche Design Gesellschaft m.b.H., Flugplatzstrasse 29, A,S700 Zell am see, Austria ("Porsche Design Studio"), to design a premium emergency flashlight (the mPower Emergency Illuminator). A pilot program that began in March of 2010 has resulted in the sale of approximately 56 emergency flashlights. The flashlight sold in the pilot program contained mPhase s proprietary mechanically-activated lithium reserve battery. The battery contains a breakable barrier that separates the solid electrodes from the liquid electrolyte until the battery is manually activated. Unlike traditional batteries, the mPhase battery remains in an inert state with no leakage or self-discharge until activation. The mPhase battery is designed to have an almost infinite shelf life making it ideal for emergency lighting applications. The premium flashlight will be marketed as an accessory for automobile roadside emergency kits.

On January 29, 2009, the Company announced that it had contracted with EaglePicher Technologies to design and manufacture, in small quantities, its mechanically-activated battery that were used in the pilot program of sales of the Company s new Emergency Flashlight. EaglePicher was selected for the pr0oject because of their experience in custom and standardized power solutions for the extreme environments of aerospace and military applications as well as medical and commercial applications.

The reserve battery is a manually activated lithium cell designed to provide Power On Command. The battery remains dormant until turned on by the user. It is built to the highest standards with a minimum storage life of 20 years. Once activated, the reserve battery is expected to deliver the electrical performance of a standard primary CR123 battery used in many portable electronic applications today.

EaglePicher Technologies, LLC, along with EaglePicher Company, is a world leader in custom and standardized power solutions for the extreme environments of aerospace and military applications as well as medical and commercial applications. The company specializes in design and manufacture of battery cells, battery packaging, battery management systems (BMS), analysis, environmental testing, and energetic devices. Active in battery development and testing since 1922, EaglePicher Technologies has the most experience and broadest capability in battery electrochemistry of any battery supplier.

Owing to cost considerations, the Company has decided to utilize a cost reduced active-reserve battery in its current version of its emergency flashlight product for potential sales after the pilot program. Such active reserve battery also has a very long shelf life and enables the Company to significantly reduce the selling price of the Emergency Flashlight. In March 2011, the Company received an initial order from Porsche Design Group in Germany for mPhase's Porsche design branded mPower Emergency illuminators to be sold in Porsche Design stores in Germany, Great Britain and the United States and it began shipments of the Emergency Illuminators in April of 2011.

Magnetometer

In March of 2005, the Company entered into a second Development Agreement for 12 months at a cost of $1.2 million per annum with the Bell Labs to develop MEMS-based ultrasensitive magnetic sensor devices, also known as magnetometers, that could be used in military and commercial electronics (*e.g.,* cell phones) for determining location, as well as in portable security and metal detection applications. The agreement was renewed in April of 2006 for another 12 months on the same terms. Although proven to work in the lab, the magnetometer technology could not be scaled up as quickly and as cost effectively as the battery. The project was suspended in September 2007 so that all technical resources could be allocated to the battery project. The Company is entitled to certain royalties from the magnetometer if Alcatel/Lucent ultimately generates revenues from the product.

DISCONTINUED BUSINESS-Internet Protocol Television (IPTV)

Historically, the Company, since its inception, had focused upon developing innovative solutions for the delivery of Broadcast Television as part of a "triple play" of services that would include voice and high-speed internet for telephone service providers globally. The Company, however, has not been able to derive any significant revenue from its TV+ solution and no active development of the product has occurred since fiscal year 2007. The Company determined to discontinue this line of business and all inventory has been written off. During the fourth quarter of the fiscal year ended June 30, 2010, the Company formally elected, for financial reporting purposes to treat its IPTV product line as a discontinued business.

Nanotechnology Products

Platform Technology

The surface is an important part of virtually every physical object and often plays an overriding role in many processes, beyond mere connectivity and structural support, but more deeply into areas involving chemical and biological interactions. In some instances, the surface provides an easy entry into the chemical or biological systems; in others it protects the internal elements of the object, surrounded by the surfaces.

mPhase's current flagship platform technology is the *Smart Surface*. By being able to control the surface properties of materials down to the nanometer scale, new and improved devices can be designed and built that may lead to compelling business opportunities. One type of smart surface of particular interest allows properties to be changed in response to an external stimulus.

Initially, mPhase's development focused on MEMS devices by manipulating the surface of silicon materials the same material used to make microelectronic materials and devices. Using physical and chemical processes, the surface of the silicon is modified to make solid porous structures known as membranes. This is where microfluidics comes into play. These membranes can be used to selectively control the flow of liquids through the pores or openings at the micrometer length scale.

Surfaces may be characterized as *hydrophilic* or *hydrophobic* depending on whether or not they attract or repel water (or other liquids). A hydrophilic surface can be wet and adsorbs water. A hydrophobic surface, on the other hand, cannot be wet. Hydrophilic and hydrophobic surfaces are abundant in nature and in synthetic materials, both organic and inorganic in chemical composition. A familiar example of a hydrophilic surface is a sponge that readily soaks up water. By contrast, many plant leaves and flower petals are hydrophobic, as are insect parts and bird feathers. Synthetic hydrophobic surfaces include Scotchgard treated fabric, Teflon® coated metal, or Rain-X® coated glass. On a hydrophobic surface, water beads up and can move around without being absorbed by the solid material that it is resting on.

So-called *superhydrophobic* surfaces are also found in nature and can now be replicated in the lab. The lotus leaf and rose petal, for example, exhibit superhydrophobicity. Here water droplets form almost perfect spheres with hardly any contact with the underlying solid surface. This makes the liquid even easier to move and manipulate.

The synthesis of superhydrophobic surfaces has recently been made possible by advances in nanotechnology and mPhase is leading the way to better understand and create materials and devices incorporating these unique surface properties.

As mPhase's research and development efforts evolve, in addition to silicon materials, the ability to control the surface properties of materials can be extended to other substances such as polymers, ceramics, metals, and fibers, as examples, providing opportunities for our platform technology to be used in a range of potential applications such as energy storage and power management for portable electronics and microelectronics, self-cleaning surfaces, filters for water purification or desalination systems, materials for environmental remediation that separate liquids or solvents, and other situations where the control of the interaction of a solid surface exposed to a liquid is vitally important.

Smart NanoBattery

Battery technology has changed little in its fundamentals over the past 150 years. As a result, ordinary batteries begin dissipating energy as soon as they are assembled and therefore have limited shelf life. Chemistries are fixed inside the package so the user cannot interact with the contents to program functionality. The size and form of batteries have not kept pace with the miniaturization of electrical components, microprocessors and integrated circuits. As a result, the optimal implementation of an electronic device is not always achieved. Some batteries contain chemicals that are not considered safe or environmentally friendly ("green"). This makes disposal a potential issue.

mPhase is challenging this convention by using their proprietary superhydrophobic porous silicon membrane technology as the basis to build the Smart NanoBattery providing Power On Command .

Superhydrophobicity initially keeps the liquid electrolyte physically separated from the solid electrodes of the battery, thus preventing the chemical reactions from occurring that cause the battery to provide power. This gives the Smart NanoBattery the benefit of potentially infinite shelf life.

A conventional battery loses some capacity while sitting on the shelf in its package or stored in an electronic or electrical device, even before being used for the first time. On the other hand, the Smart NanoBattery is built so that it is inactive and remains that way indefinitely until it is turned on. No power is lost to self-discharge or leakage current prior to activation. When needed, the Smart NanoBattery can be activated on command via the phenomenon of electrowetting. The surface properties of the porous silicon membrane are selectively controlled to shift instantly from a superhydrophobic to hydrophilic state. In other words, electrowetting acts as the triggering mechanism.

mPhase has successfully fabricated and demonstrated its first 3-volt lithium-based Smart NanoBattery, based on a design allowing either manual or remote activation by the user, the feature known as Power on Command .

By incorporating the phenomenon of electrowetting on nanostructured surfaces into a revolutionary way of storing energy, the Smart NanoBattery provides power to portable electronic and microelectronic devices exactly when and where it is needed. It is an alternative and an augmentation to conventional batteries, still converting stored chemical energy into usable electrical energy, but in a way that is potentially more reliable, more versatile, more environmentally friendly, and less expensive than the industry norm.

Applications

mPhase is exploring military and commercial applications of smart surfaces in which the properties can be accurately and precisely controlled down to the nanometer scale. Electrowetting allows the switching from a hydrophobic to hydrophilic state as a result of an electronic stimulus.

The Smart NanoBattery, mPhase's first smart surface product, has a unique architecture that enables a shelf life of decades, remote activation, programmable control, scalable manufacturing, and adaptability to multiple configurations. The value proposition to the end user is to have a source of energy or power that is literally always ready - reliable, convenient, low cost - a battery guaranteed to work at full capacity when and where you need it.

The Smart NanoBattery can conceivably supply power "*on command*" to a wide variety of portable electronic and microelectronic devices used in military, medical, industrial, and consumer applications.

mPhase has demonstrated that the battery works in lab tests as well as in a significant field test conducted for the U.S. Army as part of a guided munitions project. The relationship with the Army also included an $850,000 funded project to develop a battery for a mission critical computer memory backup application. The target was a small footprint, 3-volt lithium battery with a minimum shelf life of 20 years and uninterruptible power output during this time period. No other battery technology available today can deliver the long-term performance requirements specified by the U.S. Army for this application.

The Smart NanoBattery can potentially be designed to accommodate a variety of sophisticated portable electronic and microelectronic devices including next-generation cell phones, handheld gaming devices, wireless sensor systems, radio frequency identification tags, high-tech flashlights and beacons, health alert alarms, and non-implantable and implantable medical devices such as pacemakers.

Initial applications will address the need to supply emergency and backup power to a range of products for defense and security, with future applications in the commercial and consumer arenas.

Other Potential Products

The Company has been in active discussions with Picatinny Arsenal, Picatinny, New Jersey to jointly obtain federal funding under SBIR grants to develop additional new products for military small munitions applications. The Company has a strong historic cooperative relationship for product development and testing.

In 2007 the Company entered into a Cooperative Research and Development Agreement (CRADA) with Picatinny Arsenal to test the single cell version of the Smart NanoBattery suitable for future research and development programs for projectile launched munitions. From 2007 through the first quarter of calendar year 2010, numerous internal laboratory air gun simulation tests were performed, including a live-air gun and live gun fired test at the United States Army s facility at Aberdeen Proving Grounds, Aberdeen, Maryland. A prototype of the Smart NanoBattery was the subject of a live fire test as part of a projectile fired out of an Abrams Tank. The results of the test indicated that the battery was activated by 10,000 G forces indicating that it could supply energy necessary to operate a guidance system for small munitions. In addition, the Smart NanoBattery demonstrated extreme resiliency to shock and acceleration since, it survived tests that subjected it to high acceleration of over 30,000 G forces.

On February 9, 2011, the Company announced that it had signed a 3 year CRADA with the U.S. Army Armament Research, Development, and Engineering Center (ARDEC) at Picatinny, New Jersey, to continue to cooperatively test and evaluate the mPhase Smart NanoBattery, including new design features functionally appropriate for DoD based systems requiring portable power sources. The army researchers are evaluating the prototypes using the Army s testing facilities at Picatinny Arsenal in New Jersey in order to determine applicability of the technology to gun fired munitions and potentially to incorporate the technologies into research and development and other programs sponsored by Picatinny. The Research Agreement is supported by the Fuze & Precision Armaments Technology Directorate.

BUSINESS OF THE COMPANY

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 exploration 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.

From June of 1997-December of 2007, the Company s main business was the development and sale of telecommunication products and equipment and middleware products for the delivery of television by telephone service providers. This business was formally discontinued by the Company for financial reporting as of June 30, 2010.

Effective February 3, 2004, the Company entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. for the development of micro power source arrays fabricated using nano textured super hydrophobic materials.

Effective March 5, 2005, the Company extended its Development Agreement with Bell Labs for an additional 12 months for the development of micro power source arrays fabricated using nano textured super hydrophobic materials.

Effective March 10, 2005, the Company entered into a Development Agreement with Bell Labs for the development of a new generation of magnetic field sensors using the science of nanotechnology.

In April of 2006, the Company renewed each of the nanotechnology Development Agreements will Bell Labs dated March 5, 2005 and March 10, 2005 respectively for an additional 12 months at the cost of $100,000 per month for each agreement.

On February 3, 2007, the Company entered into Amendment No. 4 to a Development Agreement effective February 3, 2004, with Lucent Technologies, Inc. extending research and development through April 27, 2007, relating to micro-power source arrays fabricated using nano-textured superhydrophobic materials.

On February 17, 2007, the Company extended a Cooperative Research Agreement through December 31, 2007, originally entered into on July 15, 2005, with Rutgers, The State University of New Jersey governing cooperative research on a lithium nanostructured reserve battery.

On April 28, 2007, the Company extended its Development Agreement with Lucent Technologies relating to micro-power source arrays fabricated using nano-textured superhydrophobic materials originally entered into in February of 2004 with Amendment #5 through July 31, 2007.

On May 10, 2007, the Company entered into a Consulting Agreement with CT NanoBusiness Alliance to produce a report and assist the Company with respect to its strategy for development and marketing of its nano power cell product.

On July 18, 2007, the Company announced the award of a Phase I US Army Small Business Technology Transfer (STTR) Program Grant. This award was a Phase I six month research effort to develop a 30 plus year shelf life, low power, green battery (coin cell or similar) that would continuously power a static random access memory circuit for a computer device. SRAM is a common type of digital memory chip used in a wide variety of electronic systems for data storage. During the six month research period, the team was to characterize the design, conduct capacity and stability measurements of a reserve style power cell based on Lithium chemistry. Long term stability and shelf life is achieved by initially separating the active materials of the power cell during storage, and controlling the activation of the cell until needed to provide power. This research program extended the design of the company's smart battery to support the use of non-water based electrolytes that are commonly used in lithium based batteries. Lithium batteries are favored for powering many different types of electronic devices due to their higher voltage and power requirements than can be supplied by more common alkaline batteries. The Phase I grant, valued at $100,000, enabled the Company to competitively compete for a Phase II award as an avenue used by U.S. government defense agencies to adopt advanced technology for commercialization and use. Rutgers University supported the Company and its newly formed subsidiary, AlwaysReady, Inc., during the award period as a subcontractor under the award guidelines.

On October 19, 2007, the Company announced that in connection with the settlement and dismissal of a civil law suit originally filed on November 16, 2005 by the Securities and Exchange Commission in the Federal District Court in the District of Connecticut, the SEC issued a Cease and Desist Order and certain remedial sanctions against two officers of mPhase Technologies, Inc. (the "Company"). The civil suit was filed against Packetport.com, Inc. a Nevada corporation, Microphase Corporation, a Connecticut corporation that provides administrative services to the Company and shares common management with the Company, and others. The two officers of the Company were Mr. Ronald A. Durando, President and Chief Executive Officer and Mr. Gustave T. Dotoli, the Chief Operating Officer. The civil suit by the SEC named as respondents Mr. Durando, Mr. Dotoli and others in connection with their activities as officers and directors of Packetport.com. The cease and desist order from the SEC found that (1) all parties had violated Section 5 of the Securities Act of 1933, as making unregistered offers or sales of Packetport.com common stock, (2) Mr. Durando and Mr. Dotoli had violated Section 16(a) of the Securities Exchange Act of 1934, as amended, and Rule 16(a) thereunder by failing to timely disclose the acquisition of their holdings on Form 3's, and (3) Mr. Durando had violated Section 13(d) of the Securities Exchange Act of 1934, as amended, for failing to disclose the acquisition of more than five percent of the stock of Packetport.com. Under the order Mr. Durando was required to disgorge $150,000 and Mr. Dotoli was required to disgorge $100,000. The Company was not named as a party to the civil suit. More information regarding the detailed terms of the settlement can be found in SEC release No 8858 dated October 18, 2007 promulgated under the Securities Act of 1933 and SEC Release No. 56672 dated October 18, 2007 promulgated pursuant to the Securities Exchange Act of 1934. Mr. Durando and Mr. Dotoli have continued to serve as officers and directors of the Company. Mr Durando and Mr. Dotoli together with Microphase corporation and others, without admitting or denying the findings of the SEC, except as to jurisdiction and subject matter, have consented to the entry of the Order Instituting Cease and Desist Proceedings, Making Findings and Imposing a Cease and Desist Order and Remedial Sanctions pursuant to Section 8A of the Securities Exchange Act of 1933 and Section 21C of the Securities Exchange Act of 1934.

On February 20, 2008, the Company announced that a prototype of its smart reserve nanobattery was successfully deployed and activated by the resulting g-force in a gun-fired test at the Aberdeen Proving Grounds in Maryland. The test was conducted by the U.S. Army Armament Research, Development, and Engineering Center (ARDEC) of Picatinny New Jersey. In this test, the AlwaysReady battery delivered power to the test load inside the standard military anti-tank round (M830A1 or HEAT-High Explosive Anti-Tank) and demonstrated extreme resiliency, surviving the harsh environment as well as the high acceleration at a g-force in excess of 45,000 (one "g" is equal to the pull of gravity at sea level). The gun-fired test was part of a prototype evaluation process that the U.S. Army was conducting as part of its CRADA (Cooperative Research and Development Agreement). The Company's Engineers collaborated with those at Picatinny involved in the development of precision guidance components to successfully package this reserve electrochemical storage system to operate during the gun-firing and flight environment of a very high "g" round. The developmental qualification work, prior to the live test firing, was performed using Picatinny's air gun test facilities by subjecting battery prototypes to various launch accelerations and various design iterations. The test validated the performance of the AlwaysReady battery with a current armament used by the Army. The Company stated that its goal was to potentially incorporate this battery technology into smart, gun-fired munitions programs being developed by Picatinny.

On May 2, 2008, the Company announced that it had produced its first lithium-based battery that can be manually activated by providing power on command with a significantly longer shelf life prior to initial activation than those found in other batteries. The battery can be activated by command wirelessly from a remote location by a radio frequency signal giving it added mobility for sensor and similar applications.

On September 9, 2008, the Company announced that it had been awarded a Phase II Small Business Technology Transfer Program (STTR) grant, part of the Small Business Innovation Research (SBIR) program, from the U.S. Army for continued development of a reserve Smart NanoBattery for a critical computer memory application.

On September 17, 2008, the Company announced that its breakthrough research in microfluidics on understanding how micro- and nanostructured surfaces could be engineered to have properties for repelling water and other types of liquids could potentially be used in consumer applications to enable self-cleaning surfaces such as shower doors or windows and other materials used in self-cleaning systems.

On September 23, 2008, the Company announced that it had produced compact reserve lithium battery prototypes with a manually activated breakable separator capable of powering a high-intensity emergency flashlight for more than two hours continuously at full brightness. The work was done in conjunction with Eagle Picher, a respected battery design and development firm located in Joplin, Missouri. mPhase stated that it was pursuing the concept of using a reserve battery with a breakable separator in a high-intensity emergency flashlight either as the primary power supply or as a reliable source of backup power. Cylindrical and planar battery and flashlight designs are possible. These flashlights may be equipped with either a krypton bulb or light emitting diode (LED), the choice depending on the required brightness and runtime characteristics. A manually activated breakable separator technology has been created that is analogous to that of the AlwaysReady Smart NanoBattery with the patented electrowettable membrane, both of which keep the liquid electrolyte separate from the solid electrodes until the battery is actually needed. This provides a battery with potentially infinite shelf-life that will not lose power while sitting on the shelf or in storage. Whereas the electrowettable membrane is activated by applying a voltage at the interface between the liquid and membrane surface, the breakable separator is manually activated through a well-defined physical force. The result in both cases is that the liquid electrolyte mixes with the solid electrodes, thus releasing the stored energy and 3 volts of power when lithium chemistry is employed.

On December 5, 2008, the Company announced that it had signed a contract with Porsche Design Gesellschaft m.b.H., Flugplatzstrasse 29, A,S700 Zell am see, Austria ["Porsche Design Studio"], to design a premium version of the AlwaysReady emergency flashlight. The flashlight was to use mPhase's proprietary lithium reserve battery. The battery contains a breakable barrier that separates the solid electrodes from the liquid electrolyte until the battery is manually activated. Unlike traditional batteries, the mPhase battery remains in an inert state with no leakage or self-discharge until activation. The mPhase battery was designed to have an almost infinite shelf life making it ideal for emergency lighting applications. The premium flashlight was to be marketed as an accessory for automobile roadside emergency kits.

On January 15, 2009, the Company announced that its Smart NanoBattery being developed pursuant to a Phase II Army Grant for a critical mission computer backup reserve battery may also have wider application for unattended electronic ground sensors that provide mission critical information for military operatives.

On January 29, 2009, the Company announced that it had contracted EaglePicher Technologies to manufacture the reserve battery for use in its emergency flashlight. EaglePicher was selected for the project because of their experience in custom and standardized power solutions for the extreme environments of aerospace and military applications as well as medical and commercial applications.

On March 18, 2009, the Company announced that it had received the first working model for the emergency flashlight from the Porsche Design Studio in Zell am See, Austria, representing a major step forward as the Company prepared for the initial product launch.

On June 23, 2009, the Company announced that it had achieved a major milestone in the development of its Smart NanoBattery Technology. mPhase reported that it had successfully manufactured a six-inch silicon-based wafer containing its key membrane (separator) technology. This separator is responsible for keeping the Smart NanoBattery's chemicals separated until activated. The membrane's unique surface and structure allows for control of a liquid on a nanostructured surface.

On August 5, 2009, the Company announced that it had completed the first functional prototype of its lithium reserve battery intended for use in the Company's emergency flashlight. The prototype is the first time the mPhase battery technology had come together in a "ready for production" prototype. The mPhase lithium reserve battery stores energy until it is literally "turned on." It is manually activated by a unique triggering mechanism that rapidly releases and distributes the liquid electrolyte inside the battery. The electrolyte immediately contacts the solid electrode materials to produce 3 volts. The reserve battery is designed for backup power and emergency applications. With a shelf life of over 20 years, the mPhase lithium reserve battery allows the emergency flashlight to function as a reliable emergency light source in countless situations.

On August 6, 2009, the Company announced that it had completed the first fully functional prototype of its emergency flashlight. A world renowned automobile design firm created a sleek design to accompany the flashlight's unparalleled functionality. The new illuminator features mPhase's first reserve battery that allows for backup power to be always ready through a simple activation method.

On August 27, 2009, the Company announced that its Phase II grant from the United States Army had been renewed for a second year.

On November 2, 2009, the Company reported that it had been granted a United States patent for its concept for a battery that is safer for the environment in that it is based on the idea of neutralizing the harmful chemistry inside the battery by dispensing a neutralizing agent or containment polymer located inside the battery fixture and dispensed once the battery is depleted. This reduces the risk of potentially harmful chemicals leaking through the battery container and polluting the ground or air after the battery has been discarded.

On March 9, 2010, the Company announced that its mPower On Command Reserve Battery had successfully met all United Nations/US Department of Transportation safety standards and had received UN DOT certification for the safe transport of lithium-containing batteries. Certification required successful passage of eight tests, altitude, thermal, vibration, shock, impact, overcharge, forced discharge, and external short circuit.

On May 14, 2010, the Company announced that both its mPower Emergency Illuminator and the Power On Command reserve battery technology passed a series of rigorous tests necessary to qualify for CE marking. The CE mark certifies that a product has met European Union consumer safety requirements and allows both products to be sold in the European Economic Area, which includes members and non-members of the European Union.

On June 14, 2010, the Company reported that it had been granted a United States patent for the concept of the porous membrane made from silicon that is capable of controlling the flow of a wide range of liquids, including electrolytes, used in both primary and rechargeable batteries. This is the concept used in the development of the Company s Smart NanoBattery. The issued patent is jointly held between the Company and Alcatel Lucent and is based on a prior cooperative research and development agreement between the two companies.

On July 31, 2010, the Company announced that its scalable smart reserve cell technology is one of the items included in the Fiscal Year 2011 Defense Appropriations Bill that was passed out of subcommittee by the U.S. House of Representatives to receive approximately $2,500,000 in federal funding.

On August 25, 2010, the Company announced that it signed a representative agreement with Tritech Lt. of Hod HaSharon, Israel, a leading stocking representative and distributor of major manufacturers of electronic components serving the Military, Communication, Medical, Industrial Control and Security Industries to promote the Company s products exclusively in Israel.

On November 9, 2010, the Company announced that it has successfully assembled its first functional multi-cell Smart NanoBattery This was achieved by bonding an electrolyte reservoir to mPhase's patented, porous, silicon based smart surface. The combined multi-cell reservoir and honeycomb porous smart surface assembly is then bonded to a glass and silicon electrode assembly and populated with the electrode stacks consisting of lithium and carbon monofluoride materials (Li/CFx). Fully assembled units are then filled with the electrolyte and sealed, making them air tight. They are finally attached to special circuit boards for testing and characterization studies, which will include triggering and activation of each of the independent battery cells via a technique called electrowetting, which gives the mPhase reserve battery one of its key attributes -- programmable triggering. Because of the unique design of the multi-cell battery, each cell in the battery has very long shelf until it is triggered. The development of the Smart NanoBattery has been undertaken with funding support from a Phase II STTR Army award.

On November 10, 2010, the Company announced that it is developing a second new automotive product with a major European automobile manufacturer that is based on advanced battery technology and that work on the first prototype of the product commenced. A feasibility study was concluded and the product is expected to have broad appeal to both the OEM and aftermarket automobile industry

On November 11, 2010, the Company announced that it has completed the engineering and safety testing of a new Active Reserve Battery for its award winning mPower Emergency Illuminator . The new battery features a military-style housing with active Lithium-Manganese Dioxide (Li-Mn02). The battery provides up to 20 years of shelf life under normal operating temperatures and replaces our first Reserve Battery technology featured in the successful pilot run of the mPower Emergency Illuminator . The new Active Reserve Battery (illustration included) acts as a direct replacement for the Company s first twist to activate Reserve Battery and is available for sale on the mPower website for $29.99 USD. Included is the specification sheet for the new mPower On Command Active Reserve Battery.

mPower On Command Active Reserve Battery Specifications

- Nickel Plated Steel Air Tight Cylindrical Can
- Voltage Range 1.5V to 3.3V
- Average Voltage 3V
- Nominal Capacity 3.2 Ah @ 100mA to 2V @ 23 degrees C
- Max discharge 1.5A continuous

- Pulse Capacity up to 2.0A varies according to pulse characteristics, temperature, cell history and the application
- Operating Temp -40 degrees C to 72 degrees C
- Storage Temp -40 degrees C to 95 degrees C
- Nominal dimensions of case: L 2.56" x D 0.730" (L 65mm x D 18.6mm)
- Weight: 1.65 oz (41.3 grams)
- Insulating Red Protective Cap

- A hermetic glass to metal seal that ensures up to 20-year shelf life
- Active Reserve Battery chemistry: Lithium-Manganese Dioxide (Li-Mn02)
- Weight of metallic lithium in each battery: Approximately 1.10 grams of lithium

Complies with both US and EU safety regulations

On November 12, 2010, the Company reported that it had successfully triggered and activated its first functional multi-cell Smart NanoBattery, achieved by applying a brief pulse of electrical energy to a porous, smart surface membrane, located inside each cell in the battery, which caused the electrolyte to come in contact with the cell's electrodes, creating the chemical reaction to produce voltage inside the cell of the multi-cell battery. The mPhase multi-cell battery consists of a matrix of 12 individual cells populated with an electrode stack consisting of lithium and carbon monofluoride materials (Li/CFx), with each cells rated at 3.0 volts. Using a specially designed circuit board for testing and characterization studies, each of the cells in the battery were independently triggered and activated without affecting any of the non-activated cells in the multi-cell configuration. Because of the unique design of the multi-cell battery, each cell in the battery has very long shelf until it is triggered.

On December 8, 2010, the Company announced that it has successfully completed the technical work under the Phase 2 STTR grant awarded by the US Army for the multi-cell Smart NanoBattery. The team achieved this milestone by completing the work sponsored by the Army Research Office, which encourages deep technical exploration, by funding small business involved in innovative research projects for miniature energy storage designs, by helping accelerate research and development concepts for long term commercialization efforts. The STTR funding enabled the mPhase technical team to develop functional prototypes and to conduct detailed analysis of the novel multi-cell reserve battery designs. The funding allowed the mPhase team to create a substantial IP portfolio and to achieve a Technical Readiness Level (TRL level) 4/5, which conventionally means that the original Smart Nanobattery design and technology used in its implementation progressed to the extent that they now meet the criteria for prototype testing in both laboratory and simulated deployment environments. The completed Smart Nanobattery is based on a complex MEMS device consisting of layers of silicon and glass fabricated to the exact specifications of the mPhase team by its commercial foundry partner. The mPhase team finished the assembly by populating each battery with the electrode stacks of lithium and carbon monofluoride materials (Li/CFx),that delivered 3 volts per cell. Because of the unique design of the multi-cell battery, each cell in the battery has very long shelf until it is activated via a technique called electrowetting, which gives the mPhase reserve battery one of its key attributes -- programmable triggering. The development of the Smart NanoBattery has been undertaken with funding support from a Phase II STTR Army award.

On February 9, 2011, the Company announced that it signed a 3 year CRADA (Cooperative Research and Development Agreement) with the U.S. Army Armament Research, Development, and Engineering Center (ARDEC) at Picatinny, New Jersey, to continue to cooperatively test and evaluate the mPhase Smart NanoBattery, including new design features and functionally appropriate for DoD based systems requiring portable power sources. The army researchers would further evaluate the prototypes using the Army's testing facilities at Picatinny Arsenal in New Jersey in order to potentially incorporate the technologies into research and development and other programs sponsored by Picatinny.

On April 5, 2011, the Company announced that it has begun to ship branded orders of its award winning Emergency Illuminator to a luxury-design firm based in Europe. The Emergency Illuminator is a precision instrument with a powerful 180 Lumens LED and two separate battery tubes. One tube is for everyday use and holds two CR123 batteries, while the other tube holds mPhase's Power On Command active reserve battery. If the regular CR123 batteries run down, the active reserve battery takes over -- even after laying idle for 20 years. The Emergency Illuminator also features a USB port that can be used for charging portable devices such as a cell phone.

On May 20, 2011, the Company reported that it had been granted a United States patent for the unique concept of a smart battery design that could contain different battery chemistries within the same battery configuration or battery pack. The techniques described in the patent are based on the idea of creating individual cells within a battery system, where each cell could contain a custom combination of electrolyte and electrode materials. The patent describes how individual cells in a battery could be activated based on conditions such as the surrounding temperatures or other conditions such as power drain requirements, which can be used in determining which cells in the battery to activate. The concepts behind this patent could be used to create a new type of reserve battery that would work in a wide range of applications, such as electronic devices and sensors used in very high and low temperature environments, where the temperature conditions may change over time, or in other environments where optimal battery performance is not easily achieved based on a single non optimized battery chemistry.

On June 15, 2011, the Company announced that it had engaged First Principals, Inc. (FPI), a world-class technology appraisal and commercialization enterprise located in Cleveland, Ohio, to perform a complete economic and strategic evaluation of mPhase's Patent Portfolio and identify a broad array of potential innovative products for "smart surfaces." In addition, FPI is to assist the Company in identifying strategic partners leading to additional commercialization applications and opportunities with respect to its Smart NanoBattery.

On June 29, 2011, the Company received approval from its shareholders at a Special Meeting of Shareholders to amend the Company s Articles of Incorporation to increase the Company s authorized shares of common stock from 2 billion to 6 billion shares.

On October 19, 2011 the Company announced that an independent patent valuation of its technology estimates a minimum valuation of $40 million for its portfolio of patents and intellectual property. The technical study of the Company's intellectual property commenced in June of 2011 and was performed by FIRST PRINCIPALS, INC., a world-class technology appraisal and commercialization firm located in Cleveland, Ohio.

On November 28, 2011 the Company amended the par value of its common stock from $.01 to $.001, the Balance Sheet at June 30, 2011 was restated to reflect this change with a reduction of $14,656,520 to the value of common stock and a corresponding increase to additional paid in capital for the same amount. Transactions recorded in the Consolidated Statement of Changes in Stockholders Deficit were presented at the $.001 par value for the Fiscal Year Ended June 30, 2012.

On February 11, 2012, the Company announced that it had filed a new patent based upon its Smart Surface technology for a novel drug delivery system. The drug delivery patent is based on the ability of mPhases s Smart Surface technology to electronically control the precise flow of a fluid on a nano-structured surface.

On February 14, 2012, the Company announced that it was enhancing its patent portfolio for products beyond reserve battery applications. The core of the portfolio is the unique architecture relating to its Smart NanoBattery that enables a shelf life of decades, remote activation, programmable control and adaptability to multiple chemistries within the same container. These attributes which are developed by the Company s focus on Smart Surfaces lend themselves to potential applications in the areas of medical devices and portable electronic applications.

During the first three quarters of the fiscal year ended June 30, 2012, the Company attempted to acquire Energy Innovative Products, (EIP) a privately-held company that is a developer of proprietary technologies for reducing energy usage in refrigeration and cooling systems with both commercial and consumer applications. The transaction was terminated in February of 2012 by EIP prior to the Company completing its due diligence review of EIP s assets, patents contracts and other necessary records. The Company is entitled to a breakage fees and restitution of certain monies advanced to EIP during the due diligence period and is seeking to determine the solvency of EIP and enforce certain contractual remedies under an Amended Letter of Intent.

On March 6, 2012, the Company announced that it is exploring the printing of its Smart NanoBattery on graphene and other new advanced materials. Graphene is a very strong material that has been described as the most conductive material known, making it a vast improvement over silicon. Graphene has the potential to lead to faster, cheaper and more flexible devices including power sources.

In March of 2012, the Company accepted an invitation to visit a Cluster of International Technology research and development in Grenoble, France. The Cluster is made up on multinational companies and sponsored by various agencies of the French Government to perform advanced technology research is the area of energy storage devices, micro fluidics and nanotechnology. The Company is continuing exploratory negotiations with potential strategic partners each of which is a member of the cluster to custom tailor its intellectual property and component products for use in a commercial end product.

On June 6, 2012, the Company announced that negotiations with two creditors have led to a standstill agreement and restructuring of approximately $1,500,000 in floating rate convertible securities into 8% fixed rate debt instruments with payments commencing on October 1, 2012 at an aggregate amount of approximately $70,000 per month for two years The beneficial effect of restructuring of the variable convertibility feature should give the Company the control it needs to cease the automatic dilution outside of the Company s control of its issued and outstanding common stock. The debt restructuring should allow the company the flexibility it needs to obtain other funding.

During fiscal year ended June 30, 2012 the Company announced that it had successfully completed a prototype of a new automotive and marine product designed by a premiere European automotive company of luxury cars. A series of prototypes has resulted in a significant reduction in size and increased functionality of the product. The Company believes that the small footprint and distinguished designed may have significant appeal to both original equipment manufacturers and the automotive and marine aftermarket. The Company, pending establishment of a complete marketing and distribution network for the product, has not disclosed the product s identity in order to first establish a first to market presence against potential competitors. The Company has identified and had discussions with a marketing agency and launch firm for the new product.

On July 17, 2012, the Company announced that it has executed a Memorandum Of Understanding with Stevens Institute of Technology in Hoboken NJ. The Memorandum of Understanding establishes a framework formalizing a cooperative collaboration to jointly pursue business opportunities, research and development (R&D) projects, and other appropriate cooperative arrangements between the parties. The Parties anticipate joint efforts towards achieving mutually beneficial goals and objectives with the intent of working together collaboratively in the design and fabrication of an advanced battery technology utilizing intellectual property and know-how from both parties with the possibility of integrating and advancing mPhase s Smart NanoBattery Technology with Stevens graphene based inkjet printing method for printing electrodes and electronic circuits. The parties also wish to explore the possibility of funding Stevens research activities relative to graphene based research projects to advance the inkjet printing of electronics utilizing advanced materials. Stevens and mPhase also agreed to pursue joint collaborations with Government Research Agencies and other Corporations.

Products & Services

Since its inception in 1996, mPhase has been a development stage company focused on the development of intellectual property involving high technology innovative solutions and products with high-growth potential. The Company has served as an incubator for exploratory research and initial development for products that are best characterized as having a high risk/high reward profile since they involve exploratory research to achieve significant scientific breakthroughs from existing products that can have a substantial economic impact and benefit upon successful commercialization.

NanoBattery

The Smart NanoBattery is an outgrowth of the science of nanotechnology that the Company began in February of 2004 with the entry into a Project Development Agreement with the Bell Labs Division of Lucent Technologies, Inc. The Company has historically outsourced its Research and Development of new products to larger companies or institutions with significant scientific resources and experience in exploratory research. mPhase Technologies along with Alcatel/Lucent/Bell Labs jointly conducted research from February 2004 through April of 2007 that demonstrated control and manipulation of fluids on superhydrophobic surfaces to create power cells by controlling wetting behavior of electrolytes on nano structured electrode surfaces. This scientific research set the ground work for continued exploration in the development of intelligent nanotechnology power cells (nano-batteries), and formed a path to commercialization of the technology for a broad range of market opportunities. During 2005 and 2006, the battery team tested modifications and enhancements to the internal design of the battery to optimize its power and energy density characteristics, as well as engineering improvements that were essential in moving the battery from a zinc based chemistry to a design using lithium based chemistry The Company established a strategic research working relationship with the Energy Storage Research Group (ESRG), a center of excellence in Rutgers University that has lab research facilities capable of handling lithium based battery development.

mPhase's current flagship product is its Smart NanoBattery that has a significantly longer shelf life prior to initial activation than that of conventional batteries. The Smart NanoBattery has potentially significant applications for critical mission power sources that must be reliable and available upon command by the electronic device it is powering. Such applications involve emergency flashlights and beacons, back-up power sources for computers and life support products, as well as significant military applications where critical mission backup power is essential for weapons control computers and electronic warfare equipment used in combat. Other potential military applications include power sources activated by g-forces for guided munitions.

The Smart NanoBattery utilizes a proprietary technology developed over a period of 5 years. The battery design, prior to initial activation, has a membrane that separates the electrolyte and electrodes used to generate power. Conventional batteries do not provide for such separation and therefore their power begins to dissipate prior to the first time they are activated causing them to lose capacity. Conventional batteries have significant limits on how long they can be stored prior to their first activation and in providing a reliable source of power needed for critical applications requiring portable power supplies.

Mechanically-Activated Reserve Battery

In April of 2008, mPhase successfully produced its first lithium-based breakable separator. This provided the basis of a new reserve battery product that relies on mechanical rather than electrical activation to provide Power on Command. In contrast to the Company's Smart NanoBattery product that is being developed using the science of nanotechnology and relies on an electro wetting membrane, this reserve battery is designed for mechanical rather than electrical activation. Such reserve battery is based upon an innovative mechanical and battery engineering design that is activated by puncturing a soft pouch containing electrolyte. Such reserve battery was especially designed to be used in the Company's new emergency flashlight product. It was designed for the Company by Eagle Picher, a major U.S. battery designer, and the flashlight was designed for the Company by Porsche Design Studio. The Company transitioned the flashlight s backup battery from the Eagle Picher battery to a cost-reduced modified primary battery with an extended shelf life.

Magnetometer: Development Suspended in 2007

In March of 2005, the Company engaged the Bell Labs division of Lucent Technologies, Inc. to develop, using the science of nanotechnology, both a low and high sensitivity magnetometer for both military and commercial use.

Magnetometers can be used in a wide range of applications for the detection of magnetic fields in applications that include military surveillance, securing the retail environment, automotive sensors and actuators, industrial processing, medical imaging, scientific measurements, detection of mineral deposits and even air and space exploration. In sensor networks ultra-sensitive magnetometers can be used, for example, to detect and accurately pinpoint battlefield objects or they might also be used to study the workings of the human brain.

Magnetometers work by sensing changes in magnetic fields due to the motion of magnetic objects or changes in electrical currents generated by those objects. The magnetometer detects these objects by measuring time-varying magnetic signals that are superimposed on the combination of earth s background field used to orient compasses) and static magnetic fields due to near-by magnetic objects. In March of 2007, the Company ceased development with Alcatel/Bell Labs of its magnetometer product in order to conserve financial resources.

Competitive Business Conditions

Battery Segment

The design and functionality of the mPhase/AlwaysReady lithium Smart NanoBattery make it unique to the portable electronics battery market segment. To the best of our knowledge, there is no existing product that directly competes with the Smart NanoBattery in terms of its combination of small size and reserve design. As a reserve battery, the Smart NanoBattery remains dormant until it is activated on command. It does not self-discharge or die prior to its first activation, thereby offering extremely long shelf life prior to use as either a primary or backup battery in a device. Shelf life is projected to be in excess of twenty years.

There are numerous thin film batteries based on lithium metal, lithium ion and lithium polymer, as well as other chemistries, used in military devices, portable electronics, RFID tags and wireless sensor networks, that are similar in size to the Smart NanoBattery, often referred to as microbatteries. None of these designs is based on reserve battery architectures. Thin film batteries are manufactured by companies including Cymbet Corporation, Front Edge Technology, Infinite Power Solutions, ITN Energy Systems, Johnson Research and Development Company, KSW Microtec, Lithium Technology Corporation, MPower Solutions, Oak Ridge Micro-Energy, Power Paper, Solicore, VoltaFlex Corporation. Large companies such as Energizer, Ultralife, Varta and Proctor & Gamble are also involved with developing thin film batteries. Thin film battery markets are anticipated to grow substantially as the result of a wide expansion of portable devices in that time frame. With 3.5 billion cell phone users and 67 billion RFID tags per year anticipated during year 2012, it is expected that there will be substantial commercial demand for thin film batteries.

Traditional reserve batteries are distinct from the mPhase/AlwaysReady Smart NanoBattery in terms of size and activation mechanism. The market for reserve batteries has largely been limited to the military for supplying power to munitions and other mission-critical electronic devices. The traditional reserve battery tends to be larger and certain types are built by hand and contain mechanical parts to activate the battery. The Smart NanoBattery relies on the phenomenon of electrowetting to initiate activation or a mechanical barrier that can be broken, in the case of the breakable barrier design. Traditional reserve batteries for military applications have been supplied by companies such as EaglePicher, Yardney and Storage Battery Systems, Inc. The Company believes that it may be able to significantly reduce the cost of its Smart Nanobattery with the recent discovery of the potential of printing the battery on a form of graphite rather than traditional silicon surface. The Company, through its working relationship with Stevens Institute, began in fiscal year 2012 to investigate the feasibility of the use of graphite which is much stronger, flexible and inexpensive than traditional silicon.

Flashlight and Automotive Product Market

The Company believes that there may be a significant market for a high-end emergency flashlight containing its mechanically activated reserve battery. The need for absolute reliability in many emergency situations includes those of fire, police and other emergency service providers. In addition to providing an emergency light source, when needed, the flashlight developed with such lithium reserve battery has, as an alternative to providing light, a port capable of recharging a cellular telephone produced by Porsche Design Studio as well as those of other major cellular telephone providers. Since the market for new and innovative portable electronic batteries continues to expand, especially in the field of wireless hand-held devices, the Company believes that its emergency flashlight and reserve battery may benefit significantly from this trend. The Company is currently financially constrained with respect to establishing a global marketing and distribution network for the product. The Company plans to address this issue in fiscal year 2013 in conjunction with the roll-out of a new, to be announced, world class automotive product.

Outsourcing

Research and Development

The Company practices an outsourcing model whereby it contracts with third party vendors to perform research and development rather than performing the bulk of these functions internally. For current development of its flashlight and reserve battery, the Company has outsourced the majority of the work. From February of 2004 through March of 2007, the Company engaged Lucent/Bell Labs to develop, using the science of nanotechnology, micro power cell arrays creating a structure for zinc batteries that separated the chemicals or electrolytes prior to initial activation. This was done by suspending on nano grass or small spoke-like pieces of silicon a liquid electrolyte taking advantage of a superhydrophobic effect that occurs as a result of the ability to manipulate materials of a very small size or less than 1/50,000 the size of a human hair. The Company has, as a result of outsourcing, been able to have access to facilities, equipment and research capabilities that the Company would not be able to develop on its own given the financial resources and time that would be required to build or acquire such research capabilities. The Company has also been able to achieve key strategic alliances with the U.S. Army to successfully test, under military combat conditions, its SmartBattery design, leading to further validation of its path to product development under a Cooperative Research and Development Agreement (CRADA). In addition, the Company has formed a relationship with Energy Storage Research Group, a center of excellence at Rutgers University, in New Jersey, that has enabled the Company to expand its battery development from a zinc to a lithium battery capable of delivering significantly more power. During fiscal years 2009 and 2010, the Company outsourced considerable foundry work for final development of the Smart NanoBattery to Silex, a Swedish company.

During the period from March of 2005 to April of 2007, the Company engaged the Bell Labs division of Lucent Technologies, Inc. to develop a magnetometer or electronic sensor also using the science of nanotechnology. Although the Company has, in order to conserve financial resources, currently suspended further development of its magnetometer product line, we believe that the intellectual property developed from the research to date could be resumed to develop viable military and industrial products depending upon future financial resources of the Company and future competitive market conditions.

As previously noted, the Company outsourced to Eagle Picher company most of the prototype development of its mechanically-activated reserve battery and Porsche Design Studio the prototype development and MKE for its design and manufacturing of its pilot program Emergency Flashlight product. The Company continued its outsourcing model in fiscal year ended June 30, 2012 with the complete outsourcing for the design and development of its new automotive product.

During fiscal year ended June 30, 2012, the Company significantly advanced its working relationship with Stevens Institute which could serve as an additional outsourcing entity. In addition the Company had an independent appraisal of its patent portfolio performed by First Principals Inc. during fiscal year 2012 and based upon such appraisal and analysis the Company was invited in March to visit a major French Government sponsored technology cluster in Grenoble France. Membership in the Cluster would enable the Company to utilize the extensive laboratory and other research facilities sponsored by the French government and many large multinational companies that could establish strategic partnerships with the Company. The Company has been invited for a follow-up visit in September of 2012 to further establish the fit with a number of potential strategic partners that are larger companies already members of the cluster.

Prototype Development

As the Company moved from development to commercialization of its emergency flashlight products utilizing its mechanically activated reserve battery, the Company outsourced the creation of prototypes to Porsche Design Studio in December of 2008 and MKE, a mechanical design company in Austria that works closely with them. The reserve battery prototype development work was outsourced to Eagle Picher in early 2009. The Company engaged

Microphase Corporation, a related party, under contract for project management and testing of its new Emergency Flashlight and the mechanically- activated reserve battery initially used in such flashlight at a cost of $50,000 per month for 6 months beginning April 1, 2009 and ending on September 30, 2009. From October 1, 2009 through June 30, 2012 the Company has paid Microphase Corporation a total of $225,000 in connection with its Emergency Flashlight pilot sales program. As of June 30, 2012, the Company has an outstanding payable of approximately $230,000 and an outstanding purchase commitment of approximately $70,000 to Porsche Design Studio for existing and new product prototype development work.

Manufacturing

mPhase subcontracts all of the manufacturing of its products to outside sources including related parties such as Microphase Corporation. During fiscal year ended June 30, 2012 the Company paid $0 for product manufacturing of its Emergency Illuminator. During the fiscal year ended June 30, 2011, the Company paid MKE $87,766 for the manufacture and packaging of its Emergency Illuminator. During the fiscal year ended June 30, 2010, the Company engaged MKE in connection with the manufacture and packaging of its Emergency Illuminator at a cost of $199,092. From April 1, 2009 through August 31, 2009, we paid $50,000 per month to Microphase for project management services in connection with development of the Company's flashlight with Porsche Design Studio and the concurrent development of its mechanically-activated reserve battery by Eagle Picher. The Company believes that such payments are the same as would be charged by other management services provided by non-affiliated third party providers of such services. By using contract manufacturers, mPhase avoids the substantial capital investments required for internal production.

Patents and Licenses

We have filed and intend to file United States patents, in some cases EU patents 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 for some specific patents. 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 Company has intellectual property as follows:

Nano Technology, Micro Electrical Mechanical Systems (MEMS) and Battery Portfolio:

Various aspects of the mPhase technology are protected by patents either owned directly by the Company or with respect to which the Company has full sub-licensing rights. The Company s current battery related patent portfolio consists of seven issued patents, of which one is jointly owned with Rutgers University, two are jointly owned with Lucent Technologies and four are licensed from Lucent Technologies. These cover such aspects of the technology as the ability to use electrowetting to create a moveable liquid lens, methodology and apparatus for reducing friction between a fluid and a body, methodology for etching planar silicon substrates to develop a reserve battery device, methodology and apparatus for controlling the flow resistance of a fluid on nanostructured or microstructured surfaces, methodology for creating a structured membrane with controllable permeability, methodology for a nanostructured battery with end of life cells, and methodology for making a multi-cell battery system with multiple chemistries in each individual cell of the battery pack. Some of these patents are specific to the development of a battery device while others are more generalized. The Company also has four patent applications related to the Smart Surfaces technology that have been filed with the United States Patent Office and other foreign patent offices and that are in various stages of examiner review, as well as four additional patent applications related to other Smart Surfaces technologies under review.

The Company has obtained trademark protection for its mPower Emergency Illuminator and mPower on Command, and it currently has one additional trademark application pending.

Other Patents

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. The Company has discontinued further development and marketing of this product owing to the lack of demand for loop diagnostics systems by telephone service providers.

Various aspects of the mPhase technology are protected by patents either owned directly by the Company or with respect to which the Company has full sub-licensing rights. The Company s current battery related patent portfolio consists of seven issued patents, of which one is jointly owned with Rutgers University, two are jointly owned with Lucent Technologies and four are licensed from Lucent Technologies. These cover such aspects of the technology as the ability to use electrowetting to create a moveable liquid lens, methodology and apparatus for reducing friction between a fluid and a body, methodology for etching planar silicon substrates to develop a reserve battery device, methodology and apparatus for controlling the flow resistance of a fluid on nanostructured or microstructured surfaces, methodology for creating a structured membrane with controllable permeability, methodology for a nanostructured battery with end of life cells, and methodology for making a multi-cell battery system with multiple chemistries in each individual cell of the battery pack. Some of these patents are specific to the development of a battery device while others are more generalized. The Company also has four patent applications related to the Smart Surfaces technology that have been filed with the United States Patent Office and other foreign patent offices and that are in various stages of examiner review, as well as four additional patent applications related to other Smart Surfaces technologies under review.

The Company has obtained trademark protection for its mPower Emergency Illuminator and mPower on Command, and it currently has one additional trademark application pending.

In July of 2009, the Company filed for 3 new patents covering the unique design features of its manually-activated lithium reserve battery and emergency flashlight products.

On May 20, 2011, the Company announced that it had been granted a U.S. patent for multi-chemistry battery architecture.

As of fiscal year ended June 30, 2012, the Company has filed the following patents:

	Title	Awarded	Pending
1	Electrical Device Having A Reserve Battery Activation System		X
2	Combined Wetting/Non-Wetting Element for Low & High Surface Tension Liquids		X
3	Non-Pump Enabled Drug Delivery System		X
4	Device For Fluid Spreading & Transport		X
5	Adjustable Barrier For Regulating Flow of a Liquid		X
6	Reserve Battery System		X
7	Modular Device		X
8	Event Activated Micro Control Devices		X
9	Portable Battery Booster		X
10	Battery System	X	
11	Reserve Battery		X
12	Tunable liquid microlens with lubrication assisted electrowetting	X	
13		X	

	Method and apparatus for reducing friction between a fluid and a body		
14	Battery having a nano structured electrode surface	X	
15	Method and apparatus for controlling the flow resistance of a fluid on nano structured or micro structured surfaces	X	
16	Structured membrane with controllable permeability	X	
17	Nanostructure battery having end of life cells	X	

We also rely on unpatented proprietary technology, and we can make no assurance that others may not independently develop the same or similar technology or otherwise obtain access to our unpatented technology.

Research and Development

From March of 2005 through March of 2007, the Company had engaged Bell Labs under separate Development Agreements for the development of a new generation of ultra-magnetic sensors (magnetometers) using the science of nanotechnology with a total cost of $2.4 million. The Company did not renew such its engagement with Bell Labs upon expiration and did not incur any further costs with respect to its magnetometer since the Company has suspended further development of the product to conserve financial resources.

On September 23, 2008, the Company announced that its internal research and development effort had resulted in the successful creation of a compact lithium reserve battery reserve battery prototype with a breakable separator capable of powering a high-intensity emergency flashlight. The manually-activated reserve battery is based upon the same principles of separation of liquid electrolyte from solid electrodes as the Company s Smart NanoBattery but was developed based upon traditional mechanical engineering technology.

Our Smart NanoBattery and power cell technology research and development was performed by the Bell Labs division of Alcatel/Lucent from February of 2004 through March of 2007 at an aggregate cost of $3.8 million. The Company paid Bell Labs $300,000 covering the period from April 27, 2007 through July 30, 2007, at which time it determined that, in order to develop a lithium battery for higher density energy than zinc, it required facilities capable of handling lithium battery research that Bell Labs does not have. The Company engaged a number of small foundries during fiscal year ended June 30, 2008 for commercialization of its Smart NanoBattery at a cost of approximately $150,000. In fiscal year ended June 30, 2009, the Company engaged Eagle Picher at a cost of $75,000 to design and engineer a prototype of its manually-activated lithium reserve battery and Porsche Design studio at a cost of $79,123 for design of its emergency flashlight product. In addition, the Company secured a Co-Branding Agreement with Porsche Design Studio for its emergency flashlight product. In fiscal year ended June 30, 2010, the Company paid $950,018 in connection with producing and bringing this product to market, and in fiscal year ended June 30, 2011, the Company incurred $33,254 of expenses in connection with this product. During the fiscal year ended June 30, 2009, the Company engaged Silex, a silicon foundry in Sweden, at a cost of $21,200 for further development of its Smart NanoBattery; payments to Silex for fiscal year ended June 30, 2010 in connection with the Smart NanoBattery amounted to $396,780, and for fiscal year ended June 30, 2011 they were $40,800.

During fiscal years ended June 30, 2008, June 30, 2009 and June 30, 2010, the Company engaged in joint research with Rutgers University in connection with a $750,000 STTR Grant from the United States Army for purposes of developing an emergency reserve battery to back-up a computer memory application.

During fiscal years ended June 30, 2009, June 30, 2010 and June 30, 2011, the Company engaged MKE, an approved vendor of Porche Design Studio to manufacture prototypes as well as a series of commercialized emergency flashlights utilizing the design developed for the Company by Porsche Design Studio.

Commencing in fiscal year ended June 30, 2011, the Company engaged Porsche Design Studio to develop a second automotive product for the Company. During fiscal year ended June 30, 2012, the Company continued the development of its Smart Nano Battery and progressed in the development of a final prototype of its second automotive product.

Employees

mPhase and its subsidiary companies presently have a total of 5 full-time employees and consultants, two of whom are also employed by Microphase Corporation. See the description in the section entitled Certain Relationships and Related Transactions.

ITEM 1A. RISK FACTORS

Risks Relating to the Company s Early Stage of Development

Our business is at an early stage of development and we may not develop products that can be commercialized.

We have derived very limited revenues from a Phase I Army Grant of approximately $100,000 and a Phase II Army Grant of approximately $750,000 with respect to our Smart NanoBattery product from inception of development in February 2004 through March 30, 2011. We have derived revenues of only $41,283 from our Emergency Flashlight product from inception of sales in April of 2010 through June 30, 2012 and we have been forced to discontinue product development and marketing of our magnetometer product owing to limited financial resources.

We have limited manufacturing, marketing, distribution and sales capabilities which may limit our ability to generate revenues.

Due to the relatively early stage of our products, we have not yet invested significantly in manufacturing, marketing, distribution or product sales resources. We cannot assure you that we will be able to invest or develop any of these resources successfully or as expediently as necessary. The inability to do so may inhibit or harm our ability to generate revenues or operate profitably.

We have a history of operating losses and we may not achieve future revenues or operating profits.

We have generated modest revenue to date from our operations. Historically we have had net operating losses each year since our inception. As of June 30, 2012, we have an accumulated deficit of $(203,430,907) and a stockholders deficit of $(5,502,767) and incurred a net loss of $8,786,952. We incurred net losses of $8,786,952 and $486,391 for the years ended June 30, 2012 and June 30, 2011, respectively. The Company does not generate significant revenue outside of STTR grants and minor sales of its emergency illuminator product. Additionally, even if we are able to commercialize our technologies or any products or services related to our technologies it is not certain that they will result in revenue or profitability.

We have a limited operating history on which investors may evaluate our operations and prospects for profitable operations.

If we continue to suffer losses as we have in the past, investors may not receive any return on their investment and may lose their entire investment. Our prospects must be considered speculative in light of the risks, expenses and difficulties frequently encountered by companies in their early stages of development, particularly in light of the uncertainties relating to the new, competitive and rapidly evolving markets in which we anticipate we will operate. To attempt to address these risks, we must, among other things, further develop our technologies, products and services, successfully implement our research, development, marketing and commercialization strategies, respond to competitive developments and attract, retain and motivate qualified personnel. A substantial risk is involved in investing in us because, as an early stage company we have fewer resources than an established company, our management may be more likely to make mistakes at such an early stage, and we may be more vulnerable operationally and financially to any mistakes that may be made, as well as to external factors beyond our control.

Risks Relating to Technology

We are dependent on new and unproven technologies.

Our risks as an early stage company are compounded by our heavy dependence on emerging and sometimes unproven technologies. If these technologies do not produce satisfactory results, our business may be harmed.

We may not be able to commercially develop our technologies and proposed product lines, which, in turn, would significantly harm our ability to earn revenues and result in a loss of investment.

Our ability to commercially develop our technologies will be dictated in large part by forces outside our control which cannot be predicted, including, but not limited to, general economic conditions, the success of our research and field testing, the availability of collaborative partners to finance our work in pursuing applications of smart surfaces using materials science engineering, nanotechnology science and the principles of microfluidics and MEMS and technological or other developments in the field which, due to efficiencies or technological breakthroughs may render one or more areas of commercialization more attractive, obsolete or competitively unattractive. It is possible that one or more areas of commercialization will not be pursued at all if a collaborative partner or entity willing to fund research and development cannot be located. Our decisions regarding the ultimate products and/or services we pursue could have a significant adverse effect on our ability to earn revenue if we misinterpret trends, underestimate development costs and/or pursue wrong products or services. Any of these factors either alone or in concert could materially harm our ability to earn revenues or could result in a loss of any investment in us.

If we are unable to keep up with rapid technological changes in our field or compete effectively, we will be unable to operate profitably.

We are engaged in activities in the nanotechnology and microfluidics field, which is characterized by extensive research efforts and rapid technological progress. If we fail to anticipate or respond adequately to technological developments, our ability to operate profitably could suffer. We cannot assure you that research and discoveries by other companies will not render our technologies or potential products or services uneconomical or result in products superior to those we develop or that any technologies, products or services we develop will be preferred to any existing or newly-developed technologies, products or services.

Risks Related to Intellectual Property

Certain aspects of our technology are not protectable by patent.

Certain parts of our know-how and technology are not patentable. To protect our proprietary position in such know-how and technology, we require all employees, consultants, advisors and collaborators with access to our technology to enter into confidentiality and invention ownership agreements with us. We cannot assure you; however, that these agreements will provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use or disclosure. Further, in the absence of patent protection, competitors who independently develop substantially equivalent technology may harm our business.

Patent litigation presents an ongoing threat to our business with respect to both outcomes and costs.

It is possible that litigation over patent matters with one or more competitors could arise. We could incur substantial litigation or interference costs in defending ourselves against suits brought against us or in suits in which we may assert our patents against others. If the outcome of any such litigation is unfavorable, our business could be materially adversely affected. To determine the priority of inventions, we may also have to participate in interference proceedings declared by the United States Patent and Trademark Office, which could result in substantial cost to us. Without additional capital, we may not have the resources to adequately defend or pursue this litigation.

We may not be able to protect our proprietary technology, which could harm our ability to operate profitably.

Patent and trade secret protection is critical for the new technologies we utilize, nanotechnology and microfluidics, as well as the products and processes derived through them. Our success will depend, to a substantial degree, on our ability to obtain and enforce patent protection for our products, preserve any trade secrets and operate without infringing the proprietary rights of others. We cannot assure you that:

- we will succeed in obtaining any patents in a timely manner or at all, or that the breadth or degree of protection of any such patents will protect our interests,

- the use of our technology will not infringe on the proprietary rights of others,

- patent applications relating to our potential products or technologies will result in the issuance of any patents or that, if issued, such patents will afford adequate protection to us or not be challenged, invalidated or infringed, and

- patents will not issue to other parties, which may be infringed by our potential products or technologies.

- we will continue to have the financial resources necessary to prosecute our existing patent applications, pay maintenance fees on patents and patent applications, or file patent applications on new inventions.

The fields in which we operate have been characterized by significant efforts by competitors to establish dominant or blocking patent rights to gain a competitive advantage, and by considerable differences of opinion as to the value and legal legitimacy of competitors' purported patent rights and the technologies they actually utilize in their businesses.

Patents obtained by other persons may result in infringement claims against us that are costly to defend and which may limit our ability to use the disputed technologies and prevent us from pursuing research and development or commercialization of potential products.

If third party patents or patent applications contain claims infringed by either our technology or other technology required to make and use our potential products and such claims are ultimately determined to be valid, there can be no assurance that we would be able to obtain licenses to these patents at a reasonable cost, if at all, or be able to develop or obtain alternative technology. If we are unable to obtain such licenses at a reasonable cost, we may not be able to develop some products commercially. We may be required to defend ourselves in court against allegations of infringement of third party patents. Patent litigation is very expensive and could consume substantial resources and create significant uncertainties. Any adverse outcome in such a suit could subject us to significant liabilities to third parties, require disputed rights to be licensed from third parties, or require us to cease using such technology.

We may not be able to adequately defend against piracy of intellectual property in foreign jurisdictions.

Considerable research in the areas of micro fluid dynamics is being performed in countries outside of the United States, and a number of potential competitors are located in these countries. The laws protecting intellectual property in some of those countries may not provide adequate protection to prevent our competitors from misappropriating our intellectual property. Several of these potential competitors may be further along in the process of product development and also operate large, company-funded research and development programs. As a result, our competitors may develop more competitive or affordable products, or achieve earlier patent protection or product commercialization than we are able to achieve. Competitive products may render any products or product candidates that we develop obsolete.

We may incur substantial expenditures in the future in order to protect our intellectual property.

We believe that our intellectual property with respect to our Smart NanoBattery and our proprietary rights with respect to the Company's permeable membrane design consisting of both micro and nano scale silicon features that are coated with a monolayer chemistry used to repel liquids is critical to our future success. The Company s current battery related patent portfolio consists of seven issued patents, of which one is jointly owned with Rutgers University, two are jointly owned with Lucent Technologies and four are licensed from Lucent Technologies. We also have four patent applications related to the Smart Surfaces technology that have been filed with the United States Patent Office and other foreign patent offices that are in various stages of examiner review, as well as four additional patent applications related to other Smart Surfaces technologies under review. Our pending patent applications may never be granted for various reasons, including the existence of conflicting patents or defects in our applications. Even if additional U.S. patents are ultimately granted, there are significant risks regarding enforcement of patents in international markets. There are many patents being filed as the science of nanotechnology develops and the Company has limited financial resources compared to large, well established companies to bring patent litigation based upon claims of patent infringement.

***Our products may not be accepted in the marketplace*.**

The degree of market acceptance of those products will depend on many factors, including:

- Our ability to manufacture or obtain from third party manufacturers sufficient quantities of our product candidates with acceptable quality and at an acceptable cost to meet demand, and

- Marketing and distribution support for our products.

We cannot predict or guarantee that either military or commercial entities, in general, will accept or utilize any of our product candidates. Failure to achieve market acceptance would limit our ability to generate revenue and would have a material adverse effect on our business. In addition, if any of our product candidates achieve market acceptance, we may not be able to maintain that market acceptance over time if competing products or technologies are introduced that are received more favorably or are more cost-effective.

Risks Related to Third Party Reliance

We depend on third parties to assist us in the development of new products extensively, and any failure of those parties to fulfill their obligations could result in costs and delays and prevent us from successfully commercializing our product candidates on a timely basis, if at all.

We engage consultants and contract research organizations to help design, and to develop our products. The consultants and contract research organizations we engage provide us critical skills and resources that we do not have within our own company. As a result, we depend on these consultants and contract research organizations to perform the necessary research and development to create new products. We may face delays in developing and bringing new products to market if these parties do not perform their obligations in a timely or competent fashion or if we are forced to change service providers.

We depend on our collaborators to help us develop a nd test our proposed products, and our ability to develop and commercialize products may be impaired or delayed if collaborations are unsuccessful.

Our strategy for the development, testing and commercialization of our proposed products requires that we enter into collaborations with corporate partners, licensors, licensees and others. We are dependent upon the subsequent success of these other parties in performing their respective responsibilities and the continued cooperation of our partners. Under agreements with collaborators, we may rely significantly on such collaborators to, among other things:

- Fund research and development activities with us;

- Pay us fees upon the achievement of milestones under STIR and SBIR programs; and

- Market with us any commercial products that result from our collaborations.

Our collaborators may not cooperate with us or perform their obligations under our agreements with them. We cannot control the amount and timing of our collaborators   resources that will be devoted to our research and development activities related to our collaborative agreements with them. Our collaborators may choose to pursue existing or alternative technologies in preference to those being developed in collaboration with us.

The development and commercialization of potential products will be delayed if collaborators fail to conduct these activities in a timely manner, or at all.

If various outside vendors and collaborators do not achieve milestones set forth in our agreements, or if our collaborators breach or terminate their collaborative agreements with us, our business may be materially harmed.

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Our reliance on the activities of our non-employee consultants, research institutions, and scientific contractors, whose activities are not wholly within our control, may lead to delays in development of our proposed products.

We rely extensively upon and have relationships with outside consultants and companies having specialized skills to conduct research. These consultants are not our employees and may have commitments to, or consulting or advisory contracts with, other entities that may limit their availability to us. We have limited control over the activities of these consultants and, except as otherwise required by our collaboration and consulting agreements to the extent they exist, can expect only limited amounts of their time to be dedicated to our activities. These research facilities may have commitments to other commercial and non-commercial entities. We have limited control over the operations of these collaborators and can expect only limited amounts of time to be dedicated to our research and product development goals.

Product Development Risks

We have limited resources to manage development activities.

Our limited resources in conducting and managing development activities might prevent us from successfully designing or implementing new products. If we do not succeed in conducting and managing our development activities, we might not be able to commercialize our product candidates, or might be significantly delayed in doing so, which will materially harm our business.

Our ability to generate revenues from any of our product candidates will depend on a number of factors, including our ability to successfully complete and implement our commercialization strategy. In addition, even if we are successful in bringing one or more product candidates to market, we will be subject to the risk that the marketplace will not accept those products. We may, and anticipate that we will need to, transition from a company with a research and development focus to a company capable of supporting commercial activities and we may not succeed in such a transition.

Because of the numerous risks and uncertainties associated with our product development and commercialization efforts, we are unable to predict the extent of our future losses or when or if we will become profitable.

Our failure to successfully commercialize our product candidates or to become and remain profitable could depress the market price of our Common Stock and impair our ability to raise capital, expand our business, diversify our product offerings and continue our operations.

Risks Related to Competition

The market for energy storage products is highly competitive.

We expect that our most significant competitors will be large more established companies. These companies are developing products that compete with ours and they have significantly greater capital resources in research and development, manufacturing, testing, obtaining regulatory approvals, and marketing capabilities. Many of these potential competitors are further along in the process of product development and also operate large, company-funded research and development programs. As a result, our competitors may develop more competitive or affordable products, or achieve earlier patent recognition and filings.

Our industry is characterized by rapidly evolving technology and intense competition. Our competitors include major multinational energy-storage device and battery companies as well as nanotechnology companies that specialize in micro fluid dynamics and smart surfaces.

Many of these companies are well-established and possess technical, research and development, financial and sales and marketing resources significantly greater than ours. In addition, certain smaller nanotechnology companies have formed strategic collaborations, partnerships and other types of joint ventures with larger, well established industry competitors that afford these companies' potential research and development and commercialization advantages. Academic institutions, governmental agencies and other public and private research organizations are also conducting and financing research activities which may produce products directly competitive to those we are developing. Moreover, many of these competitors may be able to obtain patent protection, obtain regulatory approvals and begin commercial sales of their products before we do.

In the general area of energy storage and micro fluid dynamics, we compete with a variety of companies, including Duracell, Eveready and Ultralife.

Each of these companies is well-established and has substantial technical and financial resources compared to us. Many smaller companies may also be developing products in the rapidly changing area of energy storage and advanced micro fluid dynamics. These smaller companies may become significant competitors through rapid evolution of new technologies. Any of these companies could substantially strengthen their competitive position through strategic alliances or collaborative arrangements with larger companies.

Our competition includes both public and private organizations and collaborations among academic institutions and large companies, most of which have significantly greater experience and financial resources than we do.

Private and public academic and research institutions also compete with us in the research and development of nanotechnology products based on micro-fluid dynamics. In the past several years, the nanotechnology industry has selectively entered into collaborations with both public and private organizations to explore the development of new products evolving out of research in micro-fluid dynamics.

The energy storage device and battery business are each characterized by intense competition. We compete against numerous companies, both domestic and foreign, many of which have substantially greater experience and financial and other resources than we have.

Companies such as Duracell, Eveready and Ultralife, as well as others, many of which have substantially greater resources and experience in our fields than we do, are well situated to effectively compete with us. Any of the world's largest battery companies represents a significant actual or potential competitor with vastly greater resources than ours. These and other competitive enterprises have devoted, and will continue to devote, substantial resources to the development of technologies and products in competition with us.

RISKS RELATED TO FINANCIAL ASPECTS OF OUR BUSINESS

We may not be able to raise the required capital to conduct our operations and develop and commercialize our products. We require substantial additional capital resources in order to conduct our operations and develop and commercialize our products and run our facilities. We will need significant additional funds or collaborative partners, or both, to finance the research and development activities of our potential products. Accordingly, we are continuing to pursue additional sources of financing. Our future capital requirements will depend upon many factors, including:

- The continued progress and cost of our research and development programs,
- The costs in preparing, filing, prosecuting, maintaining and enforcing patent claims,
- The costs of developing sales, marketing and distribution channels and our ability to sell the products if developed,
- The costs involved in establishing manufacturing capabilities for commercial quantities of our proposed products,
- Competing technological and market developments,
- Market acceptance of our proposed products,
- The costs for recruiting and retaining employees and consultants.

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Additional financing through strategic collaborations, public or private equity financings or other financing sources may not be available on acceptable terms, or at all. Additional equity financing could result in significant dilution to our shareholders. Further, if additional funds are obtained through arrangements with collaborative partners, these arrangements may require us to relinquish rights to some of our technologies, product candidates or products that we would otherwise seek to develop and commercialize on our own. If sufficient capital is not available, we may be required to delay, reduce the scope of or eliminate one or more of our programs or potential products, any of which could have a material adverse effect on our financial condition or business prospects.

Risks Relating to Our Debt Financings

If we are required for any reason to repay our outstanding convertible debt we would be required to deplete our working capital, if available, or raise additional funds. Our failure to repay the convertible debentures, if required, could result in legal action against us, which could require the sale of substantial assets or liquidation of the Company.

We had outstanding, as of June 30, 2012, $1,606,523 aggregate principal amount plus accrued interest of convertible debt, of which $74,158 is immediately convertible and $1,532,365 would become convertible if the Company failed to make monthly payments of approximately $70,000 per month commencing in October 2012.

There are a large number of shares underlying our convertible debt in full. The sale of these shares may depress the market price of our Common Stock.

As of June 30, 2012, on an aggregated basis our convertible debt financings may result in conversions into 222,392,638 and 1,857,316,902 shares of our Common Stock of which $74,158 is immediately convertible and $1,532,365 would become convertible if certain payments were not made, and warrants and options that may be converted into approximately121,540,639 shares of our Common Stock.

Sales of a substantial number of shares of our Common Stock in the public market could adversely affect the market price for our Common Stock and make it more difficult for you to sell shares of our Common Stock at times and prices that you feel are appropriate.

The issuance of shares upon conversion of the convertible debt will cause immediate and substantial dilution to our existing stockholders.

The issuance of shares upon conversion of the convertible debt and shares issued under our equity line of credit will result in substantial dilution to the interests of other stockholders since the selling security holders may ultimately convert and sell the full amount issuable on conversion. Although no single selling security holder may convert its convertible debentures and/or exercise its warrants if such conversion or exercise would cause it to own more than 4.99% of our outstanding Common Stock, this restriction does not prevent each selling security holder from converting some of its holdings and then converting the rest of its holdings. In this way, each selling security holder could sell more than this limit while never holding more than this limit. There is no upper limit on the number of shares that may be issued, which will have the effect of further diluting the proportionate equity interest and voting power of holders of our Common Stock.

The Company could face certain regulatory challenges with respect to its reliance on Rule 144 of the Securities Act of 1933, as amended, with respect to certain of its convertible debenture financings entered into with JMJ Financial (JMJ) that could result in a significant negative economic impact on the Company.

The Company believes that any sales of Common Stock by JMJ are in full compliance with Rule 144 of the Securities Act of 1933, as amended, and has obtained an opinion of outside counsel regarding such compliance. Nevertheless, it is possible such compliance could be challenged in the future by either regulatory agencies or shareholders. In particular, questions regarding the economic risk of JMJ with respect to the collateral required under the secured note delivered by JMJ in payment of the purchase price for the Company's convertible notes could be raised since the secured notes each contain a prepayment provision allowing JMJ to prepay such note, in full, by returning the convertible note. If a court of law determines that any offer or sale of Common Stock of the Company received in a conversion by JMJ was not in compliance with Rule 144 then JMJ could be deemed to be an underwriter. The result would be that the Company would have been engaged in a primary offering of Common Stock through an underwriter in violation of the registration requirements of the Securities Act of 1933, as amended. The Securities Act of 1933, as amended, requires that any claim for rescission be brought within one year of the violation. The time periods within which claims for rescission must be brought under state securities laws vary and may be two years or more from the date of the violation. At June 30, 2012, approximately 41,833,333 shares of our outstanding common stock issued in respect of our convertible note transactions with JMJ Financial could be subject to rescission with a potential liability approximating $319,400, including a liability of approximately $42,900 for interest at 10% per annum.

The Company has been forced to curtail development of all products except its Smart NanoBattery and a second automotive product in order to conserve financial resources

The Company has been forced to focus on commercialization of only two of its products, thereby eliminating product diversification. The Company's lack of financial resources to simultaneously develop multiple products increases its overall risk profile as a development-stage company.

The Company currently lacks resources to cost-reduce and set up global marketing and distribution for either its emergency illuminator or second automotive product

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

The market price of our common stock closed at $7.88 on July 26, 2000 and at $.0069 on August 22, 2011. During such period the number of shares outstanding of the Company increased from approximately 30 million shares to approximately 4 billion shares. This increase was the result of periodic private placements and other financing arrangements involving convertible debt issued by the Company in order to finance company operations. Stocks in microcap companies having stock values below $1.00 per share 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 NASDAQSmall 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 may not be able to raise sufficient capital to market our SmartNanoBattery and Emergency Flashlight applications of our technology on any meaningful scale.

We may not be able to obtain the amount of additional capital needed until the Company has established significant and predictable sales and revenues from our technology. We have been successful in the past as a micro-cap development stage company in raising capital; however, recent trends in the capital markets are likely to pose significant challenges for the Company. Factors affecting the availability of capital include:

(1) the price, volatility and trading volume of our common stock;
(2) future financial results including sales and revenues generated from operations;
(3) the market's view of the business sector of nanotechnology reserve batteries and emergency flashlights; and
(4) the perception in the capital markets of our ability to execute our business plan.

We have reported net operating losses for each of our fiscal years from our inception in

We have reported net operating losses for each of our fiscal years from our inception in 1996 through the fiscal year ended June 30, 2012 and may not be able to operate profitability in the future.

We have had net losses of approximately $203.4 million since our inception in 1996 including approximately $8.8 million and $.5 million for the fiscal years ended June 30, 2012 and June 30, 2011, 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 $5 million in additional cash in the next 12 months through further equity private placements and existing convertible debt arrangements to continue operations. As of June 30, 2012, we have working capital of approximately $(3,677,969) and a stockholders deficit of $5,489,957. Cumulative negative cash flow from operations since inception has amounted to approximately $88,571,782.

Our independent auditor's report expresses doubt about our ability to continue as a going concern.

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The reports of the Company's outside auditors Demetrius & Company, L.L.C., and its prior auditors Rosenberg, Rich, Baker, Berman & Company, Arthur Andersen & Co., with respect to its latest audited reports on Form10-K for each of the fiscal years commencing in the fiscal year ended June 30, 2001 through the current fiscal year ended June 30, 2012, 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 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, 2012, outstanding convertible debt plus accrued interest is equal to $1,606,523, of which $74,158 is immediately convertible and $1,532,365 would become convertible if the Company failed to make monthly payments of approximately $70,000 per month commencing in October 2012; all of which has the right to convert into additional shares of our common stock at discounts of up to 40% of mPhase's then current stock price computed on a formula basis that may adversely affect the future price of our common stock that may result in conversions into 222,392,638 and 1,857,316,902 shares of our Common Stock based upon our stock price at June 30,2012. As of June 30, 2012, we have warrants and options convertible into 16,780,639 and 104,760,000 shares of our common stock at $.004 to $.135 per share that, upon exercise, may result in significant future dilution to many of our current shareholders and may adversely affect the future price of our common stock. In addition, the Company has also granted a conversion feature to certain officers for notes outstanding, giving these noteholder s the right to convert principal and interest outstanding, subject to availability, into 297,387,906 shares of the Company s common stock based on a $.0040 per share conversion price. We may be forced to raise additional cash for operations by selling additional shares of our common stock to shareholders at depressed prices resulting in 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 or successful deployment of any of our flagship products, including our Smart NanoBattery and our Emergency Flashlight products.

We have derived no material revenues from our Smart NanoBattery from inception of development in February 2004 through June 30, 2012 or the Emergency Flashlight and we have been forced to discontinue product development and marketing of both our TV+ and magnetometer products owing to limited financial resources.

The loss of key personnel could adversely affect 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 made significant investments in the Company in the form of equity periodic purchases of common stock and bridge loans and been granted stock and stock options that are intended to represent a key component of their compensation. Such grants may not provide the intended incentives to such officers if our stock price declines or experiences significant volatility.

RISKS RELATED TO OUR TARGETED MARKETS

The sale of new high technology products often has a long lead-time and a multiplicity of risks.

Commercialization of new technology products often has a very long lead time since it is not possible to predict when major companies will license such technology for sale to their customers. The science of nanotechnology and microfluidics used to develop our Smart NanoBattery is in its very early stages and acceptance and demand for such products can often be a long evolutionary process.

The science of nanotechnology is at a very early stage as a discipline and is subject to great uncertainty and swift changes in technology.

Microfluid dynamics and the manipulation of materials of nano size and dimensions is a very new science and the creation of new products is dependent upon new and different properties of such materials created that will result in many uncertain applications and rapid change. The evolution of nanotechnology as a new science adds greater uncertainty to new applications and new and improved product introductions is unpredictable.

We may not be able to create new products from our intellectual property using microfluidics that will be acceptable in water purification, oil separation from water and other environment markets.

The market for "green" products and solutions is characterized by changing regulatory standards, new and improved product introductions, and changing customer demands.

Large companies such as General Electric with great resources are currently focusing significant monies for new solutions.

Our future success will depend upon our ability to achieve compelling technology innovations that are economic and practical to produce in large quantities. Success in 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.

The commercialization of many applications of our technologies will depend on our ability to establish strategic relationships with commercial partners.

We are seeking commercial partners with established lines of business and greater financial resources than our own. Such partners may not place the priority that we do on joint projects because the success or failure of such projects is not as material to other existing well developed lines of business.

Our SmartBattery and our potential applications of our technology are components of end products and therefore our products are tied to the success of such end products.

The compelling need for critical mission batteries and other applications of our nanotechnology will depend upon both military and commercial needs going forward and the demand for our products as components. Thus the success of our SmartBattery and other applications of our technology will depend upon the continuing need for the end user products and market demand.

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General Risks Relating to Our Business

Our products are likely to be expensive to manufacture, and they may not be profitable if we are unable to control the costs to manufacture them.

Our products are likely to be significantly more expensive to manufacture than most other more developed currently on the market today. Our present manufacturing processes produce modest quantities of product intended for use in our ongoing research activities, and we have not developed processes, procedures and capability to produce commercial volumes of product. We hope to substantially reduce manufacturing costs through process improvements, development of new science, increases in manufacturing scale and outsourcing to experienced manufacturers. If we are not able to make these or other improvements, and depending on the pricing of the product, our profit margins may be significantly less than that of our competitors. In addition, we may not be able to charge a high enough price for any products we develop to make a profit. If we are unable to realize significant profits from our potential product candidates, our business would be materially harmed.

Our current very limited revenue depends on our ability to continue to obtain SBIR, STTR and other Government Grants for Research and Development.

We have completed a Phase II STTR Army Research grant in the amount of $750,000. Although we are actively applying for new SBIR, STTR and other government grants and funding we are unable to predict whether we will be successful in obtaining such grants.

We depend on key personnel for our continued operations and future success, and a loss of certain key personnel could significantly hinder our ability to move forward with our business plan.

Because of the specialized nature of our business, we are highly dependent on our ability to identify, hire, train and retain highly qualified scientific and technical personnel for the research and development activities we conduct or sponsor. The loss of one or more certain key executive officers, or scientists, would be significantly detrimental to us. In addition, recruiting and retaining qualified scientific personnel to perform research and development work is critical to our success. Our anticipated growth and expansion into areas and activities requiring additional expertise, such as new applications for smart surfaces , manufacturing and marketing, will require the addition of new management personnel and the development of additional expertise by existing management personnel. Despite the current economic conditions and job market there is significant competition for qualified personnel in the areas of our present and planned activities, and there can be no assurance that we will be able to continue to attract and retain the qualified personnel necessary for the development of our business. The failure to attract and retain such personnel or to develop such expertise would adversely affect our business.

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Our insurance policies may be inadequate and potentially expose us to unrecoverable risks.

We do not carry director and officer insurance and have limited commercial insurance policies. Any significant insurance claims would have a material adverse effect on our business, financial condition and results of operations. Insurance availability, coverage terms and pricing continue to vary with market conditions. We endeavor to obtain appropriate insurance coverage for insurable risks that we identify, however, we may fail to correctly anticipate or quantify insurable risks, we may not be able to obtain appropriate insurance coverage, and insurers may not respond as we intend to cover insurable events that may occur. We have observed rapidly changing conditions in the insurance markets relating to nearly all areas of traditional corporate insurance. Such conditions have resulted in higher premium costs, higher policy deductibles, and lower coverage limits. For some risks, we may not have or maintain insurance coverage because of cost or availability.

We have no product liability insurance, which may leave us vulnerable to future claims we will be unable to satisfy.

The testing, manufacturing, marketing and sale of consumer products entail an inherent risk of product liability claims, and we cannot assure you that substantial product liability claims will not be asserted against us. We have no product liability insurance. In the event we are forced to expend significant funds on defending product liability actions, and in the event those funds come from operating capital, we will be required to reduce our business activities, which could lead to significant losses.

We cannot assure you that adequate insurance coverage will be available in the future on acceptable terms, if at all, or that, if available, we will be able to maintain any such insurance at sufficient levels of coverage or that any such insurance will provide adequate protection against potential liabilities. Whether or not a product liability insurance policy is obtained or maintained in the future, any product liability claim could harm our business or financial condition.

We presently have members of management and other key employees located in various locations throughout the country which adds complexities to the operation of the business.

Presently, we have members of management and other key employees located in both Connecticut and New Jersey, which adds complexities to the operation of our business.

We face risks related to compliance with corporate governance laws and financial reporting standards.

The Sarbanes-Oxley Act of 2002, as well as related new rules and regulations implemented by the Securities and Exchange Commission and the Public Company Accounting Oversight Board, require changes in the corporate governance practices and financial reporting standards for public companies. These new laws, rules and regulations, including compliance with Section 404 of the Sarbanes-Oxley Act of 2002 relating to internal control over financial reporting, referred to as Section 404, have materially increased our legal and financial compliance costs and made some activities more time-consuming and more burdensome.

FURTHER LEGAL AND ECONOMIC RISKS

The Restructuring of two Convertible Debt instruments into fixed rate obligations creates significant additional cash flow risks for the Company

On June 6, 2012, the Company restructured approximately $1,500,000 of Convertible Debt into two year 8% fixed rate debt requiring monthly payments, in cash, of $70,000 per month. If the Company is unable to raise such funds through its equity line of credit, private placement or my other means it will be in default under such debt which will revert back into the terms of the original convertible debentures resulting in significant further dilution of its common stock and eliminating other means of regular financing which the Company has depended upon to survive.

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 $3,630 per month. The Company also maintains an office in Little Falls, New Jersey with monthly rent of $2,281 per month.

ITEM 3. LEGAL PROCEEDINGS

From time to time mPhase may be involved in various legal proceedings and other matters arising in the normal course of business. During its fiscal year ended June 30, 2012, the Company was not involved in any material legal proceedings or matters.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(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, 2004				
First Quarter	$	.42	$	.29
Second Quarter		.61		.29
Third Quarter		.69		.38
Fourth Quarter		.46		.29
Fiscal year ended June 30, 2005				
First Quarter	$	.31	$	.21
Second Quarter		.35		.23
Third Quarter		.60		.30
Fourth Quarter		.41		.25
Fiscal year ended June 30, 2006				
First Quarter	$	.29	$	.21
Second Quarter		.32		.15
Third Quarter		.45		.19
Fourth Quarter		.34		.18
Fiscal year ended June 30, 2007				
First Quarter	$	.21	$	.16
Second Quarter		.20		.15
Third Quarter		.24		.15
Fourth Quarter		.19		.09
Fiscal year ended June 30, 2008				
First Quarter	$	.13	$	.07
Second Quarter		.09		.05
Third Quarter		.14		.05
Fourth Quarter		.13		.07
Fiscal year ended June 30, 2009				
First Quarter	$	.08	$	.03
Second Quarter		.05		.01
Third Quarter		.04		.01
Fourth Quarter		.05		.01
Fiscal year ended June 30, 2010				
First Quarter	$	.03	$	.02
Second Quarter		.02		.01
Third Quarter		.03		.02
Fourth Quarter		.02		.01
Fiscal year ended June 30, 2011				
First Quarter	$	.0189	$	.0100

Second Quarter		.0147		.0080
Third Quarter		.0105		.0045
Fourth Quarter		.0032		.0123
Fiscal year ended June 30, 2012				
First Quarter	$	.0085	$	.0047
Second Quarter		.0030		.0053
Third Quarter		.0020		.0037
Fourth Quarter		.0016		.0005

(B) HOLDERS

As of June 30, 2012, mPhase had approximately 4.1 billion shares of common stock outstanding and approximately 23,000 stockholders of record and 16,780,639, 104,760,000 and 222,392,638 shares of common stock reserved for issuance upon the conversion of warrants, options and convertible securities immediately (and additionally 1,857,316,902 if certain payments are not made for convertible securities of approximately $70,000 per month commencing in October, 2012) shares of the Company's common stock based upon the conversion terms at June 30, 2012.; respectively. In addition the Company has reserved 297,387,906 shares for conversion of officer notes. Such notes may only be converted if the Board of Directors determines that such shares are not needed for general corporate financing or other purposes.

(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.

Issuances of Unregistered Securities

The following securities were issued by us within the past ten 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.

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. These issuances, which were exempt from registration pursuant to Section 4(2) and/or Rule 506 of Regulation D of the Act, included 1,000,000 shares to Mr. L. Barton, a director at that time, for an investment of $500,000; 400,000 shares to Mr. Ronald A. Durando, the Company's president and a director, for an investment of $200,000; 400,000 shares to Mr. Gustave Dotoli, the Company's vice-president and a director, for an investment of $200,000; and; 200,000 shares to Mr. Martin S. Smiley, the Company's vice-president, for an investment of $100,000.

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.

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:

(a) During December 2001, the Company converted $660,000 of liabilities due to Microphase and $360,000 of liabilities due to Janifast respectively into 2,200,000 and 1,200,000shares 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, and 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 were issued to strategic vendors pursuant to Section 3(a)(9) of the Act.

(b) During the quarter ended March 31, 2002, the Company converted $96,000 of liabilities due to strategic vendors into 320,000 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.

(c) 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 had 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 under the terms of a 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. Additionally, 1,022,996 shares of common stock were issued pursuant to Section 3(a)(9) of the Act 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 strategic vendor, to settle $761,786 of liabilities. The conversion of $1,182,658 of such liabilities, together with gains from cash settlements of $27,960, resulted in an aggregate gain on extinguishments of $142,236.

(d) Effective for June 30, 2002, the Company converted $360,000 of liabilities due to Microphase and $80,000 of liabilities due to Janifast into 2,250,000 and 500,000 shares of the Company's common stock, respectively, pursuant to debt conversion agreements pursuant to Section 3(a)(9) of the Act.

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.

During the year ended 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, generating net proceeds to the company of approximately $1,164,000.

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. Each transaction was pursuant to Section 4(2) of the Act.

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) and to Section 3(a)(9) 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 these, 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:

(a) Liabilities of $620,000 and $360,000 due to Microphase Corporation and Janifast Ltd. were converted 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, which date was determined pursuant to EITF 00-19, as to when all the contingent terms of the conversion agreements were met, in which no gain or loss was recognized on the conversion of the $980,000 of debt, and;

(b) Also included in such conversions during the year ended June 30, 2003, were transactions whereby the Company converted $525,967 of liabilities, $269,362 due to the Company's president, $211,605 due to the vice president and $45,000 due to a sales manager who was 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 $538,173. The Company recorded a settlement expense of approximately $12,206 with respect to the Company's president and vice president.

(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 conversions and the 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.

In August of 2003, the Company issued 333,334 shares of its common stock together with a like amount of warrants in a private placement pursuant to Rule 506 of Regulation D of the Act, generating net proceeds of $100,000 which was collected during the three month period ended on September 30, 2003.

During the six months ending December 31, 2003, the Company granted 924,667 shares of its common stock and warrants to purchase 249,667 shares of its common stock to consultants for services performed, valued at $307,243, and charged to operations during the period. Each transaction was pursuant to Section 4(2) of the Act.

During the three months ended December 31, 2003, the Company issued 500,000 shares of its common stock pursuant to warrants previously issued to purchase said shares pursuant to Rule 506 of Regulation D of the Act for an aggregate of $150,000 in cash.

In December of 2003, the Company issued to five accredited investors 2,300,000 shares of its common stock together with a like amount of 5 year warrants to purchase one share each of the Company's common stock, with an exercise price of $.35 per share, in a private placement pursuant to Rule 506 of Regulation D of the Act generating net proceeds of $805,000, $175,000 of which was collected in January, 2004. An advisor of the Company was issued 100,000 shares for assisting in this transaction.

In January of 2004, the Company issued to twenty-three accredited investors 7,160,720 shares of its common stock together with a like amount of 5 year warrants to purchase one share each of the Company's common stock, with an exercise price of $.35 per share, in a private placement pursuant to Rule 506 of Regulation D of the Act generating net proceeds of $2,506,250, all of which was collected in January, 2004.

In March and April of 2004, the Company issued to six accredited investors 1,811,429 shares of its common stock together with a like amount of 5 year warrants to purchase one share each of the Company's common stock, with an exercise price of $.35 per share, in a private placement pursuant to Rule 506 of Regulation D of the Act generating net proceeds of $634,000, all of which was collected in March and April, 2004. Two advisors of the company were issued 128,826 shares of its common stock together with a like amount of 5 year warrants to purchase one share each of the Company's common stock, with an exercise price of $.35 per share for assisting in this transaction.

In June of 2004, the Company issued to three accredited investors 3,844,000 shares of its common stock together with two warrants each to purchase a like amount of stock at $.35 and $.50 respectively at a price of $.25 per unit. Such warrants were exercisable for a period of 5 years and were callable at $.10 per $100,000 of the value of the shares into which such warrants might be converted if the common stock of the company traded for 20 consecutive days above (i) $.50 per share in the case of the $.35 warrant and (ii) $.75 per share in the case of the $.50 warrant.

During the year ended June 30, 2004, the Company issued 17,446,441 shares of its common stock valued at $6,419,545 and 900,000 warrants, valued at $300,901 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 $130,450 to operations for the year ended June 30, 2004. Each transaction was pursuant to Section 4(2) of the Act.

During the fiscal year ended June 30, 2004, the Company converted certain payables and accrued expenses with GTRC, a strategic vendor, aggregating approximately $1.8 million into 5 year cashless warrants pursuant to Section 4(2) and to Section 3(a)(9) of the Act to purchase an additional 5,039,200 restricted shares of the Company's common stock valued at $.35 per share plus a $100,000 term promissory note. The Company was in arrears with respect to the first payment on the note and renegotiated the amount of the note and payment schedule since the note included past and future royalty payments with respect to the Company's patents covering its Traverser DVDDS, some of which the Company considered relinquishing going forward.

A July 2004 private placement of 622,000 shares, each with two separate 5 year warrants, were sold for $155,000, each warrant specifying the right to purchase one additional share at $.25 and $.50, respectively. A September private placement of 1,050,000 shares, each with two separate 5 year warrants, was sold for $ 247,400, each warrant specifying the right to purchase one additional share at $.25 and $.35, respectively. A total of 3,344,000 shares have been reserved to provide for conversion in connection with these warrants.

During the three months ending December 31, 2004, the Company granted 134,500 shares of its common stock to consultants for services performed valued at $26,900. Additionally, the Company issued 2,817,954 shares of its common stock pursuant to the exercise of previously outstanding warrants, generating net proceeds intended to be used for general corporate purposes of $563,590. During the quarter ended December 31 of 2004, the Company issued equity units consisting of 10,717,500 shares of its common stock together with a like amount of warrants, with an exercise price of $.25, in a private placement generating net proceeds intended to be used for working capital and general corporate purposes of $2,116,600, of which $2,066,600 was collected through December 31, 2004 and $50,000 was collected in January of 2005. A consultant who assisted the Company with this transaction also received 100,000 shares of the Company's common stock.

During January of 2005, the Company issued an additional 3,750,000 shares of equity units as part of the private placement begun in the second quarter of fiscal year 2005, generating additional proceeds of $750,000. Additionally, 1,000,000 shares of common stock plus a 5 year warrant for a like amount of shares at $.25 per share were issued to

Janifast Ltd. upon conversion of $200,000 of accounts payable. In addition, 424,875 shares of common stock plus a 5 year warrant for a like amount of shares at $.25 per share were issued to Martin Smiley in connection with his conversion of a $75,000 promissory note plus accrued interest of $9,975. Also 65,000 shares of common stock and a 5 year warrant for a like amount of stock at $.25 per share were issued to Mr. Durando for conversion of $13,000 of accrued interest on various promissory notes issued by the Company as well as 1,395,400 shares of common stock of the Company in connection with the exercise of a warrant at $.01 per share previously awarded for unpaid compensation. A reduction in principal of $13,954 of a $75,000 promissory note to Mr. Durando was made for payment of the exercise price of $.01 per share under the warrant. Mr. Dotoli was issued 375,000 shares of common stock of the Company in connection with the exercise of a portion of a warrant at $.01 per share. Payment for such exercise was made in exchange for cancellation of $3,750 of accrued interest on a $75,000 promissory note. Finally Mr. Suozzo, a consultant, received 100,000 shares of common stock plus a 5 year warrant for a like amount of stock at $.25 per share in exchange for cancellation of $20,000 of accounts payable.

A December 31, 2004 subscriptions receivable balance of $50,000 was fully collected in January of 2005. Additionally, a December 2004 private placement was closed out in January of 2005 with the placement of 3,600,000 equity units at $.20 per unit consisting of one share of common stock plus 5 year warrants for a like amount of shares with a strike price of $.25 per share generating net proceeds of $720,000 to the Company.

A January 2005 private placement realized net proceeds of $357,250 upon issuance of 1,793,750 shares of Ccommon stock at $.20 per share plus 5 year warrants to purchase 1,793,750 shares of common stock at $.25 per share. A later private placement realized net proceeds of $1,351,000 upon issuance of 4,920,000 shares of common stock plus 5 year warrants to purchase 4,920,000 shares of common stock at $.25 per share.

In January of 2005 there were stock option awards issued to two consultants for services performed. The company granted 250,000 options to a consultant for professional services, which options provided for the right of stock purchase at an exercise price of $.25; these options had a five year life and expired in January of 2010. A second award issued a like number of options to another service provider under similar terms, except that the options associated with this second award offered a call feature, available to the company, for redemption of such options at a call price of $.45 at any time during their five year life. In aggregate, 400,000 options were issued in connection with these awards, resulting in a charge to general and administrative non-cash expense in the amount of 133,990 in the third quarter of fiscal 2005. The valuation of this charge was made on the basis of the fair market value of the Company's common stock on the date of grant using the Black-Scholes option model.

On January 15, 2005, the company converted a $100,000 convertible note payable to Martin Smiley in exchange for 400,000 shares and a like number of warrants that were priced at $.25 per unit or $100,000 in aggregate. Also in January of 2005, Martin Smiley was awarded additional compensation of 425,000 shares of common stock. This award resulted in a charge to general and administrative non-cash expense of $131,750 in the third quarter of fiscal 2005, representing expense recognition consistent with the market price of that stock of $.31 on the date of that award.

In February of 2005, GTARC tendered 5,069,242 of cashless warrants which they held in connection with a previous debt settlement in exchange for 4,949,684 of the company's shares of common stock; the balance of the 119,558 warrants were effectively cancelled as a result of certain warrant exercise exchange provisions adjusting the exchange rate based on specified stock pricing experience as per the original debt settlement agreement.

A March private placement resulted in the realization of net proceeds of $1,217,000 upon issuance of 4,396,667 shares of common stock at $.30 per share plus 5 year warrants to purchase 4,396,667 shares of common stock at $.30 per share.

On February 17 of 2005, the Company granted 2,600,000 warrants and 400,000 options to consultants for services performed valued at $1,328,600 and $204,400, respectively. The warrants and options provided the right to purchase a share of mPhase common stock at an exercise price $.45 and $.30 per share, respectively, over their 5 year life expiring in February of 2010. These warrant and option awards were valued on the basis of the fair market value of the Company's common stock on the date of grant using the Black-Scholes option premium model and the value of the award was expensed to general and administrative non-cash expenses in the third quarter of fiscal 2005.

In late February and early March of 2005, the Company converted approximately $173,898 in accounts payable due various vendors into 535,296 shares of common stock aggregating $183,310 in full settlement of those obligations and pursuant to Section 3(a)(9) of the Act.

During May 2005, the Company adjusted the exercise price of $.45 per share of an investor's 5 year warrant issued in January 2005 to purchase 714,296 shares of common stock to $.225 in July of 2005. In July of 2005, such investor exercised a portion of such warrant, as adjusted, to purchase 200,000 shares of the Company's common stock generating $45,000 of net proceeds to the Company.

During the fiscal year ending June 30, 2006, the following transactions impacted stockholders equity.

On July 20, 2005, at the Company's annual meeting of shareholders, the shareholders ratified an amendment to its Certificate of Incorporation to increase the number of authorized shares of common stock from 250,000,000 to 500,000,000 shares.

Private Placements:

During the first fiscal quarter, the Company issued 4,648,625 unregistered shares together with 5 year warrants to purchase 4,648,625 shares at $.25 per share in a private placement pursuant to Rule 506 of Regulation D of the Securities Act of 1933 generating $920,000 of gross proceeds. Also during the quarter, the Company issued 9,877,000 shares of its common stock together with 5 year warrants to purchase a like amount of shares at $.20 per share in two private placements pursuant to Rule 506 of Regulation D of the Securities Act of 1933, generating $2,167,400 of gross proceeds.

During the second fiscal quarter the Company issued 1,702,900 shares together with 5 year warrants to purchase 1,702,900 shares of the Company's common stock to accredited investors at $.20 per share in a private placement pursuant to Rule 506 of Regulation D of the Securities Act of 1933 generating $340,580 of gross proceeds. Also during the quarter, the Company issued 11,477,785 shares together with 5 year warrants to purchase 11,477,785 shares of the Company's common stock to accredited investors at $.18 per share in a private placement pursuant to Rule 506 of Regulation D of the Securities Act of 1933, generating $2,238,973 of gross proceeds.

During the third fiscal quarter, the Company issued 29,861,772 shares together with 5 year warrants to purchase 29,861,772 shares of the Company's common stock to accredited investors at $.18 per share in a private placement generating pursuant to Rule 506 of Regulation D of the Securities Act of 1933, generating $5,065,265 of gross proceeds.

In addition, the Company issued approximately 2,426,698 shares as finders fees as part of the private placements during the year. (See also comments regarding 12,792,117 shares explained under Reparations below)

Warrants Exercised:

During the first fiscal quarter, the Company issued 225,000 shares of common stock pursuant to the exercise of warrants issued prior to the 3 month period, generating net cash proceeds of $45,000.

During the second fiscal quarter, the Company issued 1,714,286 shares of its common stock pursuant to the exercise of warrants, generating net proceeds of $294,857.

During the third fiscal quarter, the Company issued 12,530,834 shares of its common stock pursuant to the exercise of warrants, generating net proceeds of $2,525,867.

During the fourth fiscal quarter the Company issued 1,250,000 shares of its common stock pursuant to the exercise of warrants, generating net proceeds of $250,000 to the Company.

Options and Stock Based Compensation

At various points during the fiscal year ended June 30, 2006, the Company issued stock options to employees and officers for the right to purchase 23,595,000 shares. Pursuant to the adoption of the "Modified Perspective" method, the Company recognized an expense in the amount of $3,837,423, all of which was included in general and administrative expense. The fair value of options granted in 2007 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 108.5%, a risk-free interest rate of 4.4% and expected option life of 3 years.

During the fiscal year the Company issued to key employees and consultants common stock shares in the aggregate amount of 11,500,000 for services rendered. The value of such shares was determined based on the fair market value of the Company's stock on the date that such transaction was authorized. Accordingly, the Company recorded a charge to earnings in the aggregate amount of $2,439,000.

Debt Conversions

During the second fiscal quarter, the Company converted $369,000 and $171,000 of liabilities due to Microphase Corporation and Janifast Ltd into 2,050,000 shares and 950,000 shares of stock and warrants, respectively. In addition, the Company converted $50,000 of liabilities due to a strategic vendor into 331,864 shares of stock plus warrants to purchase 277,778 shares. The value attributable to the shares was based upon the market price of the Company's common stock on the measurement date.

Reparations

At various times during the second and third fiscal quarters, the Company issued shares of its common stock together with a like amount of warrants as reparation to affect revised pricing on previous private offerings. This additional consideration was afforded to stockholders who participated in the private placement of equity units and invested a minimum of 30% of their original investment. Each unit consisted of one share of stock and a warrant to purchase an equal amount of shares at $.18 per share. As additional consideration, each investor received the amount of shares that were required to bring the average cost of the total investment down to $.18 per share (range of original investment $.25 - $.35). A total of 29,848,271 of such shares were issued as reparation under such a program and the Company recorded a charge to earnings (Other Expense) in the amount of $5,530,504. In addition, shares in the amount of 12,792,117 were issued and charged to "Additional Paid In Capital" as an appropriate incentive for the additional cash investment.

During the fiscal year ending June 30, 2007, the following transactions impacted stockholders equity.

Private Placements:

During the quarter ended September 30, 2006, the Company issued 6,780,716 shares of its common stock together with 5,555,556 of 5 year warrants to purchase one share each of the Company's common stock, with an exercise price of $.18 per share in private placements generating net proceeds of $1,104,000.

During the quarter ended December 31, 2006, the Company issued 6,622,223 shares of its common stock together with 5 year warrants to purchase 1,388,889 of the Company's common stock, with an exercise price of $.18 per share in private placements generating net proceeds of $833,866. Included in these amounts are finders fees paid in cash and 566,667 additional shares of common stock.

During the quarter ended March 31, 2007, the Company issued 14,973,083 shares of its common stock in private placements generating net proceeds of $1,777,503; included in this amount was an estimate of finders fees to be paid of $209,000.

During the quarter ended June 30, 2007, the Company issued 19,582,038 shares of its common stock in private placements generating net proceeds of $2,476,000; included in this amount was an estimate of finders fees to be paid of $41,000

Warrants Exercised:

During the quarter ended September 30, 2006, the Company issued 138,889 shares of its common stock pursuant to the exercise of warrants, generating net proceeds of $25,000 to the Company.

During the quarter ended December 31, 2006, the Company issued 12,101,780 shares of its common stock pursuant to the exercise of warrants, generating net proceeds of $1,669,667 to the Company. In addition, the Company issued to certain investors new 5 year warrants to purchase 11,111,112 of the Company's common stock, with exercise prices ranging from $.15 - $.18 per share.

During the quarter ended March 31, 2007, the Company issued 2,500,000 shares of its common stock pursuant to the exercise of warrants, generating net proceeds of $375,000 to the Company.

Options and Stock Based Compensation

During the twelve months ended June 30, 2007, the Company authorized the issuance of options and warrants to employees, officers, and consultants granting the right to purchase 10,455,000 common shares and 2,821,113 common shares, respectively. Pursuant to the adoption of the "Modified Perspective" method, the Company recognized an expense in the amount of $1,321,853, all of which was included in general and administrative expense. The fair value of options granted 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 ranging between 80% -95%, a risk-free interest rate of 4.8% and expected option life of 5 years.

During the twelve months ended June 30, 2007, the Board of Directors authorized the issuance of 18,172,983 shares of common stock, with an aggregate value of $2,668,615 as compensation to consultants and employees. The stock value ranged in price from $.12 to $.20 per share, the fair value on the date of the awards.

Debt Conversions

During the twelve months ended June 30, 2007, the Company converted accounts payable of $991,709 into 6,073,728 shares of common stock.

Reparations

During the twelve month period ended June 30, 2007, the Company became obligated to issue 22,664,580 of its common stock as reparation to affect revised pricing on previous private placements. This additional consideration was afforded to past investors who agreed to make additional cash investments as part of a new private placement. The cost of such consideration was estimated to be the fair value of such shares at the time of the investment of $1,874,020.

During the fiscal year ending June 30, 2008, the following transactions impacted stockholders equity.

Private Placements

During the quarter ended September 30, 2007, the Company issued 500,000 shares of its common stock in private placements generating net proceeds of $50,000.

During the quarter ended December 31, 2007, the Company issued 850,000 shares of its common stock in private placements generating net proceeds of $48,000.

During the quarter ended June 30, 2008, the Company issued 23,250,000 shares of its common stock in private placements generating net proceeds of $1,162,500.

Exercise of Warrants

During the quarter ended June 30, 2008, 11,111,112 warrants to purchase common stock were exercised and additional warrants for 11,111,112 shares issued. Such transaction generated net proceeds of $650,000.

Other Equity Transactions

During the year ended June 30, 2008, the Company issued 500,000 shares of stock, 110,000 of options and approximately 13.1 million warrants to purchase common stock valued at $346,985 to individuals and investors. In addition, it issued approximately 5.2 million shares of common stock valued at $230,927 to reflect re-pricing agreements, 1,109,200 shares to pay for finders fees valued at $100,000, and 5,250,000 shares of common stock valued at $165,000 in connection with debt financing arrangement (see convertible debt below) The fair value of shares issued was estimated as of the date of grant using the Black-Scholes pricing model, based on the following weighted average assumptions: annual expected return of 0%, annual volatility ranging between 70 -81%, a risk-free interest rate of 2.25% and expected option life of 5 years.

Investment in Granita Media, Inc

An investment of $514,000 was received by Granita Media, Inc, a subsidiary formed July 1, 2007, to operate its IPTV business. Since the Company remained the controlling shareholder in Granita Media and such results were consolidated, this investment was included in Additional Paid In Capital.

Convertible Debt Short Term

In September, 2007, the Company received proceeds of $154,000 of convertible debt bearing interest at an annual rate of 15% and due September 1, 2008. Such debt was convertible into the Company's common shares at a price equal to a 20% discount from the 20 day average bid and ask price. Such election was at the option of the Company on September 1, 2008. In March 2008, $100,000 of such debt was converted into 2,727,264 shares of common stock.

Long Term Convertible Debentures / Note Receivable / Debt Discount and Related Interest

During fiscal year ended June 30, 2008 the Company entered into three separate convertible debt arrangements with independent investors. These transactions were intended to provide liquidity and capital to the Company and are generally structured as follows:

The form of the transaction may involve the following:

- The receipt of cash.

- The issuance of a note payable from mPhase.
- The issuance of a note receivable due to mPhase.
- A Securities Purchase Agreement.
- The note payable contains conversion features which permit the holder to convert debt into equity. Such debt is eligible to be converted into the Company's common stock immediately, thus requiring the recording of the entire liability upfront. Finally, to encourage conversion, a discount from market value is offered.
- The aggregate amounts of notes payable exceed the amount of cash received. As "Consideration" for this difference, the Company takes back a secured note receivable. Security is generally liquid investments of the investor.
- The note receivable provides a commitment to fund mPhase. The notes are secured and collateralized and carry terms which are different from the related note payable and no right of offset exists.

Derivative Value and Debt Discount

It was determined that the value of the note payable to the holder (investor) was primarily due to the favorable conversion features of the note. In accordance with SFAS 133, the conversion feature requires the bifurcation of the embedded derivative from the host document and separate reporting of the embedded conversion feature at fair value determined by a Black-Scholes calculation. The value of the agreement includes the conversion feature and the variable amount of shares that may be converted at any particular point in time. As such and under GAAP, our Balance Sheet reflects the value of the embedded conversion feature as Derivative Value and the corresponding contra account to Notes Payable called Debt Discount.

At the end of every quarter the fair value of Derivative Securities is reviewed and adjustments made accordingly. The volatility of the stock price, the amount and variable number of shares involved and the low price of our stock has caused this value to fluctuate significantly. In addition, the debt discount is adjusted for any conversions and amortized over the remaining life of the loan.

As of fiscal year end June 30, 2012, no convertible debentures remain outstanding in respect to the three convertible debt arrangements entered into during fiscal year ended June 30, 2008. Those arrangements are briefly summarized below.

Arrangement #1 (Golden Gate Investors)

In December, 2007, the Company received proceeds of $500,000 under a Securities Purchase Agreement. This transaction involves three related agreements: 1) a Securities Purchase Agreement which may under certain circumstances permit the Company to draw up to $6,000,000 of funds, 2) a convertible debenture in the amount of $1.5 million, with an interest rate of 7 ¼% and a maturity date of December 11, 2010, and 3) a secured note receivable in the amount of $1.0 million, with an interest rate of 8 ¼% and a maturity date of February 1, 2011 due from the holder of the convertible debenture.

Conversion of the outstanding debenture into common shares is at the option of the holder. The number of shares into which this debenture was converted is equal to the dollar amount of the debenture divided by the lesser of $.35 per share or 80% of the 3 lowest volume weighted average prices during the 20 day trading period prior to conversion. At the time of the transaction (December 11, 2007) the derivative value of the conversion feature was calculated to be $1,678,471. On June 30, 2008, given the decrease in the Company's stock price, this value had decreased to $322,636. As of June 30, 2009, all of the related debt had been converted and no derivative value balance remained. This resulted in an increase in earnings for the year of $322,636. In addition, the transaction resulted in a note discount of $1.5 million which has been amortized as expense. During the year ended June 30, 2009, amortization of debt discount amounted to $1,122,649. In March of 2009, by mutual consent of the parties, the Securities Purchase Agreement was terminated. Total draws under this facility were $1.5 million.

During the fiscal year ended June 30, 2009, $1,365,000 of such debt was converted into 74,368,943 shares of common stock and the Company received a total of $950,000 under the provisions of the related Note Receivable. As of June 30, 2009, all notes receivable had been paid and all debt converted. No further obligations exist by either party.

Arrangement #2 (St. George Investments, LLC)

In February 2008, the Company entered into a convertible debenture transaction which involved the receipt of $500,000 cash, a note payable of $550,000 and the issuance of 3,250,000 shares of stock valued at $260,000. The relative fair value of the shares was $105,000 as of June 30, 2008. The terms of the debenture provided for a 7.5% interest rate, a due date of February 2012 and allowed similar conversion privileges equal to 75% of the average of the three lowest prices over a 20 day period. The derivative value of such security was estimated to be $581,428 on the date of issuance. On June 30, 2008, this value had decreased to $142,593, creating a non cash credit to earnings of $438,835. The cost of the shares issued and related debt discount was amortized to expense over the life of the debenture. In the event of default under the note payable the holder was entitled to certain compensatory fees. During the period ended June 30, 2009, amortization of debt discount amounted to $502,083.

During the fiscal year ended June 30, 2009, $614,209 of such debt plus accrued interest was converted into 60,536,582 shares of common stock. As of June 30, 2009, all debt had been converted and no further obligation exists by either party.

Arrangement #3 (JMJ Financial, Inc.)

In April, 2008, the Company received proceeds of $300,000 under a Securities Purchase Agreement. This transaction involved three related agreements: 1) a Securities Purchase Agreement which, under certain circumstances, permitted the Company to draw up to $1,300,000 of funds, 2) two convertible debentures totaling $1,450,000, with a one-time interest factor of 12% and a maturity date of March 25, 2011, and 3) a secured note receivable in the amount of $1.0 million, with a one-time interest factor of 13.2% and maturity dates of March 25, 2012 due from the holders of the convertible debentures.

Conversion of outstanding debentures into common shares was at the option of the holder. The number of shares into which the debentures could be converted was equal to the dollar amount of the debentures divided by 75% of the 3 lowest volume weighted average prices during the 20 day trading period prior to conversion. An amendment of December 31, 2008 allowed one conversion of $200,000 of principal to be converted into common stock at the rate of 70% of the lowest trading price during the 20 day period prior to conversion and reduced the conversion price from 80% to 75% for future conversions.

During the fiscal year ended June 30, 2009, $964,250 of such debt and accrued interest was converted into 100,951,309 shares of common stock. As of June 30, 2011, all notes receivable had been paid and all debt converted.

At the time of the transaction the embedded conversion feature of this security was calculated to be $2,493,212. On June 30, 2008, this value had decreased to $284,922. On June 30, 2009, such value had increased to $444,552, creating a non-cash expense for the twelve month period of $159,630. On June 30, 2010, the value was $0. In addition, the transaction resulted in a note discount which has been amortized as expense over the life of the loan. During the twelve month period ended June 30, 2009, amortization of debt discount amounted to $1,007,097, and during that same period ended June 30, 2010, amortization of debt discount amounted to $0.

During the fiscal year ending June 30, 2009, the following transactions impacted stockholders equity.

Private Placements

During the quarter ended September 30, 2008, the Company issued 4,000,000 shares of its common stock at $.05 per share in private placements, generating net proceeds of $180,000. Related to this transaction was the issuance of 3,862,000 shares as reparations shares to effect re-pricing at a cost estimated to be $216,689.

During the quarter ended March 31, 2009, the Company issued 35,000,000 shares of its common stock at $.01 per share in private placements generating net proceeds of $315,000. Related to these transactions was the issuance of 7,660,000 shares as reparations shares to effect re-pricing, costing an estimated $99,483.

During the quarter ended June 30, 2009, the Company issued 33,333,333 shares of its common stock at $.0075 per share in private placements generating gross proceeds of $225,000. Related to these transactions was the issuance of 2,000,000 shares as reparations shares to effect re-pricing, costing an estimated $64,000 and finder's fees of $25,000.

Also during the quarter ended June 30, 2009, the Company issued 20,775,000 shares in settlement of $169,875 of prior promissory notes payable plus accrued interest and incurred a beneficial conversion of $114,500.

Stock Based Compensation

During the three months ended September 30, 2008, the Company issued 5 year options to purchase 104,675,000 shares of common stock at $.05 per share. The value of such options was estimated to be $4,071,348 using the Black Scholes method, based on an assumed volatility of 78% and an interest rate of 1.5%. In addition, 61,750,000 shares of common stock valued at $3,525,615 were issued to employees and consultants. (See note 3.)

No such transactions occurred in the quarters ending December 31, 2008 and March 31, 2009.

During the quarter ended June 30, 2009, the Company granted 3 officers of the Company the right to convert an aggregate of $1,465,992 of loans and accrued and unpaid compensation and accrued interest into common stock of the Company at a price of $.0075 per share.

Conversion of debt securities

During the fiscal year ended June 30, 2009, $3,303,333 of debt was converted into 278,346,019 shares of common stock. Included in this amount is $112,500 of notes payable to a related party which were sold to an investor for $112,500 cash and subsequently converted into 15,000,000 shares of the Company's common stock valued at $.0075 per share. Additionally $57,375 of prior notes plus accrued interest outstanding was settled by the issuance of 5,775,000 shares of common stock. All other debt converted involved long term convertible debentures as described below.

Long Term Convertible Debentures / Note Receivable / Debt Discount and Related Interest

During the fiscal year ended June 30, 2009, the Company entered into convertible debt arrangements as follows:

Arrangement #4 (JMJ Financial, Inc.)

On December 31, 2008, the Company entered into a second agreement with JMJ Financial. This transaction involved 1) a convertible debenture in the amount of $1.1 million, plus a one-time interest factor of 12% ($132,000) and a maturity date of December 31, 2011, and 2) a secured note receivable in the amount of $1.0 million, plus a one-time interest factor of 13.2% ($132,000) and maturity date of December 31, 2012 due from the holder of the convertible debentures. No cash was exchanged relative to this agreement.

Conversion of outstanding debentures into common shares is at the option of the holder. The number of shares into which this debenture can be converted is equal to the dollar amount of the debenture divided by 75% of the lowest trading price during the 20 day trading period prior to conversion. At the commitment date the embedded conversion feature of such security was $536,000 and the debt discount valued at $636,000. As of June 30, 2009, the value of the embedded conversion feature increased to $855,920, creating a charge to earnings of $269,254 while the debt discount had been amortized by $97,778. As of June 30, 2011, no amounts remain outstanding under this agreement

During the fiscal year ended June 30, 2010, the Company received $1,000,000 of cash advances and $132,000 of contract interest. During the year ended June 30, 2010, the holder converted $1,232,000 of principal and interest into 78,792,702 shares of the Company s common stock. Additionally, the Company recorded $488,889 amortization of debt discount under this agreement.

Arrangement #5 (LaJolla Cove Investors, Inc.)

On Sept 11, 2008, the Company received proceeds of $200,000 under a Securities Purchase Agreement. This transaction involved three related agreements: 1) a Securities Purchase Agreement which may under certain circumstances permit the Company to draw up to $2,000,000 of funds, 2) a convertible debenture totaling $2,000,000, with an interest rate of 7 1/4% and a maturity date of September 30, 2011, and 3) a secured note receivable in the amount of $1,800,000, with an interest rate of 8 1/4% and maturity dates of September 30, 2011 due from the holder of the convertible debenture. In addition, the holder of the debenture is related to the holder in Arrangement #1.

Conversion of outstanding debentures into common shares is similar to the terms of Arrangement #1. At the time of the transaction (September 11, 2008), the embedded conversion feature of this security was calculated to be $859,756. In addition, the transaction resulted in a note discount which is being amortized as expense over the life of the loan.

As of FYE 2009, $190,000 of debt was converted into 21,714,285 shares of common stock. On June 30, 2009 and June 30, 2010 the note receivable balance was $1,800,000, the note payable was $1,810,000 and the FMV addition $387,228 for which the Company recorded a reserve for utilization against each of $600,000. As of June 30, 2010, the derivative value of this security was calculated to be $1,114,768.

On March 16, 2011, the holder and the Company entered into a termination agreement whereby $1,800,000 of the principal of both the note receivable and the convertible debenture, plus $90,291 in accrued interest receivable and $84,175 in accrued interest payable, was cancelled. Additionally in connection with the termination, the Company paid the holder $17,000 and assigned to a consultant engaged by the Company the unconverted portion of the convertible debenture in the amount of $10,000 which had been fully funded in cash and which remained outstanding at March 31, 2011 and the derivative value of the remaining security was calculated to be $3,468 As of June 30, 2011, this value was calculated to be $3,442. During the year ended June 30, 2011, amortization of debt discount amounted to $282,774, reducing the balance to $0.

During the twelve months ended June 30, 2011, the holder converted $0 of principal into 0 shares of common stock.

During the fiscal year ending June 30, 2010, the following transactions impacted stockholders equity

Stock Based Compensation

The Company did not issue any awards of common stock or options to officers, directors or employees during the fiscal year ended June 30, 2010. The Company issued 1,575,000 shares of common stock to various vendors and consultants valued at a total of $34,313 based upon the market price of the common stock on various different dates to such persons during the period.

Private Placements

During the fiscal year ended June 30, 2010, the Company received $225,000 of net proceeds from the issuance of 30,666,667 shares of common stock in private placements with accredited investors effected pursuant to Rule 506 of Regulation D under the Securities Act. The aggregate cost of these placements was $25,000, and Eagle Advisors acted as placement agent. All proceeds received from the financings were used by the Company for working capital needs. The dates and amounts of each placement are as follows: 6,666,667 common shares were issued on August 14, 2009; 6,666,667 common shares on August 15, 2009; 13,333,333 common shares on August 24, 2009; and two placements of 2,000,000 common shares each on March 17, 2010.

Conversion of debt securities

During the fiscal year ended June 30, 2010, $3,415,250 of debt was converted into 232,723,736 shares of common stock to holders of Convertible Notes. In addition the Company issued 26,666,667 shares of common stock to Microphase Corporation for the conversion of $200,000 of previously outstanding accounts payable at $.0075 per share. The price was based upon the price offered to investors in concurrent private placements with accredited investors during this period. The Company recorded an addition to interest expense on this beneficial conversion feature.

Long Term Convertible Debentures / Note Receivable / Debt Discount and Related Interest

Arrangement #6 (JMJ Financial, Inc.)

On August 19, 2009 the Company issued a 12% convertible note maturing on August 10, 2012 in the principal amount of $1,870,000 to JMJ Financial for a purchase price of $1,700,000. The Company initially received $250,000 in cash as partial payment of the purchase price for the convertible note plus a 13.2% secured promissory note maturing on August 10, 2012 in the amount of $1,450,000. As of June 30, 2010, the Company has received a total of $1,523,500 cash and has issued 109,920,635 shares of common stock to the holder upon conversions. The remaining $570, 900 of cash to be received from the holder plus accrued and unpaid interest is convertible into shares of common stock at the option of the holder. Upon receipt, in full, of cash by the Company equaling the purchase price of the convertible note plus interest or any portion thereof payable through maturity, the holder may convert such portion of the total amount of interest funded that would accrue to maturity into additional shares of common stock. The number of shares into which this convertible note can be converted is equal to the dollar amount of the debenture divided by 75% of the lowest trading price during the 20 day trading period prior to conversion. As of June 30, 2011 all principal plus accrued interest with respect to this convertible note had been converted into shares of common stock and no further obligations by the Company remained.

At the time of the transaction, the embedded feature of this security was calculated to be $1,054,395. On June 30, 2011, this value had decreased to $0, creating a non-cash credit to earnings of $1,054,395. In addition, the transaction resulted in a note discount that is being amortized as expense over the life of the loan. During the twelve month period ended June 30, 2011, amortization of debt discount amounted to $222,081. During the twelve months ended June 30, 2011, the holder converted $346,501 of principal and interest of $224,400 into 66,172,223 shares of common stock.

Arrangement #7 (JMJ Financial, Inc.)

On September 30, 2009, the Company issued a 12% convertible note maturing on September 23, 2012 in the principal amount of $1,200,000 to JMJ Financial for a purchase price of $1,100,000. The Company initially received $150,000 in cash as partial payment of the purchase price for the convertible note plus a 13.2% secured promissory note maturing on August 10, 2012 in the amount of $950,000. Through June 30, 2011the Company has received a total of $1,200,000 of principle and $144,000 of interest for full funding of the purchase price of this note. The cash received from the holder plus accrued and unpaid interest is convertible into shares of common stock at the option of the holder. Upon receipt, in full, of cash by the Company equaling the purchase price of the convertible note plus interest or any portion thereof payable through maturity, the holder may convert such portion of the total amount of interest funded that would accrue to maturity into additional shares of common stock. The number of shares into which this convertible note can be converted is equal to the dollar amount of the note divided by 75% of the lowest trading price during the 20 day trading period prior to conversion.

At the time of the transaction, the embedded feature of this security was calculated to be $480,000 on June 30, 2010 this value had increased to $938,843. On June 30, 2011, this value had decreased to $0 creating a non-cash charge to earnings of $938,843. In addition, this transaction resulted in a note discount that is being amortized as an expense over the life of the loan. During the twelve months ended June 30, 2011the holder converted $1,200,000 of principle and $144,000 of interest into 240,722,223 shares of common stock and the amortization of debt discount amounted to $386,668, reducing the debt and debt discount balances to $0.

During the fiscal year ending June 30, 2011, the following transactions impacted stockholders equity

Private Placements

During the fiscal year ended June 30, 2011, the Company received $ 265,500 of net proceeds from the issuance of 67,500,000 shares of common stock in private placements with accredited investors, that included $50,000 of stock subscriptions that were collected on July 6, 2011. The aggregate cost of such placements was $ 29,500.

Stock Based Compensation

The Company did not issue any awards of common stock or options to Officers, Directors or Employees during the fiscal year ended June 30, 2011.

Conversion of debt securities

During the fiscal year ended June 30, 2011, $ 2,346,896 of debt was converted into 382,175,312 shares of common stock to holders of Convertible Notes.

Reparations

The Company did not issue any shares to investors for reparations.

During the fiscal year ending June 30, 2012, the following transactions impacted stockholders equity

Private Placements

During the fiscal year ended June 30, 2012, the Company received $127,000 of net proceeds from the issuance of 170,000,000 shares of common stock in private placements with accredited investors. The aggregate cost of such placements was $13,000.

Stock Based Compensation

The Company issued awards of 1,035,000,000 shares of common stock to Officers, Directors or Employees during the fiscal year ended June 30, 2012 valued at $6,520,500. Directors revised the exercise price of options to purchase up to 98,000,000 shares of common stock previously granted to officers in September, 2008 (originally exercisable for 5 years with an exercise price of 5 cents per share). The exercise price of options to purchase up to 98,000,000 shares was revised to $.0040; the incremental cost of $339,700 was recorded as deferred compensation which will be amortized to expense through September 18, 2013.

Conversion of debt securities

During the fiscal year ended June 30, 2012, $1,814,368 of debt was converted into 716,962,140 shares of common stock to holders of Convertible Notes.

Reparations

The Company did not issue any shares to investors for reparations.

Long Term Convertible Debentures / Note Receivable / Debt Discount and Related Interest

On June 6, 2012 the Company announced that negotiations with respect to Arrangements #8, #9, #10 and #11 set forth below which has resulted in to a standstill agreement and restructuring of approximately $1,500,000.00. The result is the floating rate convertible securities have been converted into 8% fixed rate debt instruments with payments commencing on October 1, 2012 at an aggregate amount of approximately $70,000 per month for two years. The Company must make each of the monthly payments, in cash in a timely manner; otherwise the provisions of Arrangements #8, #9, #10 and #11 will be reinstated with an appropriate adjustment for any payments made by the Company under the fixed rate debt prior to an event of default.

Arrangement #8 (JMJ Financial, Inc.)

On November 17, 2009, the Company received a total of $186,000 of proceeds in connection with a new financing agreement with JMJ Financial. This transaction consists of the following: 1) a convertible note in the amount of $1,200,000 plus a one-time interest factor of 12% ($144,000) and a maturity date of September 23, 2012 and (2) a secured promissory note in the amount of $1,100,000 plus a one-time interest rate factor of 13.2% ($144,000 each) and a maturity date of September 23, 2012 due from the holder of the convertible note. Conversion of outstanding principal into shares of common stock is at the option of the holder. The number of shares into which this note can be converted is equal to the dollar amount of the note divided by 75% of the lowest trade price during the 20 day trading period prior to conversion.

To date the Company has received a total of $639,500 in cash and has issued 332,187,500 shares of common stock to the holder upon conversions of $325,440 of principle and $994,766 of conversion fees. The remaining $604,600 of cash which was to be received from the holder plus accrued and unpaid interest was convertible into shares of common stock at the option of the holder. Upon receipt, in full, of cash by the Company equaling the purchase price of the convertible note plus interest or any portion thereof payable through maturity, the holder may convert such portion of the total amount of interest funded that would accrue to maturity into additional shares of common stock. Based upon the price of the Company s common stock on June 30, 2011 of $.0073 per share the holder could convert the remaining principal amount plus interest of this convertible note into approximately 222,142,857 shares of common stock at the full contract value; of which the derivative liability associated with this arrangement is calculated. At June 1, this note was merged into agreement

As of June 30, 2011 the Company and the holder were negotiating potential amendments to this agreement, and funding and conversions had not occurred since April, 2011. For accounting purposes the note receivable has been fully reserved, and the liability is recorded, when netted against the debt discount and cumulative conversions, at the amount funded.

Based upon the price of the Company s common stock on June 30, 2011, the net liability of this note is convertible into approximately 115,380,952 shares of common stock. At the commitment date, the derivative value of the embedded conversion feature of such security was $536,000 and the debt discount was valued at $636,000. As of June 30, 2011, this value was calculated to be $472,773.

During the year ended June 30, 2011 the holder converted $33,750 of principal into 10,000,000 shares of common stock and amortization of debt discount amounted to $412,332, reducing the debt discount balance to $100,000.

During the year ended June 30, 2012, the Company reduced the note payable and debt discount by $42,000 in proportion with the amount funded to the total original funding commitment and amortization of debt discount amounted to $27,067 reducing the balance to $30,933. Also during the year ended June 30, 2012, the Company had incurred $994,766 of conversion fees which together with $291,690 of principle was converted into 322,187,500 shares of common stock. At June 30, 2012 this convertible note had $372,060 outstanding which was combined with arrangement #10 JMJ Financial, Inc.

Arrangement #9 (JMJ Financial, Inc.)

On December 15, 2009 the Company entered into a new financing agreement with JMJ Financial that consists of the following: 1) a convertible note issued by the Company in the amount of $1,500,000 plus a one-time interest factor of 12% ($180,000) and a maturity date of December15, 2012 and (2) a secured promissory note in the amount of $1,400,000 plus a one-time interest rate factor of 13.2% ($180,000) and a maturity date of December 15, 2012 due from the holder of the convertible note. To date the Company has received a total of $300,000 cash and has issued no shares of common stock to the holder upon conversions. The remaining $1,280,000 of cash to be received from the holder plus accrued and unpaid interest is convertible into shares of common stock at the option of the holder. Upon receipt, in full, of cash by the Company equaling the purchase price of the convertible note plus interest or any portion thereof payable through maturity, the holder may convert such portion of the total amount of interest funded that would accrue to maturity into additional shares of common stock. The number of shares into which this convertible note can be converted is equal to the dollar amount of the note divided by 75% of the lowest trade price during the 20 day trading period prior to conversion. Based upon the price of the Company s common stock on June 30, 2011 of $.0073 per share the holder could convert the remaining principal amount plus interest of this convertible note into approximately 285,714,286 shares of common stock at the full contract value; of which the derivative liability associated with this arrangement is calculated.

The Company and the holder are presently negotiating potential amendments to this agreement, and funding and conversions have not occurred since April, 2011. For accounting purposes the note receivable has been fully reserved, and the liability is recorded, when netted against the debt discount and cumulative conversions, at the amount funded. Based upon the price of the Company s common stock on June 30, 2011, the net liability of this note is convertible into approximately 38,095,238 shares of common stock. At the commitment date, the derivative value of the embedded conversion feature of such security was $542,714 and the debt discount was valued at $642,714. As of June 30, 2011, this value was calculated to be $607,994. During the year ended June 30, 2011, amortization of debt discount amounted to $418,552, reducing the balance to $100,000.

During the fiscal year ended June 30, 2012, the Company reduced the note payable and debt discount by $79,000 in proportion with the amount funded to the total original funding commitment and amortization of debt discount amounted to $8,573 reducing the balance to $12,427. As of June 30, 2012, this convertible note has $321,000 outstanding which was combined with arrangement #10 JMJ Financial, Inc.

Arrangement #10 (JMJ Financial, Inc.)

On April 5, 2010, the Company entered into a new financing agreement with JMJ Financial that consists of the following: 1) a convertible note issued by the Company in the principal amount of $1,200,000 plus a one-time interest factor of 12% ($144,000) and a maturity date of December 15, 2012, and (2) a secured promissory note from the holder of the convertible note in the amount of $1,100,000 plus a one-time interest rate factor of 13.2% ($144,000 each) and a maturity date of December 15, 2012. To date the Company has received a total of $100,000 cash and has issued no shares of common stock to the holder upon conversions. The remaining $1,144,000 of cash to be received from the holder plus accrued and unpaid interest is convertible into shares of common stock at the option of the holder. Upon receipt, in full, of cash by the Company equaling the purchase price of the convertible note plus interest or any portion thereof payable through maturity, the holder may convert such portion of the total amount of interest funded that would accrue to maturity into additional shares of common stock. The number of shares into which this convertible note can be converted is equal to the dollar amount of the note divided by 75% of the lowest trade price during the 20 day trading period prior to conversion. Based upon the price of the Company s common stock on June 30, 2011 of $.0073 per share the holder could convert the remaining principal amount plus interest of this convertible note into approximately 228,571,429 shares of common stock at the full contract value; of which the derivative liability associated with this arrangement is calculated.

The Company and the holder are presently negotiating potential amendments to this agreement, and funding and conversions have not occurred since April, 2011. For accounting purposes the note receivable has been fully reserved, and the liability is recorded, when netted against the debt discount and cumulative conversions, at the amount funded. Based upon the price of the Company s common stock on June 30, 2011, the net liability of this note is convertible into approximately 19,047,619 shares of common stock. At the commitment date, the derivative value of the embedded conversion feature of such security was $421,891 and the debt discount was valued at $521,891. As of June 30, 2011, this value was calculated to be $486,795. During the year ended June 30, 2011, amortization of debt discount amounted to $378,761, reducing the balance to $ 100,000.

During the fiscal year ended June 30, 2012, the Company reduced the note payable and debt discount by $91,000 in proportion with the amount funded to the total original funding commitment and amortization of debt discount amounted to $3,674 reducing the balance to $5,326.

As of June 30, 2012, this convertible note has $109,000 outstanding, which when combined with arrangements #8 and #9 totaled $802,060, which the company entered into an amended agreement on June 1, 2012 whereby the Company agreed to make payments of principle and interest of $37,018 per month commencing October 1, 2012 through September 1, 2014 at 8% interest and so long as the payments are not in default then no conversions into the Company s common stock would be available to the holder. Also as of June 30, 2012 the derivative value of the embedded conversion feature of this arrangement when combined with arrangements #8 and #9 totaled $0; which when compared to the combine value of $1,567,512 created a non-cash credit to earnings of $1,567,512 in fiscal 2012. As of June 30, 2012 the combined arrangements with JMJ in this note would be convertible into 200,515,000 at the conversion floor price of $.004; and only so if the Company does not make the scheduled payments pursuant to the June 1, 2012 amended agreement.

Arrangement #11 (J. Fife)

On March 5, 2010, the Company entered into an new financing agreement with J. Fife that consist of a convertible note issued by the Company in the principal amount of $550,000 bearing interest at 7.5% per annum in which the Company received $495,000 cash up front. The Convertible Note has a maturity date of one year from the date of issuance. In addition, the Company had committed to issue in the future 2 additional promissory notes each in the principal amount of $275,000 each with an interest rate of 7.5% each upon the receipt of $250,000 of cash funding in exchange for such notes. The issuance of each of such notes was expected to take place upon the full conversion of the holder of its previous note into common stock of the Company. As of June 30, 2011, the 2 additional promissory notes are expected to be cancelled as part of a new extension and forbearance agreement the Company is presently renegotiating with the holder. Conversion of each of the Convertible Notes into common stock of the Company is at the option of the holder at a price equal to the dollar amount of the note being converted divided by 75% of the three lowest volume weighted average prices during the 20 day trading period immediately preceding the date of conversion.

On October 22, 2010, the Company entered into a Forbearance Agreement with this convertible note holder in which the lender agreed not to convert any additional amounts under the convertible notes until January 15, 2011 in exchange for increasing the original principal amount of those notes by 10% from $550,000 to $605,000 resulting in a charge of $55,000 for debt extension fees corresponding with the addition to the note principal. At the time of the October 22, 2010 transaction, the embedded conversion feature of this security for this incremental liability and loan discount was calculated to be $20,005. On June 30, 2011, given the changes in the Company s stock price during the 20 day look-back period for June 30, 2011, this estimated liability decreased to $15,556; a decrease for the period from October 22, 2010 through June 30, 2011 of $4,449, creating a non-cash credit to earnings for the period ended June 30, 2011 of that amount. During the same period ended June 30, 2011, amortization of debt discount amounted to $20,005 reducing the balance to $0. Also, as of June 30, 2011, $30,000 of additional interest was accrued and $28,000 intervention fees were added to principle on the original note. This note, which was originally scheduled to mature on March 4, 2011, was extended to June 30, 2012 on September 13, 2011. These increases in the convertible note will also be convertible into common stock of the Company at the option of the holder at a price equal to the dollar amount of the note being converted divided by 75% of the three lowest volume weighted average prices during the 20 day trading period immediately preceding the date of conversion.

At the time of the transaction (March 5, 2010) the derivative value of this security was calculated to be $193,767 and the debt discount was valued at $243,767. As of June 30, 2011 and 2012 this liability was estimated to be $78,059 and $0, respectively, creating a non-cash credit to earnings of $78,059 in fiscal 2012. During the year ended June 30, 2011 the holder converted $398,245 of principal into 65,280,866 shares of common stock and amortization of debt discount amounted to $ 227,621, reducing the balance of the debt discount to $ 0. During the year ended June 30, 2012 the holder converted the remaining principal of $234,755, contractual charges of $74,848 and accrued interest of $77,895 into 161,041,617 shares of common stock and $0 remains outstanding at June 30, 2012.

Arrangement #12 (St. George Investments)

On September 13, 2011, the Company issued a second Convertible Note to John Fife founder and president of St. George Investments, in a Private Placement pursuant to Section 4(2) of the Securities Act of 1933. The initial principal amount of the first funded tranche of the Convertible Note was $357,500 and the Company received cash proceeds of $300,000. A second tranche of the Convertible Note in the amount of $200,000 cash is funded upon the filing by the Company of a Registration Statement on Form S-1 with the Securities and Exchange Commission providing for the registration of 185,400,000 shares of common stock that may be converted into from time to time by the holder of the Convertible Note.

The instrument is convertible into the Company s common stock at 75% of the volume weight average price of the stock based upon the average of the three lowest trading days in the 20 day trading period immediately preceding such conversion. Absent an effective Registration Statement, the holder of the Convertible Note may not sell any common stock prior to 6 months from the date of funding of each of the respective tranches of such instrument under Rule 144 of the Securities Act of 1933.

All proceeds received in connection with the above financing have been used by the Company as working capital.

At the time of the transaction, the embedded conversion feature of this security and the warrant was calculated to be $137,481 and the loan discount totaled 194,981 for the initial tranche and the embedded conversion feature of this security and the warrant for a second tranche of the Convertible Note was calculated to be $46,379. On June 30, 2012, given the changes in the Company s stock price during the 20 day look-back period for June 30, 2012 and conversions during the period this estimated liability had increased from $183,860 to $771,079, an increase this period of $587,219, creating a non-cash charge to earnings for the twelve months ended June 30, 2012 of that amount. During the twelve month period ended June 30, 2012 amortization of debt discount amounted to $185,456 reducing the combined balance to $55,903.

The company entered into an amended agreement on June 1, 2012,when principle of $557,500 accrued interest of $66,338 and $95,611 of contractual charges totaled $719,449; with this noteholder whereby the Company agreed to make payments of principle and interest of $33,238 per month commencing October 1, 2012 through September 1, 2014 at 8% interest and so long as the payments are not in default then no conversions into the Company s common stock would be available to the holder. As of June 30, 2012 this note would be convertible into 1,646,801,902 shares of common stock at the original terms; and only so if the Company does not make the scheduled payments pursuant to the June 1, 2012 amended agreement.

Arrangement#13- (Asher Enterprises, Inc. #I)

On November 17, 2011 the Company issued to Asher Enterprises, Inc. a Convertible Note in a Private Placement pursuant to Section 4(2) of the Securities Act of 1933 and received $53,000 in gross proceeds, net of $3,000 closing fees. The instrument is in the principal amount of $53,000 and matures on November 17, 2012. Interest only is payable at the rate of 8% per annum by the Company to the holder until maturity. The instrument is convertible into the Company s common stock at 60% of the volume weighted average price of the stock based upon the average of the three lowest trading days in the 10 day trading period immediately preceding such conversion. All proceeds received in connection with the above financing have been used by the Company as working capital.

At the time of the transaction, the embedded conversion feature of this security and the warrant was calculated to be $47,970 and the loan discount totaled the same. This Convertible Note has been converted, in full, into 162,749,128 shares of common stock.

Arrangement#14- (Asher Enterprises, Inc. #II)

On January 5, 2012 the Company issued to Asher Enterprises, Inc. a Convertible Note in a Private Placement pursuant to Section 4(2) of the Securities Act of 1933 and received $35,000 in gross proceeds, net of $2,500 closing fees. The instrument is in the principal amount of $35,000 and matures on January 5, 2013. Interest only is payable at the rate of 8% per annum by the Company to the holder until maturity. The instrument is convertible into the Company s common stock at 60% of the volume weight average price of the stock based upon the average of the three lowest trading days in the 10 day trading period immediately preceding such conversion. All proceeds received in connection with the above financing have been used by the Company as working capital.

At the time of the transaction, the embedded conversion feature of this security and the warrant was calculated to be $26,681 and the loan discount totaled the same. On June 30, 2012, given the changes in the Company s stock price during the 10 day look-back period for this estimated liability had increased to $61,627, an increase this period of $34,946 creating a non-cash charge to earnings of that amount. During the twelve month period ended June 30, 2012 amortization of debt discount amounted to $17,014 reducing the balance to $17,014. Based upon the price of the Company s common stock on June 30, 2012, this note is convertible into approximately 107,361,963 shares of common stock. On July 11, 2011 the Company prepaid in full, in cash this Convertible Note (See Subsequent Events).

Arrangement#15- (Asher Enterprises, Inc. #III)

On May 5, 2012 the Company issued to Asher Enterprises, Inc. a Convertible Note in a Private Placement pursuant to Section 4(2) of the Securities Act of 1933 and received $37,500 in gross proceeds, net of $2,500 closing fees. The instrument is in the principal amount of $33,000 and matures on January 5, 2013. Interest only is payable at the rate of 8% per annum by the Company to the holder until maturity. The instrument is convertible into the Company s common stock at 60% of the volume weight average price of the stock based upon the average of the three lowest trading days in the 10 day trading period immediately preceding such conversion. All proceeds received in connection with the above financing have been used by the Company as working capital.

At the time of the transaction, the embedded conversion feature of this security and the warrant was calculated to be $18,137 and the loan discount totaled the same. On June 30, 2012, given the changes in the Company s stock price during the 10 day look-back period for this estimated liability had increased to $66,029, an increase this period of $47,892 creating a non-cash charge to earnings of that amount. During the twelve month period ended June 30, 2012 amortization of debt discount amounted to $3,601 reducing the balance to $14,536. Based upon the price of the Company s common stock on June 30, 2012, this note is convertible into approximately 115,030,675 shares of common stock.

Arrangement#16- (Jay Wright)

On August 11, 2011 the Company issued to Jay Wright a Convertible Note plus a Warrant in a Private Placement pursuant to Section 42) of the Securities Act of 1933 and received $25,000 in gross proceeds. The purpose for this transaction was to provide working capital for the Company to use for a portion of the interim financing needed by Energy Innovative Products during the course of due diligence by the Company of a proposed acquisition of EIP. The acquisition was subsequently terminated by EIP in January of 2012.

Interest only is payable under the original terms of the Convertible Note at the rate of 1% per month by the Company to the holder. The Convertible Note was originally convertible at a price of $.0068 per share subject to a downward adjustment if the Company issues common stock below such price as long as the Convertible Note is outstanding (anti-dilution protection). The Warrant gives the holder the right to purchase up to 3,676,471 shares of the Company s common stock at a price of $.0068 per share subject also to a downward adjustment for anti-dilution protection.

The Company and the holder had negotiations with respect to a final repayment arrangement of the Convertible Note. The Company has issued the holder 18 million shares of its common stock for repayment through a conversion and the holder has disputed the conversion and the amount of shares issued in satisfaction of the obligation.

All proceeds received in connection with the above financing have been used by the Company as working capital.

At the time of the transaction, the embedded conversion feature of this security and the warrant was calculated to be $4,660 and the debt discount totaled the same.

The Company has taken the position that during the year ended June 30, 2012 this note was converted in full together with accrued interest of $1,900 for 18,000,000 shares of common stock. During the year ended June 30, 2012 amortization of debt discount amounted to $4,660 reducing the balance to $0.

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 each year ended June 30, 2002 through June 30, 2009 and the balance sheet data as of June 30, 2002 through June 30, 2009 are derived from financial statements that have been audited by Rosenberg Rich Baker Berman & Company. The statement of operations data for the years ended June 30, 2011 and 2012and the balance sheet data as of June 30, 2011 and 2012 are derived from financial statements that have been audited by Demetrius & Company, L.L.C.

SUMMARY OPERATING DATA
Year Ended June 30,
(in thousands except per share data)

		Fiscal Years Ended June 30,										
		2008		**2009**		**2010**		**2011**		**2012**		**from inception October 2, 1996 to 30-Jun-12**
Total Revenues	$	108	$	187	$	354	$	49	$	1	$	745
Cost of Sales		0		0		66		50		15		131
Research and Development		988		1,256		2,203		626		53		12,311
General and administrative		4,021		9,554		1,845		1,823		7,921		35,151
Depreciation and amortization		145		34		25		15		14		593
Operating Loss		(5,046)		(10,637)		(3,785)		1,875		(8,002)	$	(47,440)
Other income (expense) net		2,379)		(3,118)		(118)		2,120		(446)	$	(8,480)
Interest income (expense)		(215)		(1,321)		(3,463)		(141)		(344)	$	(2,971)
Discontinued Operations		(501)				-		245		5		(144,539)
Net Loss	$	(3,383)	$	(15,096)	$	(7,366)	$	(486)	$	(8,787)	$	(203,431)
Continuing per share	$	(0.01)	$	(0.03)	$	(.01)	$	(.00)	$	(.00)		
Discontinued per share	$	(0.00)	$	(0.00)	$	0	$	(.00)	$	(.00)		
Weighted Average shares		405,032,339		592,455,950		1,041,685,519		1,402,130,735		2,789,725,412		

outstanding

BALANCE SHEET DATA
in $000's

	2008	2009	2010	2011	2012
Cash and cash equivalents	$ 16	$ 100	$ 228	$ 2	$ 40
Working capital (deficit)	$ (3,853)	$ (3,991)	$ 201	$ (2,705)	$ (3,691)
Total assets	$ 2,351	$ 3,489	$ 5,844	$ 235	$ 186
Long-term obligations, net of current portion	$ 1,595	$ 4,433	$ 28	$ 16	$ 3
Total stockholders' (deficit)	$ (3,238)	$ (5,234)	$ (7,884)	$ (5,592)	$ (5,503)

Selected Quarterly Financial Information

The statement of operations data as of the quarterly periods indicated below are derived from unaudited financial statements on Form 10Q filings, and include all adjustments (consisting of normal recurring items) that management considers necessary for a fair presentation of the financial statements.

FISCAL 2012 QUARTERLY STATEMENT OF OPERATIONS DATA:	Three Months Ended September 30,	December 31,	March 31,	June 30,
	(in thousands, except share amounts)			
Total revenues	$ 0	$ 1	$ 0	$ 0
Costs and Expenses:				
Cost of sales	1	1	0	0
Research and development	41	10	1	1
General and administrative	6,888	346	359	328
Depreciation and amortization	4	4	4	2
Operating loss	(6,934)	(360)	(364)	(331)
Interest expense, Net	(71)	(44)	(72)	(157)
Other Income (expense)	826	534	(370)	(1,436)
Discontinued operations				5
Net (Loss) Income	$ (6,179)	$ 130	$ (806)	$ (1,919)
Basic net (loss) gain per share-				
Continuing operations	$ 0	$ 0	$ 0	$ 0
Discontinued operations	$ 0	$ 0	$ 0	$ 0
Diluted net (loss) gain per share-				
Continuing operations	$ 0	$ 0	$ 0	$ 0
Discontinued operations	$ 0	$ N/A	$ N/A	$ N/A
Shares used in basic net loss per share	2,053,984,273	2,765,647,479	2,971,015,232	3,419,465,827
Shares used in diluted net loss per share	N/A	3,608,180,728	N/A	N/A

Includes certain reclassification from previous reported amounts

FISCAL 2011 QUARTERLY STATEMENT OF OPERATIONS DATA:	Three Months Ended September 30,	December 31,	March 31,	June 30,
	(in thousands, except share amounts)			
Total revenues	$ 29	$ 1	$ 18	$ 1
Costs and Expenses:				
Cost of sales	9	5	37	(1)
Research and development	193	141	111	180
General and administrative	523	446	455	398
Depreciation and amortization	3	4	4	4
Operating loss	(701)	(595)	(589)	(580)
Interest expense, Net	(30)	(25)	(26)	(60)
Other Income (expense)	2,725	(100)	(709)	204
Discontinued operations				
Net (Loss) Income	$ 1,994	$ (720)	(1,324)	(436)
Basic net (loss) gain per share-				

Continuing operations	$	0	$	0	$	0	$	0
Discontinued operations	$	0	$	0	$	0	$	0
Diluted net (loss) gain per share-								
Continuing operations	$	0	$	0	$	0	$	0
Discontinued operations	$	0	$	N/A	$	N/A	$	N/A
Shares used in basic net loss per share		1,189,554,845		1,226,037,125		1,456,690,423		1,602,502,264
Shares used in diluted net loss per share		1,713,140,738		N/A		N/A		N/A

FISCAL 2010 QUARTERLY STATEMENT OF OPERATIONS DATA:	Three Months Ended September 30,	December 31,	March 31,	June 30,
	(in thousands, except share amounts)			
Total revenues	$ 52	$ 34	$ 142	$ 126
Costs and Expenses:				
Cost of sales	0	0	2	63
Research and development	515	579	712	397
General and administrative	421	489	453	482
Depreciation and amortization	5	7	7	7
Operating loss	(889)	(1041)	(1032)	(823)
Interest expense, Net	(681)	(42)	(33)	(31)
Other Income (expense)	1173	(2417)	1959	(3508)
Discontinued operations	0	0	0	0
Net (Loss) Income	$ (397	$ (3,500	$ 894	$ (4,362
Basic net (loss) gain per share-				
Continuing operations	$ (0.01	$ (0.01	$ 0.00	$ (0.01
Discontinued operations	$ -	$ -	$ -	$ -
Diluted net (loss) gain per share-				
Continuing operations	$ (0.01)	$ (0.01)	$ 0.00	$ (0.01)
Discontinued operations	$ -	$ -	$ -	$ -
Shares used in basic net loss per share	934,821,600	934,821,600	1,057,751,508	1,084,251,619
Shares used in diluted net loss per share	934,821,600	934,821,600	1,534,563,992	1,084,251,619

Includes certain reclassification from previous reported amounts

FISCAL 2009 QUARTERLY STATEMENT OF OPERATIONS DATA:	Three Months Ended September 30,	31-Dec	March 31,	June 30,
	(in thousands, except share amounts)			
Total revenues	$ 6	$ 45	$ 44	$ 92
Costs and Expenses:				
Cost of sales	-	-	-	-
Research and development	388	216	265	386
General and administrative	6,239	499	430	2,387
Depreciation and amortization	13	13	4	4
Operating loss	(6,634)	(683)	(655)	(2,685)
Interest expense, Net	(39)	(61)	(74)	(1,146)
Other Income (expense)	355	(1,845)	73	(1,702)
Discontinued Operations	-	-	-	-
Net Loss	(6,318)	$ (2,589)	$ (656)	$ (5,533)
Basic and diluted net (loss) gain per share-				
Continuing Operations	(0.01)	$ (0.01)	$ -	$ (0.01)
Discontinued Operations	$ -	$ -	$ -	$ -
Shares used in basic and diluted net loss per share	452,895,360	452,895,360	671,278,600	786,484,581

FISCAL 2008 QUARTERLY	Three Months Ended			
STATEMENT OF OPERATIONS DATA:	September 30,	December 31,	March 31,	June 30, (As Restated)
	(in thousands, except share amounts)			
Total revenues	$ 35	$ 61	$ 1	$ 10
Costs and Expenses:				
Cost of sales	0	1	0	0
Research and development	560	285	277	(134)
General and administrative	1,497	985	576	974
Depreciation and amortization	34	81	21	9
Operating loss	(2,056)	(1,291)	(873)	(833)
Interest expense, Net	(12)	(38)	(145)	(20
Other Income (expense)	(718)	1,436	(2,487)	3,653
Discontinued Operations	-	-	-	(5)
Net (Loss) Income	$ (2,786)	$ 107	$ (3,505)	$ 2,801
Basic and diluted net (loss) gain per share				
Continuing operations	$ (0.01)	$ 0	$ (0.01)	$ 0
Discontinued operations	$ -	$ -	$ -	$ -
Shares used in basic and diluted net loss per share	389,791,154	392,557,583	397,367,531	418,881,266

Includes certain reclassification from previous reported amounts

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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 Technologies, Inc. (OTC BB: XDSL.OB) is a development company focused on the development of innovative power cells and related products through the science of microfluidics, microelectromechanical systems (MEMS) and nano- technology. mPhase is primarily focused on commercializing its first nanotechnology-enabled product for military and commercial applications - the Smart NanoBattery providing Power On CommandTM. Our new patented and patent-pending battery technology, based on the phenomenon of electrowetting, offers a unique way to store energy and manage power that could revolutionize the battery industry. Features of the Smart NanoBattery include potentially infinite shelf life, environmentally friendly design, fast ramp to power, programmable control, and direct integration with microelectronic devices.

The platform technology behind the Smart NanoBattery is a porous nanostructured material used to repel and precisely control the flow of liquids. The material has a Smart Surface that can potentially be designed for heart pacemakers and other medical devices.

mPhase's Smart NanoBattery technology has been incorporated in leading-edge research and development projects supported by various groups within the U.S. Army for mission critical static random access memory (SRAM) backup and guided munitions applications. In July 2007, m Phase received a Small Business Technology Transfer (STTR) Program Phase I grant for $100,000 from the U.S. Army and in September 2008, was awarded a prestigious $750,000 (net $500,000) Phase II STTR grant to continue battery development work for the SRAM project. That award was renewed in 2009 for a second year. The company has also been working with the U.S. Army as part of a Cooperative Research and Development Agreement (CRADA). mPhase has focused on development of a lithium Smart NanoBattery. Working closely with Rutgers University, mPhase introduced the first version of the lithium Smart NanoBattery designed for portable electronics and microelectronic applications.

One version of the lithium battery based on a breakable separator was developed for an emergency flashlight application.

New Products developed during Fiscal Year 2012

The Company began development of a second automotive product as an addition to its consumer product line consisting of the emergency illuminator. The Company outsourced the design, engineering and development of the product and it is anticipated that announcement of the new product will occur during fiscal year 2013 to preserve the Company s first to market advantage. The Company incurred approximately $300,000 in development costs and has received a series of prototypes of the product. The roll-out of the product will depend upon the Company s financial resources during fiscal year 2013.

TWELVE MONTHS ENDED JUNE 30, 2012 VS. JUNE 30, 2011

Revenues. Total revenues for the year ended June 30, 2012 decreased from $ 49,210 in 2011 to $1,502 in 2012. The revenue for the current fiscal year was derived primarily from payments received by the Company under the Phase II STTR grant from the United States Army and from sales of the mPower emergency illuminator.

Cost of sales. Cost of sales decreased $35,740 for the year ended June 30, 2012 to $14,520. In addition, grants and fees received in connection with our Nanotechnology power cell have relatively low associated cost of sales.

Research and Development. Research and development expenses were $53,374 for the year ended June 30, 2012 as compared to $625,417 in the year ended June 30, 2011, a decrease of $572,043. Such decrease is attributable to the Company s completion of both a mechanically-activated reserve battery and emergency flashlight in addition to substantial completion of research on its SmartNanoBattery product.

General and Administrative Expenses. Selling, general and administrative expenses were $7,921,189 for the year ended June 30, 2012, up from $1,823,178 for the comparable period in 2011, an increase of $6,098,011. During fiscal year ended June 30, 2012, the Company incurred non-cash charges amounting to $6,645,300 for stock based compensation awarded to officers, employees and consultants. During fiscal year ended June 30, 2011, such charges amounted to $62,945, an increase of $6,582,355 in fiscal year ended June 30, 2012. This increase was offset, in part, by the reduction of salaries of employees in fiscal year ended June 30, 2012 resulting in lower payroll by approximately $356,458 as compared to the payroll for fiscal year ended June 30, 2011. Expenses were reduced across the board, including a reduction in travel expense of $28,211 and consulting expense of $55,148.

Other Income and Expense. During the current FYE 2012 non-cash charges included $0 for reparations, and net settlement income of $2,782. During the prior FYE 2011 non-cash charges included $0 for reparations, and net settlement income of $8,915. In addition during FYE 2012, the Company realized a non-cash net loss of approximately $320,480 compared to a non-cash net gain of $1,866,669 in FYE 2011 resulting from the issuance and the changes in the derivative liability values relative to convertible debt. The current FYE 2012 includes a gain resulting from a change in derivative value of $1,047,148 offset in part by amortization of debt discount of $298,014, stock issuance costs and other charges including conversion floor fees and charges of $1,069,614. This compares to prior FYE 2011 which includes a gain resulting from the change in derivative value of $4,068,545 offset in part by amortization of debt discount, stock issuance costs and other charges including a $55,000 extension and forbearance fee and a $28,000 intervention fee amounting to $2,319,318.

Net loss. mPhase recorded a net loss of $8,786,952 for the year ended June 30, 2012 as compared to a loss of $486,391 for the same period ended June 30, 2011. This represents a loss per common share of ($.00) in 2012 as compared to $(.00) in 2011, based upon weighted average common shares outstanding of 2,789,725,412 and 1,402,130,735 during the periods ending June 30, 2012 and June 30, 2011 respectively.

CURRENT PLAN OF OPERATIONS

The Company is actively pursuing both military and commercial applications of its smart surface technology. The Company is actively seeking a strategic partner and is developing a significant working relationship with Stevens Institute in helping to identify new STTR and SIBR technology development grants from the U.S. government. The Company, subject to financial resources, is also seeking to become a member of a major Technology Cluster located in Grenoble, France and thereby partner with a large multinational corporation to custom tailor its Smart NanoBattery as a component for a commercial or military end product. The Company, subject to available capital, will seek to significantly increase sales of its current product, the mPower Emergency Illuminator, and to enhance profitability of this product by offering a cost reduced version containing a modified primary battery with extended shelf life instead of its proprietary Eagle Picher designed mechanically activated lithium reserve battery. In March 2011, the Company received an initial order from Porsche Design Group in Germany for mPhase's Porsche design branded mPower

Emergency illuminators to be sold in Porsche Design stores in Germany, Great Britain and the United States and it began shipments of the Emergency Illuminators in April of 2011. As previously noted, the Company, during fiscal year ended June 30, 2012, began development of a second automotive consumer product expected to be announced in fiscal year 2013.

Expanded Market Potential for Proprietary Membrane Technology

The core membrane technology used to enable the Smart NanoBattery's propriety membrane design can potentially be used to develop other non-power source applications and products. The Company's market potential for using the membrane design of this patent pending core technology broadens the application areas outside the portable power energy field.

The Company's permeable membrane design consisting of both micro and nano scale silicon features is coated with a monolayer chemistry used to repel liquids. The membrane works using a microfluidics principle that permits the dynamic control of surfaces when interacting with liquids, and as a result, the membrane can be tuned to filter out certain types of materials. In the reserve battery application, the properties of the membrane are used to create a superhydrophobic surface that prevents the battery s electrolyte from coming into contact with the dry electrodes of the battery until activation. In a similar way, the membrane can be designed so that it can control the passing of liquids through the pores of the membrane, acting as a filter, allowing and restricting materials to pass through the membrane. This ability opens up the potential to use the membrane's design in new configurations for applications that require controlled filtering of materials used in the health, environmental, food services, as well as other industries.

RESEARCH AND DEVELOPMENT

mPhase throughout its history has outsourced its research and development activity with respect to all of its product lines. The Company engaged the Bell Labs division of Lucent Technologies in February of 2004 to develop a power cell using the science of nanotechnology. The Company terminated its development efforts with Lucent Bell Labs in fiscal year 2008 with respect to micro power cell products using the science of nanotechnology since the facilities at Bell Labs were only able to provide development of zinc based batteries. The Company determined that in order to develop a commercially viable product, higher energy lithium based batteries were required and it established a research relationship with Rutgers University that has facilities capable of handling development of lithium batteries.

From March of 2005 through March of 2007, the Company, pursuant to the terms of a Project Development Agreement engaged Bell Labs to develop a magnetometer or electronic sensor products using the science of nanotechnology. The Company did not renew this Project Development Agreement in order to conserve financial resources. No further development has occurred on the magnetometer; however, the Company believes that the intellectual property created may have significant value in the future depending upon further scientific progress in the field and market developments.

Since inception, but prior to the end of fiscal year 2006, the Company incurred $13.5 million for research and development conducted by Georgia Tech Research Corporation in connection with its legacy Traverser DVDDS technology that was a proprietary end to end solution of hardware and software enabling telecommunications service providers to delivery broadcast television, high-speed internet and voice over copper telephone lines. Expenditures for discontinued Traverser DVDDS product are included in discontinued operations. In fiscal year 2003 the Company began the transition of its product to development of a carriers standard open platform using middleware platform and transferred its research and development from Georgia Tech Research Corporation to the Bell Labs division of Lucent Technologies Inc. In May of 2007, the Company decided not to renew its Project Development Agreement for its TV+ solution with Bell Labs and chose a number of new software vendors to finalize its IPTV solution. The Company incurred research and development expenses with Lucent for fiscal years ended June 30, 2007 and 2006 of $2.3 million and $4.4 million. It should be noted that all expenditures during with Lucent/Bell Labs in FYE 2007 have been in connection with nanotechnology.

During the year ended June 30, 2008, the Company incurred research and development expenses of $188,000 related to the development of IPTV solutions compared to $4.1 million for the same period ended June 30, 2007. Expenditures for the IPTV discontinued product are included in discontinued operations . In addition the Company incurred research and development expenses for the fiscal year June 30, 2008 of $800,000 for its nanotechnology products as compared to $2.3 million for fiscal year ended June 30, 2007.During the fiscal year ended June 30, 2009, the Company incurred research and development expenses of $1,255,655, all of which was in connection with its nanotechnology, manually activated battery and emergency flashlight products. During the fiscal year ended June 30, 2010, the Company incurred research and development expenses of $2,203,383 and during the fiscal years ended June 30, 2011 and 2012, such research and development expenses amounted to $625,417 and $53,374.

During the years ended June 30, 2009, June 30, 2010 and June 30, 2011 the Company was primarily engaged in joint research and development with Rutgers University in connection with a $750,000 Phase II STTR grant from the United States Army for development of a reserve battery with an extended shelf life suitable for serving as a backup energy source for a computer memory application. In addition, during such period significant design services were provided by Porsche Design Studio in connection with the development of the Company s emergency flashlight product.

During fiscal year ended June 30, 2012 the Company commenced research, design and development of a prototype of a second new innovative automotive product with an initial cost of approximately $300,000.

The amount of research and development costs the Company has expended on its current technology, from its inception through June 30, 2012, is $12,310,936.

STRATEGIC ALLIANCES IMPLEMENTED

The Company and Lucent share jointly in certain intellectual property developed with respect to nanotechnology products. The Company has established a working relationship with Rutgers University for development and testing of lithium based batteries. In addition, the Company has a co-branding agreement with Porsche Design Studio for its emergency flashlight product.

CRITICAL ACCOUNTING POLICIES

RESEARCH AND DEVELOPMENT

Research and development costs are charged to operations as incurred in accordance with FASB ASC Topic 730 Research and Development, formerly Statement of Financial Accounting Standards ("SFAS"), No.2, "Accounting for Research and Development Cost."

OPTIONS, WARRANTS AND OTHER CONVERTIBLE EQUITY INSTRUMENTS

STOCK BASED COMPENSATION

Effective, July 1, 2005, the Company adopted the promulgated authority "modified prospective" method, and has recorded as an expense the fair value of all stock based grants to employees after such date. The Company has not restated its operating results for any prior fiscal year end or quarter.

EQUITY LINE OF CREDIT

The Company entered into a $10,000,000 equity line of Credit with Dutchess Opportunity Fund II, LLC in December of 2011. Under the equity line, the Company is eligible to PUT to the fund, 20,000,000 shares of its common stock during any pricing period. The Company has registered a total of 250,000,000 shares of its common stock on a Form S-1 Registration Statement with the Securities and Exchange Commission that was declared effective on January 17, 2012 in connection with the Dutchess Equity Line.

As of June 30, 2012, the Company has received $145,428 of proceeds under the Equity Line relating to the resale of 89,587,447 shares of the Company s common stock, net of $13,500 transaction fees. The amount of proceeds to be received under the Equity Line will depend upon the stock price of the Company at the various points in time it exercises the Put Option. (SEE NOTE 13-Subsequent events)

MATERIAL EQUITY INSTRUMENTS

The Company has material equity instruments including convertible debentures and convertible notes that are accounted for as derivative liabilities and options and warrants that are evaluated quarterly for potential reclassification as liabilities pursuant to FASB ASC Topic 815 Derivatives and Hedging previously known as EITF 00-19 (SEE ALSO NOTE 8 "Stockholders Equity" under the caption "Other Equity"). The Company utilized a sequencing method prescribed by ASC Topic 815, based upon applying shares available to contracts with the earliest inception date first.

Subsequent to September 30, 2009 the Company has not entered into, and presently the Company did not have, any contracts for warrants or other equity instruments subject to reclassification to liabilities as prescribed by FASB ASC Topic 815 (previously known as EITF 00-19) until August 10,2011, when it entered into a Convertible Note of $25,000 that concurrently provided the note holder with a warrant and recorded an additional liability for the warrant.

DERIVATIVE FINANCIAL INSTRUMENTS

Presently promulgated accounting literature requires all derivatives to be recorded on the balance sheet at fair value. The conversion features of the convertible debentures are embedded derivatives and are separately valued and accounted for on our balance sheet with changes in fair value recognized during the period of change as a separate component of other income/expense. Fair values for exchange-traded securities and derivatives are based on quoted market prices. The pricing model we use for determining fair value of our derivatives is the Black-Scholes Pricing Model with a 20 day life for the look-back period of each conversion feature using volatility of 100%. Valuations derived from this model are subject to ongoing internal and external verification and review. The model uses market-sourced inputs such as interest rates and stock price volatilities. Selection of these inputs involves management's judgment and may impact net income.

REPARATION EXPENSE

As an incentive for additional equity contributions, the Company will, from time to time, adjust the cost of past private purchases of common stock through the issuance of additional shares in such magnitude as to reduce an investor's cost to an average price that more closely approximates current market value. The market value of additional shares issued without cash investment is charged to Reparation Expense, which is included in Other Expenses.

LIQUIDITY AND CAPITAL RESOURCES

Through June 30, 2012, the Company had incurred development stage losses totaling approximately $203,430,907 and had cash and cash equivalents of $39,913. At June 30, 2012, mPhase had a working capital deficit of $(3,690,779) as compared to a working capital deficit of $(2,705,943) as of June 30, 2011.

In addition, on June 23, 2011, the common stock of the Company ceased to be eligible for fast trading by investors by the Depository Trust Company that handles the clearance of all securities in the United States. As a result the liquidity of the Company s common stock has contracted and financing the Company exclusively through such instruments may be limited in the future. The Company believes that supplemental private placements of equity will enable it to satisfy short-term liquidity.

In December of 2011, the Company entered into a $10,000,000 equity line of credit with Dutchess Opportunity Fund II, LLC. Under the equity line, the Company is eligible to PUT to the fund 20,000,000 shares of its common stock during any pricing period. The Company has registered a total of 250,000,000 shares of its common stock on a Form S-1 Registration Statement with the Securities and Exchange Commission that was declared effective on January 17, 2012. As of June 30, 2012, the Company has received $145,428 of proceeds under the equity line from the resale of 89,587,447shares of the Company s common stock, net of $13,500 transaction fees. The amount of proceeds to be received under the equity line will depend upon the stock price of the Company and the various points in time it exercises its Put option.

On June 6, 2012 the Company announced the restructuring of all of its convertible securities that were issued to JMJ Financial and John Fife of approximately $1,500,000. The result of the restructuring is that such debt is now 8% fixed rate debt payable in equal monthly payments over a two year period of time commencing October of 2012. The monthly payments that must be made by the Company amount to approximately $70,000 per month. The Company intends to raise funds in the equity private placement market and though its equity line of credit to meet this obligation as well as short term operating needs.

In the longer term, we estimate that the Company will need to raise approximately $5-10 million of additional capital above the funds anticipated from the monthly funding s and conversions by holders of revised or replacement convertible securities, to meet longer term liquidity needs through June 30, 2013. Such monies will be necessary primarily to fund future operating expenditures as well as marketing, cost-reductions and commercialization of its Smart NanoBattery and automotive products. Finally, depending upon sales and margins in fiscal year 2013, additional capital may be required to fund a portion of any growth necessary in operations.

Cash used in operating activities was $1,091,944 during the twelve months ended June 30, 2012. During such period, the cash used by operating activities consisted principally of the net loss ($8,786,952) plus non-cash credits related to convertible debt issued and associated changes in derivative value ($2,116,064) reduced by an increase of accounts payable and accrued expenses of $61,008. These amounts are offset in part by non-cash charges related to issuance of common stock and options for services of $6,645,300.

During the twelve-month period ended June 30, 2012, the Company raised capital through private placements with accredited investors, whereby the Company issued 170,000,000 shares of the Company's common stock, generating net proceeds to the Company of $140,000.

During the twelve-month period ended June 30, 2011, the Company raised capital through private placements with accredited investors, whereby the Company issued 67,500,000 shares of the Company's common stock, generating net proceeds to the Company of $265,500.

Equity Conversions of Debt and Other Financial Instruments with Related Parties

Conversion of debt with related parties and strategic vendors during the periods enumerated is as follows: During the fiscal years ended June 30, 2011 and June 30, 2012, there were no equity conversions of debt or other financial instruments with related parties.

		2010		2011		2012
Janifast:						
Number of shares		NONE		NONE		NONE
Number of warrants		NONE		NONE		NONE
Amount converted to equity	$	NONE	$	NONE	$	NONE
Microphase Corporation:						
Number of shares		26,666,667		NONE		NONE
Number of warrants		0		NONE		NONE
Amount converted to equity	$	200,000	$	NONE	$	NONE
Strategic Vendor Conversions:						
Number of shares		NONE		NONE		NONE
Number of warrants		NONE		NONE		NONE
Amount converted to equity	$	NONE	$	NONE	$	NONE
Officers						
Number of shares		NONE		NONE		NONE
Number of warrants (A)		NONE		NONE		NONE
Amount converted to equity	$	NONE	$	NONE	$	NONE
Total Related Party Conversions						
Number of shares		26,666,667		NONE		NONE
Number of warrants		0		NONE		NONE
Amount converted to equity	$	200,000	$	NONE	$	NONE

LOSSES DURING THE DEVELOPMENT STAGE AND MANAGEMENT'S PLANS

As noted above, through June 30, 2012, the Company incurred development stage losses totaling approximately $203,430,907 and at June 30, 2012 had a working capital deficit of $(3,690,779). Funding in our traditional capital markets was difficult during FYE 2012. Management of the Company desired to avoid unnecessary dilution by issuing large amounts of equity at depressed prices to raise larger sums of cash. The Company was able to enter into an equity line of credit with Dutchess Capital to provide liquidity and capital resources during the year.

The Company renegotiated its convertible debt arrangements whereby $1,532,365 of its $1,606,523 convertible debt, otherwise convertible into approximately 1,857,316,902 shares of the Company s common stock based upon terms as of June 30, 2012, will not be subject to conversion through October, 2012 and thereafter through fiscal 2013 so long as the Company makes scheduled payments of principle and interest of approximately $70,000 per month. The Company has also significantly reduced employee compensation, in many instances by as much as 20%, effective July 2010. In addition and from time to time the Company has raised necessary working capital via bridge loans from officers (see notes payable to officers). 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, (3) continue its efforts to commercialize and sell and receive military grants for its SmartBattery, and (4) commercialize and sell its emergency flashlight.

The Company is currently focused on development and commercialization of its emergency flashlight product as well as the further development of its smart nano battery in both single and multi-cell form. The Company believes that these reserve batteries which have a much longer shelf life than conventional batteries will have significant commercial and military applications which the Company intends to actively pursue. The Company has temporarily suspended, to conserve financial resources, development of its magnetometer sensor devices, also developed using the science of nanotechnology.

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, 2012. 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

See pages beginning page 77.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES Assessment of Internal Controls Evaluation of Disclosure Controls and Procedures

The Company has implemented disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act) that are designed to ensure that information required to be disclosed in the Company s Exchange Act reports are recorded, processed, summarized, and reported within the time periods specified in rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of June 30, 2012, the management of the Company carried out an assessment, under the supervision of and with the participation of the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15(b) and 15d-15(b). As of the date of this assessment, the Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective as of June 30, 2012.

Management s Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America. The Company utilizes the COSO Framework for internal control over financial reporting. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company s assets that could have a material effect on the interim or annual financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

The Company s management assessed the effectiveness of the Company s internal control over financial reporting as of June 30, 2012. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company s annual or interim financial statements will not be prevented or detected on a timely basis. Our evaluation concluded that the company had no material weakness which would result in the reasonable possibility of a material misstatement described above.

This report does not include an attestation report of our registered public accounting firm regarding our internal controls over financial reporting. The disclosure contained under this Item 9A was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only the disclosure under this Item 9A in this annual report.

Changes in Internal Control over Financial Reporting

The Company has made steps toward remediating the internal control condition identified in the fiscal year June 30, 2009, described above. The Company has obtained, on a fee basis, an outside consultant to act as an accounting manager to assist the Company with the accounting of convertible debentures and derivatives and the consultant was utilized during all four quarters of the fiscal year ended June 30, 2012. However, mPhase Technologies is a small company with a total staff of approximately 6 employees and consultants. This size limits, and may continue to limit, the Company s ability to provide for adequate backup of financial personnel. Accordingly, efforts individually and in the aggregate may be insufficient to fully eliminate the condition that could adversely affect the organization s ability to record, summarize and report financial data consistent with the assertions of management in the financial statements.

There were no changes in our internal control over financial reporting during the fiscal year ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

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, 2012are as follows:

NAME	AGE	POSITION(S)
Ronald A. Durando	55	Chief Executive Officer and Director
Gustave T. Dotoli (2)	75	Chief Operating Officer and Director
Martin Smiley	64	Chief Financial Officer
OUTSIDE DIRECTORS		
Anthony H. Guerino (1)(2)	65	Director
Abraham Biderman (1)(2)	64	Director
Dr. Victor Lawrence	63	Director

(1) Member of the Audit Committee
(2) Member of the Compensation Committee

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 a Director of Microphase Corporation. From 1986-1994, Mr. Durando was President and Chief Executive Officer of Nutley Securities, Inc., a registered broker-dealer. Mr. Durando also served as president of PacketPort until his resignation in February, 2008, when PacketPort merged with Wyndstorm Corporation.

GUSTAVE T. DOTOLI has served as mPhase's Chief Operating Officer as well as 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 was also a Director and Vice President of Packet Port. He was 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.

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. He currently is the Managing Director of Eagle Advisers, Inc, a small investment banking firm. From 1990 through September 30, 2003, Mr. Biderman had 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.

MARTIN SMILEY was elected on June 28, 2006 to the Board of Directors. He 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.

DR VICTOR LAWRENCE is Batcheler Chair Professor of Electrical Engineering and Associate Dean for Special Programs in the Charles V Schafer, Jr. School of Engineering, at Stevens Institute of Technology. Dr. Victor Lawrence is a member of the National Academy of Engineering and has worked in the information technology and communications field for over thirty years. He is an industry leader in digital communications R&D and services, an entrepreneur, an active member of engineering professional organizations, an author, and a teacher who has extensive international experience. Prior to joining Stevens Institute of Technology, Dr. Lawrence was Vice President, Advanced Communications Technology, Bell Laboratories, Lucent Technologies. He led the development of technologies that go into the most innovative, reliable, and cost-effective communications networks for the leading telecommunications service providers. He has supported Lucent's businesses with a staff of about 500 leading technologists and a budget of about $100M. Major projects included gigabit, photonic, and wireless networking developments and services. He was responsible for a team of engineers that worked on performance analysis, simulations and development of broadband access and backbone networks for many national and international service providers. All of Lucent's R&D organizations relied on his high-technology support of computer-aided hardware design, physical and thermal design, systems compliance testing and certification, and design for high performance network control, signaling, and management. Earlier, he was Director, Advanced Multimedia Communications at Bell Labs, where he was responsible for systems engineering, exploratory development of multimedia signal processing, transmission, and switching, including speech and audio coding, modems, broadband transmission, ATM switching and protocols, and wireless communication and signal processing. He held a variety of leadership positions in data communications research, digital techniques, and information systems. His application of digital signal processing to data communications in the late 1980s and early 1990s led to many significant advances in high-speed transmission over copper lines (e.g., voice band modems and DSL), which helped create a global industry that leverages the public switched telephone network. Dr. Lawrence played a significant role in the development of major international voiceband modem standards, making high-speed data communication over international networks possible. The universal availability of high-speed data connectivity stimulated the growth and widespread use of the Internet. He led the development of high-speed modem/fax chip sets that are used in data terminals, computers, and voice terminals for secure communications worldwide. His work on high-speed transceivers for local loop and for premises applications led to the development of a variety of DSL technologies, many of which are deployed today for broadband services. As an entrepreneur, Dr. Lawrence spun off several ventures internal and external to Lucent to maximize the impact of technology developed in his organization.

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 event a director resigns or is removed from office, or continues until a successor director is elected and qualified.

SECTION 16 (A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Directors, executive officers, and individuals 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 2012 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 2012. All the officers and directors filed all of the required forms in a timely manner.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth, for the fiscal year ended June 30, 2012 and the two previous fiscal years, the compensation earned by mPhase's chief executive officer and the 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, 2012.

SUMMARY EXECUTIVE COMPENSATION

NAME& PRINCIPAL POSITION	YEAR	SALARY	BONUS	STOCK AWARDS	OPTION AWARDS	NON-EQUITY INCENTIVE	PENSION VALUE	OTHER	TOT
Ronald	**2012**	$ 110,000	$ 0	$ 2,488,500(2)	$ 173,316(3)	N/A	N/A	$ 54,681(1)	$ 164,6
Durando	**2011**	$ 160,000	$ 0	$ 0	$ 0	N/A	N/A	$ 33,728(1)	$ 193,7
Chief Executive Officer	**2010**	$ 200,000	$ 0	$ 0	$ 0	N/A	N/A	$ 56,486(1)	$ 256,4
Gustave	**2012**	$ 107,333	$ 0	$ 1,858,500(2)	$ 103,952(3)	N/A	N/A	$ 36,103(1)	$ 143,4
Dotoli	**2011**	$ 144,000	$ 0	$ 0	$ 0	N/A	N/A	$ 18,610(1)	$ 162,6
Chief Operating Officer	**2010**	$ 180,000	$ 0	$ 0	$ 0	N/A	N/A	$ 39,375(1)	$ 219,3
Martin	**2012**	$ 106,667	$ 0	$ 1,858,500(2)	$ 62,394(3)	N/A	N/A	$ 26,744(1)	$ 133,4
Smiley	**2011**	$ 140,000	$ 0	$ 0	$ 0	N/A	N/A	$ 16,569	$ 156,5
CFO and General Counsel	**2010**	$ 175,000	$ 0	$ 0	$ 0	N/A	N/A	$ 24,536	$ 199,5

FOOTNOTES

(1) Interest on loans to the Company.

(2) Share grants are valued at the share price on the date the grant was authorized by the board of directors. The shares under the 2011 grant to officers are restricted from resale through August, 2015.

(3) Directors revised the exercise price of options to purchase up to 98,000,000 shares of common stock previously granted to officers in September, 2008 (originally exercisable for 5 years with an exercise price of 5 cents per share). The exercise price of options to purchase up to 98,000,000 shares was revised to $.0040; the incremental cost of $339,700 was recorded as deferred compensation which will be amortized to expense through September 18, 2013.

OUTSTANDING EQUITY AWARDS at FISCAL YEAR END JUNE 30, 2012

	Number of Securities underlying Unexercised Options (Exercisable)	Number of Securities underlying Unexercised Options (Unexercisable)	Equity Incentive Plan awards Number of Securities	Option Exercise Price	Option Expiration Date	Number of shares of stock that has not been vested	Market Value of Shares not vested	Equity Incentiv
Ronald Durando	50,000,000			$ .004	9/16/2013			
President				$				
CEO								
				$				
				$				
				$				
				$				

		$ $		
Gustave Dotoli COO	30,000,000	$ $ $ $ $ $ $	.004	9/16/2013
Martin Smiley Executive VP CFO Chief Legal Council	18,000,000	$ $ $ $ $ $	.004	9/16/2013

EMPLOYMENT AGREEMENTS WITH EXECUTIVE OFFICERS

The Company does not have written employment agreements with any of the named Executive Officers.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The members of the Compensation Committee during fiscal 2012 were Messrs. Dotoli, Biderman and Guerino. Neither Messrs. Biderman nor Guerino has been an mPhase officer or employee. 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 2012 that has a director or executive officer serving also as a director on mPhase's Board of Directors. Mr. Dotoli, together with Mr. Durando and Mr. Ergul, were collectively controlling shareholders and Directors of Janifast Ltd. In March of 2009, Janifast Ltd. terminated operations.

COMPENSATION OF DIRECTORS

No Directors received compensation for their services as a Director.

AUDIT COMMITTEE

No members of the Audit Committee received compensation for their services on the Committee.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth as of July 26, 2012 certain information regarding the beneficial ownership of our shares:

1 by each person who is known by us to be the beneficial owner of more than five percent (5%) of our outstanding common stock;

2 each of our directors;

3 by each executive officer named in the Summary Compensation Table; and

4 by all of our directors and executive officers as a group.

AFFILIATES (1 & 2)	Shares	Warrants/ conversion rights	Options	TOTAL	%
Victor Lawrence	10,100,000	-	200,000	10,300,000	0.25%
Anthony Guerino	-	-	260,000	260,000	0.01%
Abraham Biderman	45,226,890	-	2,160,000	47,386,890	1.16%
Gustave Dotoli (3)	318,107,805	93,101,823	30,000,000	441,209,628	10.84%
Ron Durando (3)	452,241,922	128,836,205	50,000,000	631,078,127	15.50%
Ned Ergul	2,850,000	-	450,000	3,300,000	0.08%
Martin Smiley (3)	313,760,629	75,449,895	18,000,000	407,210,524	10.00%
Microphase Corporation(4) (5)	42,726,686	-	-	42,726,686	1.05%
Total Affiliates	1,185,013,932	297,387,923	101,070,000	1,583,471,855	38.90%

(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 beneficially owned by them. The percentage for each beneficial owner listed above is based on 4,071,051,851 shares outstanding on July 26, 2012, and, with respect to each person holding options or warrants to purchase shares that are exercisable within 60 days after July 26, 2012, 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 ownershi p of any other person.

(3) Includes as warrants 128,836,205 shares, 93,101,823 shares and 75,449,895 shares issuable for unpaid compensation and loans plus accrued interest, if converted, for Messrs. Durando, Dotoli and Smiley respectively. Such conversions are subject to availability of authorized shares. On April 27, 2009, and amended as of August 25, 2011; the board of directors consolidated all amounts outstanding for all obligations to the officers, including unpaid compensation, and authorized the issuance of new notes with a term of five years, an interest rate of 12% and a conversion feature at a price of $.0040 on amounts outstanding plus accrued interest thereon. During the fiscal years ended June 30, 2009, June 30, 2010 and 2012, the Company recorded $914,060, $82,609 and $2,360, respectively, of beneficial interest expense with respect to the conversion feature.

(4) Messrs. Ergul and Durando and certain members of their families may be deemed to exercise shared majority voting and dispositive power for Microphase Corporation through their indirect ownership interests in Microphase

Holding Company, LLC which owns 88.4% of Microphase common stock. The holding company is owned 43.9% by the Ergul Family Limited Partnership, which is wholly owned by Mr. Ergul, his wife and daughters, and 50% by Edson Realty Inc. which is 83% owned by Mr. Durando, 12% by Mr. Ergul and 5% by three unrelated shareholders. Mr. Durando owns an additional 1.6% of Microphase common stock in his individual name.

(5) Includes 26,666,667 shares issued in June 2009 in connection with which the Company, during the quarter ended September 30, 2009, recorded $586,667 in beneficial interest expense in respect of the conversion of $200,000 of accounts payable.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Material Related Party Transactions

The Company has material related party transactions. The Company incurs costs for engineering, design and production of prototypes and certain administrative functions from Microphase Corporation. Prior to March, 2008, it had purchased finished goods, primarily consisting of DSL splitter shelves and filters, from Janifast Limited.

Mr. Durando, President and CEO of mPhase, owns a controlling interest and is a director and President of Janifast Limited. Mr. Durando and Mr. Dotoli are officers of Microphase Corporation. Mr. Dotoli was also a shareholder of Janifast Limited prior to its discontinuing operations in March of 2009. Mr. Ergul owns a controlling interest and is a director of Microphase Corporation and is a director and shareholder of Janifast Limited. Microphase Corporation and Janifast Ltd. are significant shareholders of mPhase.

Mr. Abraham Biderman is a Managing Director of Eagle Advisers, Inc., a firm that performs investment banking services for the Company and was employed until September 30, 2003, by our former investment banking firm Lipper & Company.

Management believes the amounts charged to the Company by Microphase and Janifast Ltd. are commensurate with amounts that would be incurred if outside parties were used. The Company believes Microphase Corporation has the ability to fulfill its obligations to the Company without further support from the Company.

Transactions with Officers, Directors and their Affiliates

Directors that were significant shareholders of Janifast Limited prior to its ceasing operations in March of 2009 included Messrs. Durando and Dotoli

Total compensation and payables to related parties and to officers is summarized below:

Summary of compensation to related parties for the Twelve Months Ended June 30, 2012

	Durando	Dotoli	Smiley	Biderman	Microphase	Total
Consulting / Salary	$ 110,000	$ 107,333	$ 106,667			$ 324,000
Interest	$ 54,681	$ 36,103	$ 26,744			$ 117,528
Rent					$ 43,560	$ 43,560
G&A					$ 7,225	$ 7,225
R&D						$ 0
Finders Fees				$ 18,000		$ 18,000
Stock based compensation (shares issued)	$ 2,488,500	$ 1,858,500	$ 1,858,500	$ 252,000	$ 63,000	$ 6,520,500
Stock based compensation (options issued)	$ 173,316	$ 103,990	$ 62,394			$ 339,700
Total compensation for the Twelve Months Ended June 30, 2012	**$ 2,826,497**	**$ 2,105,926**	**$ 2,054,305**	**$ 270,000**	**$ 113,785**	**$ 7,370,513**

Summary of compensation to related parties for the Twelve Months Ended June 30, 2011

	Durando	Dotoli	Smiley	Biderman	Microphase	Total
Consulting / Salary	$ 160,000	$ 144,000	$ 140,000			$ 444,000
Interest	$ 33,728	$ 18,610	$ 16,569			$ 68,907

Rent					$ 36,000	$ 36,000
G&A					$ 9,356	$ 9,356
R&D						$ 0
Finders Fees				$ 24,500		$ 24,500
Total compensation	**$ 193,728**	**$ 162,610**	**$ 156,569**	**$ 24,500**	**$ 45,356**	**$ 582,763**

Summary of compensation to related parties for the Twelve Months Ended June 30, 2010

	Durando	Dotoli	Smiley	Biderman	Microphase	Total
Consulting / Salary	$ 200,000	$ 180,000	$ 175,000			$ 555,000
Interest	$ 56,483	$ 39,375	$ 24,356			$ 120,214
Rent					$ 36,000	$ 36,000
G&A					$ 9,936	$ 9,936
R&D					$ 337,500	$ 337,500
Finders Fees				$ 25,000		$ 25,000
Total compensation	**$ 256,483**	**$ 219,375**	**$ 199,356**	**$ 25,000**	**$ 383,436**	**$ 1,083,650**

Summary of payables to related parties as of June 30, 2012	**Durando**	**Dotoli**	**Smiley**	**Total Notes Payable**	**Biderman**
Notes payable	$ 456,573	$ 333,663	$ 273,177	$ 1,063,413	
Accrued Wages Officers	$ 29,167	$ 29,167	$ 10,417		
Due to Officers / Affiliates					$ 150,000
Interest Payable	$ 58,771	$ 38,745	$ 28,623	$ 126,139	
Total Payable to Officers / Affiliates as of June 30, 2011	**$ 544,511**	**$ 401,575**	**$ 312,217**	**$ 1,189,552**	**$ 150,000**

Summary of payables to related parties as of June 30, 2011	Durando	Dotoli	Smiley	Total Notes Payable	Biderman	Microphase	Total
Notes payable	$ 263,479	$ 148,306	$ 111,030	$ 522,815			$ 522,815
Due to Officers / Affiliates					$ 150,000	$ 27,242	$ 177,242
Interest Payable	$ 151,685	$ 120,498	$ 80,725	$ 352,909			$ 352,909
Total Payable to Officers / Affiliates	**$ 415,164**	**$ 268,804**	**$ 191,755**	$ **875,724**	**$ 150,000**	**$ 27,242**	**$ 1,052,966**

In July of 2009, Microphase Corporation converted $200,000 of Accounts Payable owed by the Company into common stock valued at $.0075 per share (26,666,667 shares). Such price was determined based upon the price of private placements of equity by the Company during such period.

On October 7, 2009, the Company paid Messrs. Durando, Dotoli and Smiley $45,000, $45,000 and $25,000 respectively in reduction of amounts owed to them by the Company for unpaid compensation and bridge loans.

During the twelve months ended June 30, 2010, the Company incurred finders fees of $25,000 with Mr. Biderman s affiliated firm of Palladium Capital Advisors. Mr. Biderman was employed until September 30, 2003, by our former investment banking firm, Lipper & Company. As of June 30, 2010, the Company owed Palladium Capital Advisors $25,000 in unpaid finders fees.

During the twelve months ended June 30, 2011 and 2012, the Company incurred additional finders fees of $24,500 and $13,000 with Mr. Biderman s firm Eagle Strategic Advisers.

During the twelve months ended June 30, 2007, Mr. Biderman, through his affiliated firm of Palladium Capital Advisors, earned finder's fees of $520,000 in connection with the raising of approximately $5 million in various equity transactions during the year.

In addition, at various points during fiscal year ended June 30, 2007, Messrs. Durando, Dotoli and Smiley provided $650,000 in bridge loans to the Company which was evidenced by individual promissory notes. During December 2006, Messrs. Durando and Dotoli agreed to convert their notes, in the amounts of $130,000 and $200,000 respectively, to a deferred compensation arrangement, the repayment terms of which have not been specified. Mr. Smiley has extended bridge loans to the Company of $160,000, evidenced by promissory notes for $101,000 and a $60,000 note with a 12% rate of interest. In summary as of June 30, 2007, bridge loans outstanding were $85,000, $75,000 and $161,000 to the Messrs. Durando, Dotoli and Smiley, respectively. All of the foregoing promissory notes were payable on demand and only the $161,000 payable to Mr. Smiley remained outstanding in June 2008. As of June 30, 2010, only $110,030 payable to Mr. Smiley remained outstanding.

During the 12 month period ended June 30, 2006, Eagle Advisers, an investment banking firm founded by Mr. Biderman earned fees and reimbursement expenses of approximately $782,568 in connection with services in regard to private placements of the Company's common stock and warrants and raised a total of $5,820,652 net of such fees for the Company.

During the fiscal year ended June 30, 2006, Mr. Edward Suozzo, a consultant of the Company, converted $50,000 of accounts payable owed by the Company into 331,864 shares of common stock plus a 5 year warrant to purchase 277,778 shares of common stock at $.18 per share. During fiscal year ended June 30, 2005, Mr. Suozzo converted $20,000 of accounts payable owed by the Company into 100,000 shares of common stock plus a 5 year warrant to purchase 100,000 shares of common stock at $.25 per share.

During fiscal year ended June 30, 2006, Microphase Corporation and Janifast Corp., both related parties, respectively converted $369,000 and $171,000 of accounts payable owed by the Company into 2,050,000 and 950,000 shares of common stock plus a 5 year warrant to purchase 2,050,000 and 950,000 shares of common stock at $.18 per share.

Effective June 30, 2004, the Company was $473,787 in arrears with respect to a promissory note issued to Piper Rudnick LLP plus other legal fees of $118,773.36. It should be noted that Piper & Rudnick, the Company s outside counsel, received such promissory note in March of 2002 plus two warrants that expired in March 8, 2007 in exchange for cancellation of certain payables. Such warrants had conversion rights into our common stock for a total of 2,233,490 shares that had been registered under a Form S-1 Registration Statement, and were cashless. On September 3, 2003, in exchange for reducing the total payable to $550,000, the Company paid $10,000 in cash to Piper and issued an additional cashless warrant for $150,000 worth of the Company's common stock valued at $.25 per share. The remaining $300,000 payable had the following future payment schedule: payments of $25,000 each on December 1, 2004, March 1, 2005, June 1, 2005, September 1, 2005, March 1, 2006, June 1, 2006 and September 1, 2006, a payment of $50,000 on December 1, 2005, and a payment of $75,000 due on December 1, 2006. On August 30, 2004, the Company paid $100,000 to Piper & Rudnick, LLP in connection with the renegotiation of a Payment Agreement effective June 30, 2004. Under the terms of the renegotiated Payment Agreement, the Company agreed to payments of $25,000 each on December 1, 2004, March 1, 2005, June 1, 2005 and September 1, 2005 and a payment of $50,000 on December 1, 2006 plus $25,000 payments on March 1, 2006, June 1, 2006, September 1, 2006 and a final payment of $75,000 payment on December 1, 2007. In addition, Piper & Rudnick LLP agreed to convert $150,000 of such payable into a 5 year cashless warrant to purchase the Company's common stock at $.25 per share. The Company has made all of the above payments except for $65,000 of the $75,000 due December 1, 2006, that is presently in arrears.

Necdet F. Ergul, Ronald A. Durando and Gustave T. Dotoli are executive officers and shareholders of Microphase and Ronald Durando and Gustave T. Dotoli served as president and vice- president of PacketPort.com., respectively until Packetport.com merged with Wyndstorm Corporation in February of 2008, at which time Mr. Durando and Mr. Dotoli resigned from their respective positions..

On November 26, 1999, PacketPort, Inc., a company owned 100% by Mr. Durando, acquired a controlling interest in Linkon Corp., which subsequently changed its name to PacketPort.com, Inc. In connection with this transaction, Mr. Durando transferred 350,000 shares of our common stock to PacketPort, Inc.

Transactions with Microphase Corporation

mPhase's President and Chairman of the Board of the Company are also employees of Microphase. On May 1, 1997, the Company entered into an agreement with Microphase whereby it would use office space as well as the administrative services of Microphase, including the use of accounting personnel. This agreement for fiscal year 2011 required mPhase to pay Micophase $3,000 per month. Microphase also charges fees for specific projects on a project-by-project basis. During the year ended June 30, 2012 and for the period of time from mPhase's inception (October 2, 1996) to June 30, 2012, $50,785 and $9,528,746, respectively, have been charged to expense or inventory under these Agreements and is included in discontinued operations in the accompanying consolidated statements of operations. Management believes that amounts charged to the Company by Microphase are commensurate with amounts that would be incurred if outside third parties were used. 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.

Mr. Durando, President and CEO of mPhase, owns a controlling interest and is a director and President of Janifast Limited. Mr. Durando and Mr. Dotoli are officers of Microphase Corporation. Mr. Dotoli was also a shareholder of Janifast Limited prior to its discontinuing operations in March of 2009. Mr. Ergul owns a controlling interest and is a director of Microphase Corporation and is a director and shareholder of Janifast Limited. Microphase Corporation is a significant shareholder of the Company. Janifast Limited had been a significant shareholder of the Company until September 17, 2009, when it transferred to Mr. Durando 11,735,584 shares, representing all the shares of the Company held by Janifast, in partial consideration of the cancellation of loan obligations to Mr. Durando in connection with the plan of its liquidation.

Transactions with Janifast

Janifast Ltd., a Hong Kong corporation manufacturer, had produced components for our now discontinued Traverser_ DVDDS product. 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. Janifast Ltd. ceased operations in March, 2009, and the Company has had no transactions with Janifast during or since its fiscal year ended June 30, 2010.

Reparation Shares issued to related parties

During the fiscal year ended June 30, 2006, the Company issued 3,931,382 shares valued at $728,434 and 4,504,542 shares valued at $834,633 for reparation of investments of $200,000 for 1,000,000 shares and $250,000 for 1,250,000 shares made during fiscal year ended June 30, 2005 by Janifast and Microphase, respectively, concurrently on the same terms reparations were issued to other investors of the same private placements.

During the fiscal year ended June 30, 2007, Janifast was issued 769,231 shares valued at $138,462 for reparation of an investment of $171,000 for 950,000 shares issued for an investment made in fiscal year ended June 30, 2006, concurrently on the same terms reparations were issued to other investors of the same private placement.

Transactions with Other Related Parties

In March 2000, mPhase acquired a 50% interest in mPhaseTelevision.Net (formerly Telco Television Network, Inc.), an incorporated joint venture. This percentage was increased to approximately 57% in fiscal year 2001. Alpha Star International, Inc. currently owns the remaining joint venture interest. The joint venture has been inactive for a period of five years and is in the process of being dissolved.

Mr. Durando, President and CEO of mPhase, owned a controlling interest and was a director and President of Janifast Limited. Mr. Durando and Mr. Dotoli are officers of Microphase Corporation. Mr. Dotoli was also a shareholder of Janifast Limited prior to its discontinuing operations in March of 2009. Mr. Ergul owns a controlling interest and is a director of Microphase Corporation and is a director and shareholder of Janifast Limited.

Microphase Corporation is a significant shareholder of the Company. Janifast Limited had been a significant shareholder of the Company until September 17, 2009, when it transferred to Mr. Durando 11,735,584 shares, representing all the shares of the Company held by Janifast, in partial consideration of the cancellation of loan obligations to Mr. Durando in connection with the plan of its liquidation.

SUBSEQUENT EVENTS

On July 11, 2012, the Company prepaid $53,888 in cash to Asher Enterprises, Inc. to redeem, in full, its Convertible Promissory Note in Asher Agreement II, funded on January 11, 2011 in the principal amount of 35,000, together with a prepayment fee of $17,500 and accrued interest thereon of $1,388.

Through July 24, 2012, the Company has completed transactions in a private placement of its common stock to 8 accredited investors pursuant to Rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933, as amended. The Company received net proceeds of $155,500, made available for working capital, and paid placement fees of $6,500 in connection with the issuance of 405,000,000 shares of its common stock. The Company is continuing such Private Placement until early October of 2012 with the goal of raising up to $150,000 additional gross proceeds to be used as working capital in exchange for approximately 375,000,000 shares of its common stock with accredited investors.

On August 15, 2012, the Company put 20,000,000 shares to Dutchess Capital under the terms of its Investment Agreement covering the Company s Equity Line of Credit. Through August 31, 2012 Dutchess has resold approximately 5,500,000 shares that are anticipated to generate approximately $4,000 of working capital to the Company.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

Audit Fees

The audit fees billed by our accounting firm of Demetrius & Company, L.L.C. for fiscal years ended June 30, 2011 and June 30, 2012 were $55,800 and $55,000.

Audit Related Services

The fees billed for audit related services for the fiscal year ended June 30, 2012 were $5,000. There were no audit related services for the fiscal year ended June 30, 2011.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this Form 10-K (1) Consolidated Financial Statements

(2) Financial Statement Schedules None.

(3) The Exhibits filed with this Form 10-K or, where so indicated by footnote in the case of previously filed exhibits, incorporated by reference are as set forth below:

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 the Company.
3.2***	Bylaws of the Company
4.1*	Minutes of Special Meeting of the Board of Directors held on April 27, 2009, authorizing convertibility of officers promissory notes. (Amendment No. 4 to Form 10-K for the period ended June 30, 2010, filed January 11, 2011 (file no. 000-30202))
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)).
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)).

10.9* 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 Preliminary Proxy on Schedule 14A filed on March 21, 2001 (file no. 000- 30202).
10.18***	Development Agreement effective February 3, 2004 between Lucent Technologies, Inc. and mPhase Technologies, Inc for development of micro fuel cell Nano Technology.
10.21***	Development Agreement effective March 1, 2005 between Lucent Technologies Inc and mPhase Technologies relating to development of Magnetometers.
10.22***	Amendment No. 2 to Development Agreement executed as of March 9, 2005 amending Development Agreement effective as of February 5, 2004, as amended relating to Micro Power Source Cells between mPhase Technologies, Inc. and Lucent Technologies, Inc.
10.33***	Amendment No. 3 dated May 19, 2006 to Development Agreement between Lucent Technologies, Inc. and mPhase Technologies, Inc. effective February 3, 2004 for Development of micro fuel cell Nanotechnology.
10.34***	Amendment No. 4 dated February 3, 2007 to Development Agreement between Lucent Technologies, Inc. and mPhase Technologies, Inc. effective February 3, 2004 for Development of micro fuel cell Nanotechnology.
10.35***	Cooperative Research Agreement Rutgers University and mPhase Technologies, Inc. executed October 18, 2005.
10.36***	Modification No. 1 to Cooperative Research Agreement with Rutgers University dated February 22, 2006.
10.37***	Modification No. 2 to Cooperative Research Agreement with Rutgers University dated September 22, 2006.
10.38***	Modification No. 3 to Cooperative Research Agreement with Rutgers University dated February 7, 2007.
10.40***	CT NanoBusiness Alliance Consulting Agreement dated May 10, 2007.
10.41***	Amendment No.5 dated April 28, 2007 to Development Agreement between Lucent Technologies, Inc. and mPhase Technologies, Inc. effective February 3, 2004 for Development of micro fuel cell Nanotechnology.
10.43*	Cooperative Research and Development Agreement between US Army Picatinny Arsenel and mPhase Technologies, Inc. dated December 20, 2006. (Exhibit 43 to Form S-1 filed July 12, 2007, File No. 333-144527).
10.44***.	Small Business Technology Transfer Collaboration Agreement between Rutgers University and mPhase Technologies, Inc. dated June 25, 2007
10.46*	Phase I Army Grant dated July 7, 2007 (Form 10-K filed October 7, 2009, Commission File No. 000-24969)
10.47*	Securities Purchase Agreement dated December 11, 1007 between mPhase Technologies, Inc. and Golden Gate Investors and Related Documents in connection with $1,500,000 Convertible Debenture Financing (Form 10-K filed October 7, 2009, Commission File No. 000-24969)
10.48*	Securities Purchase Agreement dated February 29, 2008 between St. George Investments and mPhase Technologies, Inc and Related Documents in connection with $550,000 Convertible Debenture Financing. (Form 10-K filed October 7, 2009, Commission File No. 000-24969)
10.49*	Documentation including $350,000 Convertible Note and $1,000,000 Convertible Note and Secured Note for $1,000,000 Financing between mPhase Technologies, Inc. and JMJ Financial dated March 25, 2008 (Form 10-K filed October 7, 2009, Commission File No. 000-24969)
10.52*	Phase II Army Grant dated August 29, 2008 (Form 10-K filed October 7, 2009, Commission File No. 000-24969)
10.53*	Securities Purchase Agreement dated September 12, 2008 between mPhase Technologies, Inc. and La Jolla Cove Investors and Related Documents in connection with $2,000,000 Convertible Debenture Financing (Form 8K filing dated September 18, 2008)
10.54*	Design Development Agreement between mPhase Technologies, Inc. and Porsche Design Studio for Emergency Flashlight dated November 3, 2008. (Form 8K filed on March 12, 2009) **
10.55*	Documentation dated December 31, 2008 for $1,100,000 Convertible Note and Secured Note Financing between mPhase Technologies, Inc. and JMJ Financial and Amendment to $350,000 Convertible Note

	Financing (Form 8K Filing dated January 21, 2009, Commission File No. 000-24969)
10.56*	Eagle Picher Proposal for mPhase Technologies, Inc. dated January 26, 2009 for design and development of mechanically- activated Reserve Battery to be used in Emergency Flashlight. (Form 8-K filed January 30, 2009)**
10.57*	Termination Agreement with Golden Gate Investors dated March 17, 2009 with respect to Convertible Debenture Financing dated December 11, 2007 (Form 10-K filed October 7, 2009, Commission File No. 000-24969)
10.59*	Documentation including $1,870,000 Convertible Note and Secured Note for Financing with JMJ Financial dated August 21, 2009 (Form August 21, 2009, Commission File No. 000-24969)
10.60*	Documentation including two $1,200,00 Convertible Notes executed September 23, 2009 and November 17, 2009 and Secured Notes r connection with financing with JMJ Financial (Form Amendment No. 3 to Form 10Q for the period ended December 31, 2009 file Septe Commission File No. 000-30202)
10.61*	Promissory Notes Payable to Mr. Durando (Amendment No. 4 to Form 10-K for the period ended June 30, 2010, filed January 11, 2011 30202))

10.62*	Promissory Notes Payable to Mr. Dotoli (Amendment No. 4 to Form 10-K for the period ended June 30, 2010, filed January 11, 2011 (fil 10.63*Promissory Notes Payable to Mr. Smiley (Amendment No. 4 to Form 10-K for the period ended June 30, 2010, filed January 11, 2011 (fi 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
10.63*	Promissory Notes Payable to Mr. Smiley (Amendment No. 4 to Form 10-K for the period ended June 30, 2010, filed January 11, 2011 (Commission File No. 000-30202))
10.64*	Forbearance Agreement dated as of September 13, 2011 between mPhase Technologies, Inc. and John Fife (Exhibit 99.1 to Form 8k filed September 16, 2011, (Commission file No. 000-24969))
10.65*	Securities Purchase Agreement, dated as of September 13, 2011 between mPhase Technologies, Inc and John Fife (Exhibit 99.2 to Form 8k filed September 16, 2011, (Commission file No. 000-24969))
10.66*	Officer s Certificate delivered pursuant to Securities Purchase Agreement, dated as of September 13, 2011 between mPhase Technologies, Inc. and John Fife (Exhibit 99.3 to Form 8k filed September 16, 2011, (Commission file No. 000- 24969))
10.67*	Confession of Judgment 1 delivered pursuant to Securities Purchase Agreement, dated as of September 13, 2011 between mPhase Technologies, Inc. and John Fife (Exhibit 99.4 to Form 8k filed September 16, 2011, (Commission file No. 000- 24969))
10.68*	Confession of Judgment 2 delivered pursuant to Securities Purchase Agreement, dated as of September 13, 2011 between mPhase Technologies, Inc. and John Fife (Exhibit 99.5 to Form 8k filed September 16, 2011, (Commission file No. 000- 24969))
10.69*	Registration Rights Agreement dated as of September 13, 2011 between mPhase Technologies, Inc. and John Fife (Exhibit 99.6 to Form 8k filed September 16, 2011, (Commission file No. 000-24969))
10.70*	Convertible Note dated September 13, 2011issued by mPhase Technologies, Inc. to John Fife (Exhibit 99.7 to Form 8k filed September 16, 2011, (Commission file No. 000-24969))
10.71*	Convertible Note dated August 11, 2011 issued by mPhase Technologies to Jay Wright (Exhibit 10.71 to Amendment No.4 to Form S-1 filed January 17, 2012(Commission File No. 333-77248))
10.72 *	Warrant dated August 11, 2011 issued by mPhase Technologies to Jay Wright (Exhibit 10.72 to Amendment No.4 to Form S-1 filed January 17, 2012(Commission File No. 333-77248))
10.73*	Investment Agreement for Equity Line of Credit dated as of November 30, 2011 between mPhase Technologies, Inc. and Dutchess Opportunity Fund L.L.P. (Exhibit 10.73 to Amendment No.4 to Form S-1 filed January 17, 2012(Commission File No. 333-77248))
10.74*	Registration Rights Agreement for Equity Line of Credit dated as of November 30, 2011 between mPhase Technologies, Inc. and Dutchess Opportunity Fund II L.L.P. (Exhibit 10.74 to Amendment No.4 to Form S-1 filed January 17, 2012(Commission File No. 333-77248))
10.75*	Securities Purchase Agreement dated as of November 17, 2011 between Asher Enterprises, Inc. and mPhase Technologies, Inc.(Exhibit 99.1 to Form 8K filed November 30, 2011 (Commission file No. 000-24969))
10.76*	8%Convertible Note issued to Asher Enterprises, Inc. dated November 17, 2011 by mPhase Technologies, Inc.(Exhibit 99.2 to Form 8K filed November 30, 2011 (Commission file No. 000-24969))
10.77*	Securities Purchase Agreement dated as of January 5, 2012 between Asher Enterprises, Inc. and mPhase Technologies, Inc.(Exhibit 99.1 to Form 8K filed January 17, 2012 (Commission file No. 000-24969))
10.78*	8%Convertible Note issued to Asher Enterprises, Inc. dated January 5, 2012 by mPhase Technologies, Inc.(Exhibit 99.2 to Form 8K filed January 17, 2012 (Commission file No. 000-24969))
10.79	Securities Purchase Agreement dated as of May 4, 2012 between Asher Enterprises, Inc. and mPhase Technologies, Inc.
10.80	8%Convertible Note issued to Asher Enterprises, Inc. dated May 4, 2012 by mPhase Technologies, Inc.

10.81* Stand Still and Restructuring Agreement entered into as of May 31,2012 with John Fife (Exhibit 99.1 to Form 8K filed June 5, 2012 pany. In 1999, Mr. Lance was named Executive Vice President with operating responsibility for its Electronics and Telecommunications businesses. Earlier, Mr. Lance held sales and marketing positions with the Scott-Fetzer Company and Caterpillar, Inc. Mr. Lance has been a member of the board of directors of Harris since January 2003. Mr. Lance is also a director of Eastman Chemical Company and serves on the Board of Trustees of the Aerospace Industries Association, the Manufacturers Alliance/MAPI, Inc., the Florida Council of 100, the United Way of Brevard County and the Florida Institute of Technology.

Dr. Mohsen Sohi
Class of Director: Class B Director
Appointed By: Harris Corporation

Dr. Sohi, 47, is, and has served since 2003, as President and Chief Executive Officer of Freudenberg-Nok, a privately-held joint venture partnership between Freudenberg & Co. of Germany and NOK Corp. of Japan, the world s largest producer of elastomeric seals and custom molded products for automotive and other applications. From 2001 through 2003, he was President, Retail Store Automation Division of NCR Corporation and from 1986 through 2001, he served in various senior positions at Honeywell/Allied Signal Inc., including President, Honeywell Electronic Materials and President, Honeywell Commercial Vehicle Systems.

Dr. James C. Stoffel
Class of Director: Class B Director
Appointed By: Harris Corporation

Dr. Stoffel, 60, currently serves on the board of directors of Harris where he has been a member since August 2003 and sits on its Finance Committee and Management Development and Compensation Committee. Prior to his retirement, Dr. Stoffel was Senior Vice President, Chief Technical Officer and Director of Research and Development of Eastman Kodak Company, a film and digital imaging company. He held this position from 2000 to April 2005. He joined Kodak in 1997 as Vice President, Director Electronic Imaging Products Research and Development and became Director of Research and Engineering in 1998. Prior to joining Kodak, he was with Xerox Corporation where he began his career in 1972. His most recent position with Xerox was Vice President, Corporate Research and Technology. He is currently Chairman of the Board of Aster Wireless, Inc. Dr. Stoffel is also a trustee of the George Eastman House museum. He serves on the Advisory Board for Research and Graduate Studies at the University of Notre Dame and is Chairman of the Board of the Information Technologies Industries Association and a member of the advisory board of ASTRI, Hong Kong.

Edward F. Thompson
Class of Director: Class A Director
Appointed By: Stratex Networks, Inc.

Mr. Thompson, 69, was a member of the board of directors of Stratex from November 2002 until the combination of the Microwave Communications Division and Stratex. He chaired its Audit Committee and served on its Nominating and Corporate Governance Committee. Mr. Thompson has been a consultant to Fujtsu Labs of America since 2002. From 1976 to 1994, he held executive positions at Amdahl Corporation, including Chief Financial Officer and Corporate Secretary and Chairman and CEO. Mr. Thompson also held positions at U.S. Leasing International, Inc., Computer Sciences Corporation, IBM and Lockheed Missiles and Space Company. Mr. Thompson has served as a director or advisor to a number of companies including Fujitsu, Ltd. and several of its subsidiaries, SonicWALL Inc. and ShoreTel, Inc., a voice-over-IP PBX company. He is on the advisory boards of Diamondhead Ventures, LLP and Santa Clara University s Leavey School of Business.

Of the five directors to be appointed by Harris, Harris has agreed that until the second anniversary of the combination of the Microwave Communications Division and Stratex at least one must meet the independence requirements for directors serving on an audit committee as prescribed by the NASDAQ rules and one must not be an employee of Harris or any of its subsidiaries (without regard to Harris Stratex or any of its subsidiaries). Of the four directors to be appointed by Stratex, Stratex has agreed that two must meet the independence requirements for directors serving on an audit committee as prescribed by the NASDAQ rules.

Officers of Harris Stratex

The following individuals hold the positions at Harris Stratex identified below:

Guy M. Campbell
Position at Harris Stratex: Chief Executive Officer
Previous Position: President, Microwave Communications Division, Harris Corporation

See the biographical information for Guy M. Campbell under *Management Board of Directors of Harris Stratex* on page 61 of this prospectus. Mr. Campbell holds, and will continue to hold, equity interests in Harris, including grants of stock options or other equity awards received as an employee of Harris.

Sarah A. Dudash
Position at Harris Stratex: Chief Financial Officer
Previous Position: Vice President and Controller, Microwave Communications Division, Harris Corporation

Ms. Dudash, 52, joined the Microwave Division of Harris Corporation as Division Controller in October, 2003 and was promoted to Vice-President, Controller of the Microwave Communications Division in September, 2006. She has over 20 years of experience in financial management in both the public and private sectors.

From March 1999 until October 2003, Ms. Dudash was Business Unit Controller for the Integrated Information Communication Systems Business Unit of the Government Communications Systems Division of Harris.

Ms. Dudash began her career with Deloitte Haskins & Sells. She has a bachelor s degree in general studies and an MBA degree from the University of Pittsburgh and is a licensed certified public accountant in the State of Florida. Ms. Dudash holds, and will continue to hold, equity interest in Harris, including grants of stock options or other equity awards received as an employee of Harris.

Robert W. Kamenski
Position at Harris Stratex: Corporate Controller
Previous Position: Corporate Controller, Stratex Networks, Inc.

Mr. Kamenski, 52, joined Stratex in March 2006 as Corporate Controller. Prior to joining Stratex he was Vice President of Finance for GoRemote Internet Communications, Inc. from April 2004 to February 2006, and Chief Financial Officer for Iridex Corporation from March 1997 to August 2003. Earlier in his career, Mr. Kamenski also held various management positions at Tandem Computers (now a division of Hewlett Packard) and was an audit supervisor for Touche Ross & Co. (now combined with Deloitte and Touche LLP). He is a member of the American Institute of CPAs and the Silicon Valley Chapter of Financial Executives International. Mr. Kamenski received an M.B.A. from Santa Clara University and holds a B.B.A. degree in Accounting from the University of Wisconsin, Milwaukee.

Paul A. Kennard
Position at Harris Stratex: Chief Technical Officer
Previous Position: Vice President Products and Chief Technology Officer, Stratex Networks, Inc.

Mr. Kennard, 55, joined Stratex in April 1996 as Vice President, Engineering. In December 2004, he was appointed Vice President, Corporate Marketing and Chief Technology Officer and currently serves as Vice President, Products and Chief Technology Officer. Prior to joining Stratex, Mr. Kennard was with California Microwave Corporation, a satellite and wireless communications company, where he served as a Director of the Signal Processing Technology, and as Senior Vice President of Engineering for the Microwave Network Systems Division.

Thomas H. Waechter
Position at Harris Stratex: Chief Operating Officer
Previous Position: Chief Executive Officer, Stratex Networks, Inc.

Mr. Waechter, 54, became President and Chief Executive Officer of Stratex effective May 18, 2006.

Mr. Waechter joined the board of directors of Stratex as an independent director on December 1, 2005. He is a technology veteran with more than twenty years experience. Mr. Waechter held a number of senior management roles over 14 years at Schlumberger Ltd., an international services company. Recently, he served as President and Chief Executive Officer of REMEC, a wireless communications manufacturer from July 2004 until December 2005. Prior to that, he was President and Chief Operating Officer of REMEC from December 2002 until July 2004. From March 2000 until December 2002, Mr. Waechter was President and Chief Executive Officer of Spectrian Corporation, which was acquired by REMEC. Mr. Waechter currently serves on the Endowment Board of the College of William and Mary. He has a bachelor s degree in business administration from the College of William and Mary in Virginia.

Juan Otero
Position at Harris Stratex: General Counsel and Secretary
Previous Position: General Counsel and Assistant Secretary, Stratex Networks, Inc.

Mr. Otero, 42, joined Stratex in July 2002 as Director of Legal Affairs. He was promoted to General Counsel in July of 2004 and to General Counsel and Assistant Secretary in February of 2005. Prior to joining Stratex, Mr. Otero was Director and Senior Counsel for Compaq Computer Corporation and the Hewlett-Packard Company, and Corporate Counsel for Hitachi Data Systems. Mr. Otero has also practiced law both in the private and public sectors. Mr. Otero holds a B.A. degree in International Relations from the University of California, Davis, and a J.D. from the University of Colorado, School of Law.

Other officers of Harris Stratex will be appointed from time to time in accordance with its certificate of incorporation and bylaws by its board of directors and management team.

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Compensation of Directors and Executive Officers

Director Compensation

Harris Stratex s board of directors has approved the following schedule of fees payable to non-executive directors and Committee chairs:

Annual retainer	$	30,000
Meeting fees:		
In-person board meetings	$	3,000
Telephonic meetings	$	1,500
In-person committee meetings	$	2,000
Telephonic committee meetings	$	1,000
Chair annual retainers:		
Audit Committee	$	10,000
Corporation Committee	$	8,000
Governance Committee	$	5,000
Chairman of the Board of Directors	$	10,000

The retainer fees are payable quarterly. Harris Stratex will reimburse the directors reasonable travel expenses to board meetings, including expenses such as supplies, and the education costs, including travel for one course per year.

Each director will receive an initial grant of restricted shares with a value of $90,000 upon commencement of the director s service, and an annual grant of restricted shares with a value of $60,000 for each year of service on the board of directors.

The shares will vest at a rate of 25% per quarter over the year following the date of grant. In addition, a director may elect to receive the annual retainer fee in the form of shares of restricted stock. All shares will be issued under Harris Stratex s 2007 Stock Equity Plan pursuant to a form of agreement approved by the compensation committee of Harris Stratex s board of directors but have not been granted yet.

Mr. Campbell, Harris Stratex s President and Chief Executive Officer, and Mr. Lance, the Chairman of the Board, President and Chief Executive Officer of Harris, are not eligible for equity awards and will not be paid directors fees.

Compensation Plans, Contracts and Arrangements with Covered Officers

In connection with the completion of the transactions contemplated by the Combination Agreement and the appointment of new directors and officers named above, the board of directors of Harris Stratex approved the following compensation plans, contracts and arrangements:

Charles D. Kissner

Harris Stratex and Stratex entered into a Non-Competition Agreement dated as of January 26, 2007 with Charles D. Kissner, Stratex s former Chairman of the Board of Directors under which Mr. Kissner agreed not to compete with the business conducted by Stratex for one year commencing on the later of the date of termination of his employment with Stratex and the closing date under the Combination Agreement, Harris Stratex agreed to pay Mr. Kissner $330,000 in two equal installments six and 12 months after the commencement of the non-competition period, and Stratex and Mr. Kissner amended his employment agreement dated May 14, 2002 to eliminate the obligation to pay him the target bonus otherwise due upon a change of control of Stratex. The severance payments provided under Mr. Kissner s employment agreement with Stratex and related matters are described in the proxy statement/prospectus, included in the S-4, which disclosure is incorporated by reference in response to this item.

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Guy M. Campbell

Harris Stratex entered into an at will employment agreement dated as of January 26, 2007 with Guy M. Campbell. The terms of Mr. Campbell s compensation are set forth in the table below under the caption Executive Compensation Packages.

Under the terms of his employment agreement, if Mr. Campbell s employment is terminated without cause, or he is prevented from performing his duties as CEO and President of Harris Stratex due to a disability for more than six consecutive months and his employment is terminated, or he resigns for good reason (other than for good reason following a change of control) he will receive benefits as described below:

severance payments at his final base salary (offset by any disability income payments) for a period of 30 months following his termination; such payments will be subject to applicable withholding and made in accordance with Harris Stratex s normal payroll practices;

payment of premiums necessary to continue his group health insurance under COBRA or to purchase other comparable health insurance coverage on an individual or group basis when he is no longer eligible for COBRA coverage until the earlier of (1) the date on which he reaches the age of 65 or (2) the date on which he first becomes eligible to participate in another employer s group health insurance;

if he is terminated without cause Harris Stratex will pay the prorated portion of any incentive bonus that he would have earned during the incentive bonus year in which his employment was terminated;

the right to purchase all vested shares of Harris Stratex s common stock subject to outstanding options granted to him until the earlier of (1) 30 months and (2) the date on which the applicable option(s) expire; and

outplacement assistance selected and paid for by Harris Stratex.

The employment agreement also provides that within 18 months following the completion of a change of control (as defined in the employment agreement) if Mr. Campbell s employment terminates without cause, or Mr. Campbell resigns for good reason following a change of control, the benefits provided in the employment agreement will vest upon his termination or resignation, and he will be entitled to receive the same severance benefits from Harris Stratex listed above, except:

he will receive severance payments at his final base salary (offset by any disability income payments) for a period of 42 months following his termination;

Harris Stratex will accelerate the vesting of all unvested stock options as of the date of his termination;

the right to purchase all vested shares of Harris Stratex s common stock subject to outstanding options will be granted to him until the earlier of (1) 42 months and, (2) the date on which the applicable option(s) expire; and

he will receive a payment equal to the greater of (1) the average of the annual incentive bonus payments received, if any, for the previous three years, or (2) the target incentive bonus for the year in which his employment terminates.

The employment agreement also contains an agreement that Mr. Campbell will not compete with Harris Stratex s business for 18 months following termination of his employment.

For purposes of Mr. Campbell s employment agreement, the following terms are defined as follows:

Cause means:

theft, dishonesty, misconduct or falsification of any employment or Harris Stratex records;

improper disclosure of Harris Stratex s confidential or proprietary information;

action which has a material detrimental effect on Harris Stratex s reputation or business;

refusal or inability to perform any assigned duties (other than as a result of a disability) after written notice; or

conviction (including any plea of guilty or no contest) for any criminal act that impairs his ability to perform his duties.

Good reason means any of the following conditions:

a reduction in his base salary of 20% or more, other than a reduction that is similarly applicable to a majority of the members of Harris Stratex s executive staff;

a material reduction in his employee benefits, other than a reduction that is similarly applicable to a majority of the members of Harris Stratex s executive staff;

a material reduction in his responsibilities or authority without his written consent;

a material breach by Harris Stratex of any material provision of the employment agreement; or

the relocation of his main workplace without his concurrence to a location that is more than 75 miles from Harris Stratex s current facility in Morrisville, North Carolina; or any other acts or omissions by Harris Stratex that constitute constructive discharge under federal or North Carolina law.

Good reason following a change of control means any of the following conditions:

a material and adverse change in position, duties or responsibilities for Harris Stratex;

a reduction in base salary as measured against his base salary immediately prior to the change of control;

a material reduction in employee benefits, other than a reduction that is similarly applicable to a majority of the members of Harris Stratex s executive staff; or

the relocation of Harris Stratex s workplace to a location that is more than 75 miles from Harris Stratex s current facility in Morrisville, North Carolina.

The foregoing description of the employment agreement is not complete and is qualified in its entirety by reference to the employment agreement, which is included as Exhibit 10.14 to this report.

Thomas H. Waechter

Mr. Waechter s employment by Harris Stratex is subject to the terms of his existing employment agreement with Stratex, but his current compensation is as set forth in the table below. Under Mr. Waechter s existing employment agreement with Stratex in the event his employment is terminated by Harris Stratex without cause or if he resigns for good reason, other than upon a change of control, he will be entitled, upon satisfaction of certain conditions to the following benefits:

severance payments at his final base salary rate for a period of 24 months following his termination; such payments will be subject to applicable withholding and made in accordance with Harris Stratex s normal payroll practices;

payment of the premiums necessary to continue his group health insurance under COBRA (or to purchase other comparable health insurance coverage on an individual basis if he is no longer eligible for COBRA coverage) until the earlier of (x) 24 months following his termination date; or (y) the date he first became eligible to participate in another employer s group health insurance plan; provided, however, that if he is 60 years of age or older on the date of his termination without cause, and if he has been employed by Harris Stratex for not less than three years as of the date of his termination without cause, Harris Stratex will pay the premiums necessary to continue his Harris Stratex group health insurance coverage under COBRA (or to provide him with comparable health insurance coverage) until he reaches the age of 65 or until he is eligible to participate in another employer s group health insurance plan, whichever comes first;

with respect to any stock options granted to him by Harris Stratex, he will cease vesting upon his termination date; however, he will be entitled to purchase any vested shares of stock that are subject to those options until the earlier of (x) 18 months following his termination date, or (y) the date on which the applicable option(s) expire(s); except as set forth in this subparagraph, his Harris Stratex stock options will continue to be subject to and governed by the Plan and the applicable stock option agreements between he and Harris Stratex;

payment of his then-provided Harris Stratex car allowance for 24 months following his termination; and

outplacement assistance selected and paid for by Harris Stratex.

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For purposes of Mr. Waechter s employment agreement, the terms for cause and good reason have substantial the same definition as are contained in Mr. Campbell s employment agreement, described above.

If Mr. Waechter is terminated by Harris Stratex without cause or if he resigns for good reason within 24 months after a change of control (as defined in his agreement which includes the merger of Stratex with Harris Stratex), he will be entitled to receive the following severance benefits from Harris Stratex:

- severance payments at his final base salary for a period of 36 months following his termination;
- payment of premiums necessary to continue his group health insurance under COBRA or to purchase other comparable health insurance coverage on an individual or group basis when he is no longer eligible for COBRA coverage until the earlier of (1) 36 months or (2) the date on which he first becomes eligible to participate in another employer s group health insurance;
- if his employment termination or resignation occurs after March 31, 2007, the prorated portion of any incentive bonus that he would have earned during the incentive bonus year in which his employment was terminated;
- if his employment termination or resignation occurs after March 31, 2007, a payment equal to the greater of (1) his target incentive bonus for the year in which his employment terminates and (2) the average of the annual incentive bonus payment for the previous three years;
- acceleration of the vesting of all his unvested stock options;
- the right to purchase all shares of Harris Stratex common stock subject to outstanding options granted to him until the earlier of (1) 36 months and (2) the date on which the applicable option(s) expire;
- payment of his then-provided car allowance for a period of 36 months; and
- outplacement assistance selected and paid for by Stratex.

As a result of Harris Stratex s acquisition of Stratex, these change of control severance provisions will be applicable to Mr. Waechter for the next 24 months. Mr. Waechter s employment agreement provides that Harris Stratex will adjust all payments to Mr. Waechter to minimize the impact of any excise taxes. The foregoing description of Mr. Waechter s employment agreement is not complete and is qualified in its entirety by reference to the employment agreement, which is included as Exhibit 10.15 to this report.

Sarah A. Dudash and Robert Kamenski

Ms. Dudash s and Mr. Kamenski s employment is at will and are expected to be subject to the terms set forth in Harris Stratex s standard form of executive employment letter agreement. Their current compensation packages are set forth in the table below. Under the standard form of executive employment letter agreement if the executive s employment is terminated by Harris Stratex without cause or because of disability, or the executive resigns for good reason, the executive will be entitled to the following severance benefits:

- severance payments at the executive s final base salary rate for a period of 12 months following the executive s termination; such payments will be subject to applicable withholding and made in accordance with Harris Stratex s normal payroll practices;
- payment of the premiums necessary to continue the executive s group health insurance under COBRA (or to purchase other comparable health insurance coverage on an individual basis if he or she is no longer eligible for COBRA coverage) until the earlier of (1) 12 months following the termination date; or (2) the date he or she first became eligible to participate in another employer s group health insurance plan; or (3) the date on which he or she is no longer eligible for COBRA coverage;

if the executive s termination without cause occurs, Harris Stratex will pay the executive the prorated portion of any incentive bonus that the executive would have earned, if any, during the incentive bonus period in which the executive s employment terminates (the pro-ration shall be equal to the percentage of that bonus period that he or she is actually employed by Harris Stratex), and such prorated bonus will be paid to the executive at the time that such incentive bonuses are paid to other Harris Stratex employees;

with respect to any stock options granted to the executive by Harris Stratex, he or she will cease vesting upon the termination date; however, for options granted prior to the date of the agreement, the options will be exercisable in accordance with the terms of the applicable option agreement, for options granted subsequent to the date of the agreement, he or she will be entitled to purchase any vested shares of stock that are subject to those options until the earlier of (1) 12 months following the termination date, or (2) the date on which the applicable option(s) expire(s); and

outplacement assistance selected and paid for by Harris Stratex.

In the event of a change of control (as defined in the form of employment agreement), if the executive s employment is terminated without cause or the executive resigns for good reason within 18 months after the occurrence of the change of control he or she will receive the same severance benefits described above, except:

severance payments at the executive s final base salary rate for a period of 24 months following the executive s termination;

payment of the premiums necessary to continue the executive s group health insurance under COBRA (or to purchase other comparable health insurance coverage on an individual basis if he or she is no longer eligible for COBRA coverage) until the earlier of (1) 24 months following the termination date; or (2) the date he or she first became eligible to participate in another employer s group health insurance plan; or (3) the date on which he or she is no longer eligible for COBRA coverage;

Harris Stratex will accelerate the vesting of all unvested stock options as of the date of the executive s termination;

the executive will be entitled to purchase any vested shares of stock that are subject to those options until the earlier of (1) 24 months following the termination date, or (2) the date on which the applicable option(s) expire(s); and

the executive will receive a payment equal to the greater of (1) the average of the annual incentive bonus payments received, if any for the previous three years, or (2) the target incentive bonus for the year in which his employment terminates.

For purposes of the standard form of executive employment letter agreement the terms Good reason following a change of control and Good reason have the same definitions as are contained in Mr. Campbell s employment agreement, described above.

The foregoing description of the employment agreements for Ms. Dudash and Mr. Kamenski is not complete and is qualified in its entirety by reference to the standard form of executive employment agreement, which is included as Exhibit 10.16 to this report.

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Executive Compensation Packages

The Compensation Committee of the Harris Stratex s board of directors has approved the following compensation packages for the executives named above in connection with their new employment by Harris Stratex.

Name and Title	Salary(1)	Incentive Pay (2)	LTIP (3)	Retention Bonus (4)
Guy M. Campbell	$ 500,000	$ 500,000	$ 950,000	
Thomas H. Waechter	$ 450,000	$ 360,000	$ 760,000	
Sarah A. Dudash	$ 240,000	$ 132,000	$ 360,000	$ 240,000
Robert Kamenski	$ 195,000	$ 87,800	$ 126,800	$ 195,000

1 Represents the executive s base salary payable every two weeks in equal installments.

2 Represents the maximum potential annual bonus payable for the achievement of revenue and net income or earnings per share, objectives established by the Compensation Committee of the board of directors. For the remainder of Harris Stratex s 2007 fiscal year, which ends June 29, 2007, the maximum incentive pay is 50% of the amount in the table.

3 Represents the value of equity awards under a

Long-Term Equity Incentive Plan to be approved by the Compensation Committee of the board of directors, of which 50% will be in the form of shares of restricted stock and 50% will be in the form of stock options. The equity awards will be made on standard forms of agreement approved by the board of directors pursuant to the Harris Stratex s 2007 Stock Equity Plan. The restricted shares will vest in full after three years, if the Compensation Committee determines that the performance objectives selected by the Compensation Committee have been achieved and other criteria established by the Compensation Committee have been satisfied. The option shares will vest based on continued employment, with 50% of the shares vesting after the first year and 25% of the shares vesting at the end of each of the following two years. The number of shares to be awarded to each of the officers under this plan has not been determined yet.

4 Represents the value of a grant of restricted shares to be issued as a one-time retention bonus. The shares will vest in full based on continued employment for three years.

Stock Incentive Plan

The Harris Stratex Networks, Inc. 2007 Stock Equity Plan, or the 2007 Plan, has been adopted by the board of directors of Harris Stratex and approved by Harris, as its sole stockholder. It is expected that the board of directors of Harris Stratex will grant awards to its directors and officers under the 2007 Plan.

Number of Shares

As a general matter, at no time may the number of shares of Harris Stratex Class A common stock issued pursuant to or subject to outstanding awards granted under the 2007 Plan exceed 5,000,000 shares of Harris Stratex Class A common stock. The 2007 Plan provides for a limited number of exceptions to this provision, including adjustments for extraordinary corporate events.

Purpose

The 2007 Plan is intended to retain and reward highly qualified employees, consultants, and directors and encourage their ownership of Common Stock.

Administration

The 2007 Plan may be administered by the compensation committee of the board of directors of Harris Stratex, by another designated committee, or by the board directly. The designated administrator, or the committee, has the discretion, subject to the provisions of the 2007 Plan, to determine the employee, consultant or director to receive an award, the form of award and any acceleration or extension of an award. Further, the committee has complete authority to interpret the 2007 Plan, to prescribe, amend and rescind rules and regulations relating to it, to determine the terms and provisions of the respective award agreements (which need not be identical), and to make all other determinations necessary or advisable for the administration of the 2007 Plan.

Eligibility

Awards may be granted to any employee of or consultant to or its affiliates or to non-employee members of the board of directors of Harris Stratex or of any board of directors (or similar governing authority) of any affiliate.

Shares Subject to the 2007 Plan. The shares issued or to be issued under the 2007 Plan are authorized but unissued shares of Harris Stratex Class A common stock. The maximum number of shares of Harris Stratex Class A common stock which may be issued or made subject to awards under the 2007 Plan is 5,000,000, and no more than 10% of the available 2007 Plan shares of Harris Stratex Class A common stock may be covered by awards issued to any one person in any one calendar year.

Type of Awards. Awards under the 2007 Plan may include incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock, restricted stock units and performance units, qualified performance-based awards, and stock grants. Each award will be evidenced by an instrument in such form as the Committee may prescribe, setting forth applicable terms such as the exercise price and term of any option or applicable forfeiture conditions or performance requirements for any restricted stock or restricted stock units. Except as noted below, all relevant terms of any award will be set by the committee in its discretion.

Nonstatutory stock options and incentive stock options, or stock options, are rights to purchase Harris Stratex Class A common stock. A stock option may be immediately exercisable or become exercisable in such installments, cumulative or non-cumulative, as the committee may determine. A stock option may be exercised by the recipient giving written notice to Harris

Stratex, specifying the number of shares with respect to which the stock option is then being exercised, and accompanied by payment of an amount equal to the exercise price of the shares to be purchased. The purchase price may be paid by cash, check, by delivery to Harris Stratex (or attestation of ownership) of shares of Harris Stratex Class A common stock (with some restrictions), or through and under the terms and conditions of any formal cashless exercise program authorized by Harris Stratex.

Incentive stock options may be granted only to eligible employees of Harris Stratex or any parent or subsidiary corporation and must have an exercise price of not less than 100% of the fair market value of the Harris Stratex Class A common stock on the date of grant (110% for incentive stock options granted to any 10% stockholder of Harris Stratex). In addition, the term of an incentive stock option may not exceed seven years (five years, if granted to any 10% stockholder). Nonstatutory stock options must have an exercise price of not less than 100% of the fair market value of the Harris Stratex Class A common stock on the date of grant and the term of any nonstatutory stock option may not exceed seven years. In the case of an incentive stock option, the amount of the aggregate fair market value of Harris Stratex Class A common stock (determined at the time of grant) with respect to which incentive stock options are exercisable for the first time by an employee during any calendar year (under all such plans of his or her employer corporation and its parent and subsidiary corporations) may not exceed $100,000.

Stock appreciation rights, or SARs, are rights to receive (without payment to Harris Stratex) cash, property or other forms of payment, or any combination thereof, as determined by the committee, based on the increase in the value of the number of shares of Harris Stratex Class A common stock specified in the SAR. The base price (above which any appreciation is measured) will in no event be less than 100% of the fair market value of Harris Stratex Class A stock on the date of grant of the SAR or, if the SAR is granted in tandem with a stock option (that is, so that the recipient has the opportunity to exercise either the stock option or the SAR, but not both), the exercise price under the associated stock option.

Awards of restricted stock are grants or sales of Harris Stratex Class A common stock which are subject to a risk of forfeiture, such as a requirement of the continued performance of services for stated term or the achievement of individual or Harris Stratex performance goals. Awards of restricted stock include the right to any dividends on the shares pending vesting (or forfeiture), although the committee may determine, at the time of the award, that dividends will be deferred and, if dividends are deferred, the committee may determine that the deferred dividends will be reinvested in additional restricted stock.

Awards of restricted stock units and performance units are grants of rights to receive either shares of Harris Stratex Class A common stock (in the case of restricted stock units) or the appreciation over a base value (as specified by the committee) of a number of shares of Harris Stratex Class A common stock (in the case of performance stock units) subject to satisfaction of service or performance requirements established by the committee in connection with the award. Such awards may include the right to the equivalent to any dividends on the shares covered by the award, which amount may in the discretion of the committee be deferred and paid if and when the award vests.

Qualified performance-based awards are awards which include performance criteria intended to satisfy Section 162(m) of the code. Section 162(m) of the code limits Harris Stratex s federal income tax deduction for compensation to certain specified senior executives to $1 million dollars, but excludes from that limit performance-based compensation. Qualified performance-based awards may be in the form of stock options, restricted stock, restricted stock units or performance units, but in each case will be subject to satisfaction of one of the following criteria, either individually, alternatively or in any combination, applied to either Harris Stratex as a whole or to a business unit or affiliate, either individually, alternatively, or in any combination, and measured either annually or cumulatively over a period of years, on an absolute basis or relative to a pre- established target, to previous years results or to a designated comparison group, in each case as specified by the committee in the award:

cash flow (before or after dividends)
stock price
stockholder return or total stockholder return
return on investment
market capitalization
debt leverage (debt to capital)
sales or net sales
income, pre-tax income or net income
operating profit, net operating profit or economic profit
return on operating revenue or return on operating assets
operating ratios

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working capital ratios
market share improvement customer service
earnings per share (including, without limitation, earnings before stock based compensation, profitsharing, interest, taxes, depreciation and amortization)
return on equity
return on capital (including without limitation return on total capital or return on invested capital)
return on assets or net assets
economic value added
revenue
backlog
operating income, pre-tax income, or net income
gross margin, operating margin or profit margin
cash from operations
patent applications and patent awards
general and administrative expenses

Qualified performance-based awards in the form of stock options must have an exercise price which is not less than 100% of the fair market value of Harris Stratex Class A common stock on the date of grant. No payment or other amount will be available to a recipient of a qualified performance-based award except upon the committee s determination that particular goal or goals established by the committee for the criteria (from among those specified above) selected by the committee have been satisfied.

A stock grant is a grant of shares of Harris Stratex Class A common stock not subject to restrictions or other forfeiture conditions. Stock grants may be awarded only in recognition of significant contributions to the success of Harris Stratex or its affiliates, in lieu of compensation otherwise already due, or in other limited circumstances which the committee deems appropriate.

Effect of Termination of Employment or Association. Unless the committee determines otherwise in connection with any particular award under the 2007 Plan, stock options and SARs will generally terminate three months following the recipient s termination of employment or other association with the Company. The effect of termination on other awards will depend on the terms of those awards.

Transferability. In general, no award under the 2007 Plan may be transferred by the recipient and during the life of the recipient all rights under an award may be exercised only by the recipient or his or her legal representative. However, the committee may approve the transfer, without consideration, of an award of a nonstatutory option or restricted stock to a family member.

Effect of Significant Corporate Event. In the event of any change in the outstanding shares of Harris Stratex Class A common stock through merger, consolidation, sale of all or substantially all the property of Harris Stratex, reorganization, recapitalization, reclassification, stock dividend, stock split, reverse stock split, or other distribution with respect to such shares of Harris Stratex Class A common stock, an appropriate and proportionate adjustment will be made in (1) the maximum numbers and kinds of shares subject to the 2007 Plan and the 2007 Plan limits, (2) the numbers and kinds of shares or other securities subject to the then outstanding awards, (3) the exercise or hurdle price for each share or other unit of any other securities subject to then outstanding Harris Stratex Class A stock options or SARs (without change in the aggregate purchase or hurdle price as to which stock options or SARs remain exercisable), and (4) the repurchase price of each share of restricted stock then subject to a risk of forfeiture in the form of a Harris Stratex repurchase right. In the event of an acquisition, any then outstanding award will accelerate in full to the extent not assumed or replaced by the acquirer of Harris Stratex. Upon dissolution or liquidation of Harris Stratex other than as part of an acquisition or similar transaction, each outstanding stock option or SAR shall terminate, but the participant shall have the right, immediately prior to the dissolution or liquidation, to exercise the stock option or SAR to the extent exercisable on the date of dissolution or liquidation.

Change of Control. Award agreements pursuant to the 2007 Plan may provide, as determined by the committee, that, in the event of a change of control, stock options and stock appreciation rights will accelerate; the risk of forfeiture applicable to restricted stock and restricted stock units will lapse; and all conditions on restricted stock and restricted stock units shall be deemed to have been satisfied. A change of control is defined as the occurrence of any of (a) a transaction after which 50% of the voting power of the resulting entity or ultimate parent entity is represented by previously issued and outstanding Harris Stratex securities, or securities into which the Harris Stratex securities were converted, (b) a merger, consolidation, share exchange or acquisition after which less than 50% of the voting power of the resulting entity or ultimate parent entity is represented by previously issued and outstanding Harris Stratex securities, or securities into which the Harris Stratex securities were converted; (c) other than by means of a merger, consolidation, share exchange or acquisition, a person or group of persons obtains more than 30% of the total combined voting power of Harris Stratex (exempting Harris, until such time as it beneficially owns less than 30% of the total voting power

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of Harris Stratex, and also the employee benefit plans and trustees of employee benefit plans for Harris Stratex and its affiliates (other than Harris), and any underwriters temporarily holding securities prior to an offering of such securities); (d) the composition of the board changes, over a period of 36 months or less, such that that a majority of the individuals on the board are no longer at least one of the following: (i) directors appointed before the adoption of the plan or directors who have served throughout the period, (ii) appointees of Harris Corporation, or (iii) directors elected by a majority of directors that (x) belong to the same class of directors as such director, and (y) satisfied the criteria above at the time they voted for such director; or (e) a majority of the Harris Stratex board of directors determines that a change in control has occurred. No change of control is held to have occurred if (i) immediately before the occurrence Harris owns more than 30% of the total voting power of Harris Stratex, and (ii) immediately after such occurrence, Harris owns a majority of the total voting power of Harris Stratex

Amendments to the 2007 Plan. Generally the board of directors of Harris Stratex may amend or modify the 2007 Plan at any time subject to the rights of holders of outstanding awards on the date of amendment or modification.

Compensation Committee Interlocks and Insider Participation

No interlocking relationship exists between our board of directors or compensation committee and the board of directors or compensation committee of any other entity, nor has any interlocking relationship existed in the past.

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CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The following describe certain ongoing arrangements between Harris and Harris Stratex which may be material to Harris or Harris Stratex. In addition to the following arrangements, for information relating to transactions between Harris and Harris Stratex, see *Note 1. Significant Accounting Policies Related Party Transactions* in the Notes to the Combined Financial Statements of MCD beginning on page F-7 of this prospectus.

The Combination Agreement

Harris Stratex has agreed pursuant to the combination agreement to indemnify, defend and hold Harris and its subsidiaries, directors, officers, partners, employees, representatives and agents harmless from and against any and all losses incurred by any such Harris indemnified person arising out of or relating to:

any breach by Harris Stratex or any of its subsidiaries of any covenants of Harris Stratex contained in the combination agreement to be performed following the closing; however, any action or inaction approved by the board of directors of Harris Stratex will not be subject to indemnity under this paragraph if a majority of the directors of Harris Stratex at the time of such action or inaction were the initial Harris directors or otherwise elected or appointed by Harris or the directors of Harris Stratex appointed or elected by Harris;

any liability assumed by Harris Stratex under the combination agreement; or

any liability arising out of or relating to the operation of the businesses or properties or liabilities of (1) Stratex prior to the closing or (2) Harris Stratex and/or any of its subsidiaries on or after the closing.

Harris will indemnify and defend and hold Harris Stratex and its subsidiaries, directors, officers, partners, employees, representatives and agents harmless from and against any and all losses incurred by any such Harris Stratex indemnified person arising out of or relating to:

any breach of the covenants contained in the combination agreement to be performed by Harris or any of its subsidiaries following the closing; or

any asset or liability of Harris or its subsidiaries that is not transferred to or assumed by Harris Stratex as provided by the combination agreement.

Harris Stratex has agreed that, in connection with the combination agreement, it will cause Stratex, as the surviving corporation in the merger, for a period of six years from the effective time of the merger to indemnify and hold harmless each past and present director and officer of Stratex or any of its subsidiaries (in each case, for acts or failures to act in such capacity), against any costs or expenses (including reasonable attorneys fees), judgments, fines, losses, claims, damages or liabilities incurred in connection with any claim, action, suit, proceeding or investigation, whether civil, criminal, administrative or investigative, arising out of matters existing or occurring at or prior to the effective time of the merger, whether asserted or claimed prior to, at or after the effective time of the merger, to the fullest extent that Stratex would have been permitted to indemnify such person under the laws of the State of Delaware and its certificate of incorporation or bylaws as in effect on the date of the combination agreement. Harris Stratex has also agreed to advance expenses as incurred to the fullest extent permitted under applicable law so long as the person to whom expenses are advanced provides an undertaking to repay such advances if it is ultimately determined that such person is not entitled to indemnification.

Stratex purchased a six-year tail policy upon the effective time of the merger, for a period of six years after the effective time of the merger, to maintain officers and directors liability insurance covering those persons who were covered by such insurance in effect as of the date of the combination agreement.

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The Investor Agreement

As provided in the investor agreement and the amended and restated certificate of incorporation and amended and restated bylaws of Harris Stratex, the Harris Stratex Class A and Class B common stock are identical in all respects except that holders of shares of Harris Stratex Class B common stock have the additional right to vote separately as a class to elect, remove and replace the Class B directors, the right to receive Class B common stock instead of Class A common stock in certain circumstances, the absence of certain duties and obligations with respect to corporate opportunities and preemptive rights providing holders of Harris Stratex Class B common stock with the right to participate in additional offerings of Harris Stratex common stock.

Board of Directors of Harris Stratex

Initial Board of Directors: The board of directors of Harris Stratex has nine members. Five of these directors are appointed by Harris as the sole holder of Harris Stratex Class B common stock and include Howard L. Lance, Chairman, President and Chief Executive Officer of Harris, and Guy M. Campbell, President and Chief Executive Officer of Harris Stratex, each of whom was previously a director of Harris Stratex, and also include Eric C. Evans, Dr. Mohsen Sohi and Dr. James C. Stoffel. The four remaining directors of Harris Stratex are appointed by Stratex and include Charles D. Kissner, Chairman of Stratex, as well as the following former Stratex directors: William A. Hasler, Clifford H. Higgerson and Edward F. Thompson.

Harris has agreed that, until the second anniversary of the combination of the Microwave Communications Division and Stratex, one of the Harris directors must meet the independence requirements for directors serving on an audit committee as prescribed by the NASDAQ rules and one must not be an employee of Harris or any of its subsidiaries (without regard to Harris Stratex or any of its subsidiaries). Stratex has agreed that two of the directors to be appointed by Stratex must meet the independence requirements for directors serving on an audit committee as prescribed by the NASDAQ rules. With respect to Harris Stratex, Eric C. Evans, William A. Hasler, Clifford H. Higgerson, Dr. Mohsen Sohi, Dr. James C. Stoffel and Edward F. Thompson each meet the independence requirements for directors serving on an audit committee as prescribed by the NASDAQ rules. In addition, none of the proposed directors of Harris Stratex is an employee of Harris or any of its subsidiaries (without regard to Harris Stratex of any of its subsidiaries). Both Harris and Stratex have satisfied the requirements relating to directors imposed on them by the combination agreement.

The initial directors will serve until their successors are elected at the first annual meeting of Harris Stratex. The Harris Stratex directors will be elected at each annual meeting.

Committees: At all times the audit, nominating and compensation committees of the board of directors of Harris Stratex must comply with the applicable requirements under the NASDAQ rules (after taking advantage of all available exemptions for controlled companies).

On January 26, 2007, the following directors became members of the following committees upon the filing the amended and restated certificate of incorporation:

Directors:		Committees:
Class A Directors:		
	William A. Hasler	Governance (Chair), Audit, Nominating
	Clifford H. Higgerson	Compensation, Nominating
	Charles D. Kissner	Governance, Nominating
	Edward F. Thompson	Audit (Chair), Nominating
Class B Directors:		

Guy M. Campbell (continuing director)	
Eric C. Evans	Audit
Howard L. Lance (continuing director)	Governance
Dr. Mohsen Sohi	Compensation
Dr. James C. Stoffel	Compensation (Chair)

Voting Requirements: All actions of the board of directors of Harris Stratex must be approved by a majority of a quorum.

Restrictions on Related Party Transactions

Harris and its affiliates are only permitted to enter into transactions with Harris Stratex if the transaction is approved by a majority of the directors not elected by Harris or is on terms no less favorable in any material respect to Harris Stratex than those that could have been obtained by Harris Stratex, taking into consideration the then prevailing facts and circumstances, if it had negotiated the transaction with an informed, unrelated third party. However, if a transaction has a fair market value of more than $5 million, it must be approved in advance by a majority of the Class A directors. Harris and Harris Stratex have agreed that certain specified transactions relating to the payment of directors fees, employee benefits and other similar arrangements, indemnification arrangements and tax-sharing arrangements between Harris Stratex and any other entity with which Harris Stratex files a consolidated tax return or with which Harris Stratex is part of a consolidated group for tax purposes will not be subject to these restrictions.

Standstill Provision

Harris has agreed that, for two years following the combination of the Microwave Communications Division and Stratex, it will not acquire or dispose of any of its voting securities in Harris Stratex with the following exceptions:

pursuant to preemptive rights provided to Harris Stratex further described in *Description of Harris Stratex Capital Stock Preemptive Rights* ;

unless approved in advance by a majority of the non-Harris directors; and

as a result of actions taken by Harris Stratex that do not increase or decrease Harris percentage of total voting power which Harris and its affiliates are entitled to cast in respect of all classes of capital stock or securities of Harris Stratex then outstanding and entitled to vote generally in the election of Class A directors (including the holders of Harris Stratex Class B common stock) beneficially owned by Harris.

In addition, Harris has agreed that from the second to the fourth anniversary of the combination of the Microwave Communications Division and Stratex, it will not (1) beneficially own more than 80% of the voting power of Harris Stratex without the prior approval of a majority of the non-Harris directors or (2) transfer all or a portion of its interest in Harris Stratex to a person if, following such transfer, that person would be entitled to cast a majority of the outstanding votes in an election of the directors of Harris Stratex (other than an election of the Class B directors) unless a majority of the non-Harris directors approve such transfer in advance or the person purchasing Harris interest in Harris Stratex offers to acquire all the outstanding voting securities of Harris Stratex at the same price and on the same terms as apply to the transfer from Harris.

There are no prohibitions or restrictions on any *pro rata* dividends or other *pro rata* distributions of Harris Stratex voting securities to the stockholders of Harris or any *bona fide* sale to the public of Harris Stratex securities pursuant to Rule 144 under the Securities Act or a *bona fide* registered public offering.

See *Description of Harris Stratex Capital Stock Special Rights of Holders of Class B Common Stock* for more information regarding the terms and provisions of the Investor Agreement.

The Non-Competition Agreement

In consideration for the issuance to Harris of Harris Stratex shares pursuant to the combination agreement and the performance by Stratex of its obligations under the combination agreement and the other agreements entered into in connection with the combination agreement, Harris agrees that, during the period commencing on the date of the non-competition agreement and ending on the fifth anniversary of such date, Harris will not, and will not permit any of its subsidiaries to:

engage, directly or indirectly, in the restricted business (as defined below);

form any person other than Harris Stratex and its subsidiaries, any such person a covered person , or change or extend the current business activities of any existing covered person for the purpose of engaging, directly or indirectly, in the restricted business; or

invest, directly or indirectly, in any covered person engaged, directly or indirectly, in the restricted business in any material respect;

provided, however, that notwithstanding the foregoing Harris and/or its subsidiaries may:

collectively own less than 20% of the total equity interests in any covered person engaged in the restricted business as long as none of the employees of Harris or any of its subsidiaries is involved in the management of such covered person;

participate as a passive investor with no management rights in any investment fund that holds an ownership interest in covered persons engaged in the restricted business that is managed by persons that are not affiliates of Harris (1) with any employee benefit or retirement plan funds and (2) with any other funds subject, in the case of this clause (2) only, to a maximum interest in such investment fund of 15%; and

acquire a covered person or business unit of a covered person engaged in the restricted business if (1) the restricted business contributed less than 20% of such covered person s or business unit s, as applicable, total revenues (based on its latest annual audited financial statements, if available) and (2) such covered person or Harris, as applicable, divests or ceases to conduct the restricted business within 18 months after the acquisition date.

The term restricted business means the development, manufacture, distribution and sale of any microwave radio systems and related components, systems and services which are (1) competitive with the then current products of Stratex and the Microwave Communications Division, or (2) which are substantially similar to such products in form, fit and function when used in terrestrial microwave point-to-point communications networks that provide access and trunking of voice and data for telecommunications networks.

Notwithstanding anything in the non-competition agreement to the contrary, the term restricted business does not include, and the prohibition contained in the non-competition agreement does in no way prohibit Harris and/or its subsidiaries from:

- purchasing and reselling products produced by, and marked with the brands of, an unaffiliated person in connection with the sale, service, design or maintenance of a system that contains or uses microwave radios or related components, systems or services; or

- developing, manufacturing, distributing or selling microwave radios or related components, systems or services for use by government entities.

For purposes of the non-competition agreement, neither Harris Stratex nor any of its subsidiaries are deemed to be a subsidiary or affiliate of Harris or any of its other subsidiaries or affiliates.

Intellectual Property Agreement

Assignment of Contributed Trade Secrets to Harris Stratex: Under the terms of the intellectual property agreement, Harris and its subsidiaries irrevocably transferred and assigned to Harris Stratex all of their rights and interest in the trade secrets and copyrights that are primarily related to or primarily used in connection with the business conducted by the Microwave Communications Division, subject to limited restrictions. The rights to trade secrets and copyrights transferred and assigned by Harris and its subsidiaries to Harris Stratex pursuant to the provisions described in this paragraph are referred to in this *Intellectual Property Agreement* section as the contributed trade secrets.

License Back to Harris and its Subsidiaries and Sublicense of Contributed Trade Secrets: In exchange for the contributed trade secrets, Harris Stratex granted to Harris and its subsidiaries a personal, nonexclusive, non-transferable, irrevocable, worldwide, fully paid-up license to use, copy, execute and perform, and to display and distribute (subject to agreed confidentiality restrictions), the contributed trade secrets, and to create, use, copy, execute and perform, and to display and distribute (subject to agreed confidentiality restrictions), derivative works from the contributed trade secrets, subject to limited exceptions. The license back to Harris and its subsidiaries of the contributed trade secrets includes a personal, non-transferable and nonexclusive right to communicate portions of and grant nonexclusive sublicenses (subject to agreed confidentiality restrictions) to such contributed trade secrets to customers, suppliers, sublicensees or other third parties as necessary regarding any products or services sold by Harris or its subsidiaries now or in the future, subject to limited exceptions.

Trade Secrets Licensed to Harris Stratex: Under the terms of the intellectual property agreement, Harris and its subsidiaries granted to Harris Stratex a fully paid-up, worldwide, irrevocable, non-transferable and nonexclusive license to use any trade secrets or copyrights owned by Harris that are not contributed trade secrets but are otherwise used in connection with the business conducted by the Microwave Communications Division immediately prior to the closing. The trade secrets and copyrights licensed by Harris and its subsidiaries to Harris Stratex pursuant to the provisions described in this paragraph are referred to in this *Intellectual Property Agreement* section as the licensed trade secrets.

Right to Sublicense Licensed Trade Secrets: In addition, subject to any and all pre-existing licenses granted by Harris or its subsidiaries, Harris and its subsidiaries granted to Harris Stratex a personal, non-transferable and nonexclusive right to communicate portions of and grant nonexclusive sublicenses to (subject to agreed confidentiality restrictions) the licensed trade secrets in connection with any products or services then-sold by Harris Stratex or sold in the future to (1) suppliers to the extent necessary to produce products or components for such products for Harris Stratex and (2) customers to the extent necessary to permit such customers to use any product or service produced or provided by Harris Stratex for its intended purpose. Harris Stratex may not grant sublicenses of such rights in connection with a general licensing program, for settlement purposes or other purposes not directly related to its own operations.

Assignment of Contributed Patents to Harris Stratex: Under the terms of the intellectual property agreement, Harris and its subsidiaries assigned and transferred to Harris Stratex those patents specifically identified as being transferred by Harris and its subsidiaries to Harris Stratex in connection with the combination of the Microwave Communications Division and Stratex, which are generally those patents primarily related to the operations of the Microwave Communication Division, subject to limited exceptions. The patent rights transferred and assigned by Harris and its subsidiaries to Harris Stratex pursuant to the provisions described in this paragraph are referred to in this *Intellectual Property Agreement* section as the contributed patents.

Licensed Patents: Harris and its subsidiaries have also granted to Harris Stratex a personal, fully paid-up, worldwide, non-transferable, irrevocable and nonexclusive license under certain patents to make, have made, use, sell, offer to sell, lease, transfer, import, export or otherwise distribute products or services of Harris Stratex now or in the future and to use and perform all processes and methods claimed by the licensed patents, subject to limited exceptions. The patents to be licensed pursuant to the provisions described in this paragraph include patents owned or controlled by Harris or its Subsidiaries as of the closing date of the combination of the Microwave Communications Division and Stratex (other than the contributed patents) that are used in the business conducted by the Microwave Communications Division immediately prior to the closing and for which Harris or its subsidiaries have the right to grant licenses under the agreement without material restrictions. The licenses granted by the provisions described in this paragraph include the right to convey to any customer of Harris Stratex, regarding any product that is sold or leased by Harris Stratex to such customer, rights to use and resell such products as sold or leased by Harris Stratex.

License Back to Harris and its Subsidiaries: Harris Stratex granted to Harris and its subsidiaries a personal, fully paid-up, worldwide, non-transferable, irrevocable and nonexclusive license under the contributed patents to make, sell or distribute the products or services then-sold by Harris or its subsidiaries or sold in the future. The licenses granted by the provisions described in this paragraph include the right to convey to any customer of Harris or its subsidiaries, regarding any product that is sold or leased by Harris and its subsidiaries to such customer, rights to use and resell such products as then-sold or leased by Harris and its subsidiaries or sold or leased in the future.

Right to Sublicense Licensed Patents: In addition, subject to limited exceptions, Harris and its subsidiaries granted to Harris Stratex a personal, non-transferable, irrevocable and nonexclusive right to grant nonexclusive sublicenses under the licensed patents in connection with any products or services then-sold by Harris Stratex or sold in the future to (1) suppliers to the extent necessary to produce products or components for such products for Harris Stratex and (2) customers to the extent necessary to permit such customers to use any product or service produced or provided by Harris Stratex for its intended purpose. Harris Stratex may not under any circumstances grant sublicenses of such rights in connection with a general licensing program, for settlement purposes or other purposes not directly related to its own operations.

Trademark and Trade Name License Agreement

Grant of Trademark License

In connection with the transactions, Harris granted to Harris Stratex and its subsidiaries for use solely by Harris Stratex and its subsidiaries, a worldwide, royalty-free, fully paid-up, non-transferable, non-exclusive license to use the HARRIS mark, or the licensed trademark, and the HARRIS mark with a stylized A , or the stylized mark, as described below:

With respect to the packaging, marketing, sale, licensing, distribution and support of the products of the MCD business (including products that have been partially manufactured) existing as of the closing date, with certain limitations, for one year from the closing date of the combination of the Microwave Communications Division and Stratex, Harris Stratex is permitted to use the licensed trademark and the stylized mark in the same manner as they were used in the MCD business by Harris and its subsidiaries immediately prior to the closing date of the combination of the Microwave Communications Division and Stratex; and

With respect to any Harris Stratex business products and marketing and promotional material and packaging produced after the closing of the combination of the Microwave Communications Division and Stratex, Harris Stratex may only use the licensed trademark if the licensed trademark is used as part of the HARRIS portion of a combined HARRIS STRATEX trademark as provided in the trademark and trade name agreement.

Within three months after the combination of the Microwave Communications Division and Stratex, Harris Stratex and its subsidiaries have agreed to remove the stylized mark from all buildings, signs and vehicles used in connection with its business.

Grant of Trade Name License

Harris has also granted to Harris Stratex for use solely by Harris Stratex and its subsidiaries a personal, royalty-free, fully paid-up, worldwide, non-transferable, non-exclusive license to use the trade name HARRIS without a stylized A , which we refer to as the licensed trade name, subject to those limitations as provided in the trademark and trade name agreement.

No Transfers; No Sublicensing: Neither Harris Stratex nor its subsidiaries has the right to transfer its rights under the agreement or grant sublicenses to the licensed trademark, the stylized mark or licensed trade name, although Harris Stratex and its subsidiaries may authorize persons contracted by Harris Stratex to manufacture its products to affix the licensed trademark or the licensed trade name to new Harris Stratex business products, marketing and promotional material and packaging in accordance with the trademark and trade name license agreement.

Other Trademarks and Trade Names: Harris Stratex and its subsidiaries are required to refrain from the adoption or use of any other trademark or trade name or logo that is, or contains any element that is, confusingly similar to the licensed trademark, the stylized mark or the licensed trade name. Harris Stratex and its subsidiaries are not permitted to use any logo, trademark or trade name including the name Harris except as expressly permitted by the terms of the agreement.

Ownership and Compliance: The licensed trademark, the stylized mark and the licensed trade name are the exclusive and sole property of Harris, and all use of the licensed trademark, the stylized mark and the licensed trade name by Harris Stratex and its subsidiaries pursuant to the agreement will inure solely to Harris s benefit. Neither Harris Stratex or its subsidiaries nor any of their agents or affiliates are permitted to challenge, contest, call into question or raise any questions concerning Harris ownership or the validity of the licensed trade name, the licensed trademark, the stylized mark or any registration or application for registration for the licensed trademark or the stylized mark or the fact that Harris Stratex s and its subsidiaries rights under the agreement are solely those of a licensee, which rights terminate (except as otherwise set forth in the agreement) upon termination of the trademark and trade name license agreement.

In addition, Harris Stratex and its subsidiaries are required to comply with reasonable trademark and trade name usage guidelines provided by Harris, as established from time to time.

Term: Harris has the right to terminate the trademark and trade name license agreement and the licenses granted under it if:

Harris Stratex and its subsidiaries materially default in performing any of the terms and conditions of the trademark and trade name license agreement and fail to remedy the material default within 30 days of written notice, subject to additional provisions relating to Harris Stratex s efforts and ability to remedy any material breach;

Upon written notice to Harris Stratex in the event that Harris Stratex or any of its subsidiaries are adjudged bankrupt, become insolvent, make an assignment for the benefit of creditors, have a receiver or trustee appointed, file a petition for bankruptcy, or initiate reorganization proceedings or take steps toward liquidation of a substantial part of its property or assets; or

Upon six months written notice to Harris Stratex at any time Harris no longer is entitled to cast majority of the total number of votes then entitled to be cast generally in the election of Class A directors of Harris Stratex.

Harris Stratex has the right to terminate the trademark and trade name license agreement at any time for any reason upon written notice.

Transition Services Agreement

Services

Harris has agreed to provide Harris Stratex and Harris Stratex s affiliates certain services for use in connection with the MCD business as that business is conducted by Harris Stratex. Harris will provide the services in a manner, amount and quality substantially consistent with the identified services provided by Harris to the MCD business six months before the effective date of the contribution transaction and the merger.

These services primarily include the services which were provided by Harris to the Microwave Communications Division prior to the combination of the Microwave Communications Division and Stratex which were charged to the Microwave Communications Division, including information services, human resources, financial services, facilities, legal support and supply chain management services.

Upon the request of Harris Stratex, Harris may elect to provide additional services to Harris Stratex on terms and fees to be determined by Harris and Harris Stratex. The parties currently anticipate that, Harris may in the future provide information technology services to Harris Stratex that are different in type and amount than that currently provided by Harris to the Microwave Communications Division. These additional services will be negotiated pursuant to and subject to the terms of the transition services agreement.

Exceptions to Harris Obligation to Perform

Notwithstanding anything to the contrary, Harris is not required to provide any service to Harris Stratex (1) to the extent performing the service would require Harris to violate any law or would result in the breach of any contract or agreement due to a failure to obtain certain necessary consents, licenses, sublicenses or approvals, (2) if Harris reasonably determines that providing such service would result in a significant disruption of its or any of its affiliates businesses or operations, would materially increase the scope of Harris responsibilities under the transition services agreement or would be impracticable or (3) if any such service unreasonably inhibits any employee of Harris or any of its affiliates from discharging his or her obligations to Harris or any of its affiliates or places any employee of Harris or any of its affiliates in a conflict of interest with respect to his or her employment with Harris or any of its affiliates. Until an alternative approach is found or the problem is otherwise resolved to the satisfaction of the parties, Harris has agreed to use its commercially reasonable efforts to provide a comparable service, or in the case of data systems, support the function to which the data system relates or permit Harris Stratex to have reasonable access to the data system so that Harris Stratex can support the function itself.

However, if Harris Stratex elects to decommission, replace, modify or change its information technology or communications systems, networks, equipment, configurations, processes, procedures, practices or any other aspect of its business relationship relating to a service in a manner that adversely affects Harris ability to provide such service as required under the transition services agreement, then Harris has no liability regarding the effectiveness or quality of such service and is excused from performance of such service until Harris Stratex mitigates the adverse effect of the change, and Harris Stratex is responsible for all direct expenses incurred by Harris in connection with the cessation and, if applicable, the resumption of such service. Additionally, Harris may suspend its performance of any service and Harris Stratex s access to information technology or communications systems used by Harris if, in Harris reasonable judgment, the integrity, security or performance of these systems, or any data stored on the system, is being or is likely to be jeopardized by the activities of Harris Stratex, its employees, agents, representatives or contractors.

Cost of Services

In consideration of the provision of services by Harris under the transition services agreement, Harris Stratex pays to Harris, without set-off, a service fee for each such service in the amount equal to:

- all internal costs allocated to the maximum extent reasonably practicable to providing the service on a fully allocated basis consistent with the charges in effect at the time of the combination of the Microwave Communications Division and Stratex, and

- any additional out-of-pocket costs or expenses incurred by Harris in connection with providing the service, including without limitation, payments or costs for an ongoing license, grant or provision of rights or services.

Term

The transition services agreement will terminate regarding each service as provided by the transition services agreement regarding such service, although the transition services agreement will terminate, including all services provided pursuant to its terms, no later than the one-year anniversary of the closing of the merger and the contribution transaction, unless the agreement is terminated sooner by default or by Harris Stratex or extended by mutual written agreement of the parties. Any termination or expiration of the agreement regarding any particular service will not terminate the agreement regarding any other service provided under the agreement. Notwithstanding any other provision of the transition services agreement, upon written notice received by Harris at least 30 days prior to the termination of the information technology services, Harris will continue to provide the information technology service provided by Harris to Harris Stratex immediately prior to such termination for an additional six-month period, although the cost-of-services provision in the agreement will not apply during such six-month period and the parties will negotiate in good faith to determine a commercially reasonable fee for those services during that six-month period.

Termination

By Default: Harris has the right, in its sole discretion, to terminate the applicable services and/or the transition services agreement in the event that Harris Stratex fails to pay for any or all services in accordance with the terms of the transition services agreement (and the payment is not disputed by Harris Stratex in good faith in accordance with the terms of the transition services agreement).

Either party has the right, in its sole discretion, to terminate the applicable services and/or the transition services agreement in the event that: (1) the other party defaults under the transition services agreement in any material respect or (2) the other party becomes insolvent as provided in the transition services agreement, subject to applicable cure periods.

By Harris Stratex: The agreement may be terminated with respect to all services by Harris Stratex prior to the one-year anniversary of the closing of the merger and the contribution transaction upon the expiration of the longer of (1) 30 days prior written notice to Harris or (2) the longest notice period applicable to any service that has not been terminated or expired in accordance with the transition services agreement at the time of such termination. Any particular service may be separately terminated by Harris Stratex upon the expiration of the longer of (a) 30 days prior written notice to Harris or (b) the required prior written notice to Harris as specified for such service by the transition services agreement.

Indemnification

The transition services agreement includes customary indemnification.

Lease Agreement (Real Property)

Harris leases to Harris Stratex approximately 23,000 square feet of office space previously utilized by the Microwave Communications Divisions located in Melbourne, Florida, with a term of approximately two years for approximately $45,000 per month. Harris Stratex has two one-year options to renew the lease; provided that the parties can agree on the rent for each additional year, which will at least be 103% of the prior year s rent. Harris Stratex may terminate the lease at any time upon 90-days written notice to Harris provided that it pays the following early termination fee: (1) one-year s rent if such termination occurs in the first year of the two-year term or (2) the lesser of six-months rent and the rent for the remaining term of the lease, if such termination occurs after the first year of the term. Harris Stratex may not transfer the lease without the consent of Harris.

NetBoss® Service Agreement

Pursuant to the terms and conditions of the NetBoss® service agreement, Harris sold, assigned, transferred, conveyed and delivered to Harris Stratex all of Harris and any of its subsidiaries right, title and interest in and to certain contracts to the extent such rights, title and interests in and to such contracts arose out of the provision of goods and services that related to any NetBoss® integrated communications network management platform to any affiliate of Harris or any of its subsidiaries. In addition, Harris Stratex accepted the assignment and assumed and will pay, honor, perform and discharge when due all of the obligations that otherwise would be provided by Harris or one of its subsidiaries under the contracts assigned that arose out of or resulted from the provision of goods and services that related to any NetBoss® integrated communications network management platform to any affiliate of Harris or any of its subsidiaries. Harris will (or will cause one of its subsidiaries to) pay to Harris Stratex promptly when due any amounts owed to Harris Stratex in connection with the provision of goods and services relating to any NetBoss® integrated communications network management platform to any affiliate of Harris or any of its subsidiaries pursuant to and, in accordance with, the assigned contracts. For purposes of the NetBoss® service agreement, neither Harris Stratex nor any of its subsidiaries are deemed to be a subsidiary or affiliate of Harris or any of its other subsidiaries or affiliates.

Registration Rights Agreement

Harris and Harris Stratex entered into a registration rights agreement upon the combination of the Microwave Communications Division and Stratex containing the following terms:

Securities that may be registered under the agreement include (1) Harris Stratex Class A and Class B common stock or other securities acquired by Harris from Harris Stratex, (2) any securities issued or distributed regarding, or in exchange for, any such Class A or Class B common stock or securities (whether directly or indirectly or in one or a series of transactions) pursuant to any reclassification, merger, consolidation, reorganization or other transaction or procedure and (3) any securities issued or distributed regarding, or in exchange for, any securities described in clause (2) or this clause (3) (whether directly or indirectly or in one or a series of transactions) pursuant to any reclassification, merger, consolidation, reorganization or other transaction or procedure, other than, in the case of each of clauses (1), (2) and (3), any such securities that:

have been offered and sold pursuant to a registration statement that has become effective under the Securities Act;

have been transferred in compliance with Rule 144 under the Securities Act (or any successor provision thereto) under circumstances after which such registrable securities became freely transferable without registration under the Securities Act and any legend relating to transfer restrictions under the Securities Act has been removed; or

are transferable pursuant to paragraph (k) of Rule 144 (or any successor provision thereto).

Harris is permitted two shelf registrations upon request but solely for use in connection with delayed underwritten offerings;

Harris is permitted four non-shelf demand registration statements relating to underwritten offerings that have become effective and that covered all the registrable securities requested to be included;

Any demand for registration must be in respect of securities with a market value of at least $50 million based on the then prevailing market price, represent at least 5% of the outstanding Harris Stratex common stock or represent all of the securities that can be registered under the agreement by a holder and its affiliates;

Harris is entitled to customary piggyback registration rights; and

Harris Stratex has the right to postpone (or, if necessary or advisable, withdraw) the filing, or delay the effectiveness of a registration statement or offers and sales of applicable securities registered under a shelf demand registration statement if its board of directors determines in good faith that such registration would interfere with any pending financing, acquisition, corporate reorganization or other corporate transaction involving Harris Stratex or any of its subsidiaries, or would otherwise be seriously detrimental to Harris Stratex and its subsidiaries, taken as a whole, and furnishes to the electing holders of registrable shares a copy of a resolution of its board of directors setting forth such determination; *provided, however*, that Harris Stratex may not postpone a demand registration or offers and sales of applicable securities under a shelf demand registration statement more than once in any twelve-month period and that no single postponement shall exceed 90 days in the aggregate.

Lease Agreement (Equipment and Machinery)

Harris and Harris Stratex respective Canadian subsidiaries have entered into a lease agreement in connection with the combination of the Microwave Communications Division and Stratex pursuant to which the Canadian subsidiary of Harris Stratex leases from the Canadian subsidiary of Harris certain machinery, equipment and other assets as specified in the lease agreement. In consideration of its rights to the equipment, machinery and other assets, the Canadian subsidiary of Harris Stratex pays rent to the Canadian subsidiary of Harris equal to 103% of the annual depreciation of the assets leased pursuant to the lease agreement (determined in accordance with US GAAP), plus applicable taxes (or approximately $7.313 million over the term of the lease). The term of the lease agreement is five years from the closing date of the merger and the contribution transaction, unless terminated earlier pursuant to its terms. In general terms, if the aggregate option and rental payments made or due and payable under the lease agreement at the time of the termination exceed $7.313 million, the Canadian subsidiary of Harris will pay such difference to the Canadian subsidiary of Harris Stratex. However, if the aggregate option and rental payments made or due and payable under the lease agreement at the time of the termination are less than $7.313 million, the Canadian subsidiary of Harris Stratex will pay such difference to the Canadian subsidiary of Harris. At any time during the term of the lease (but not earlier than six months after its commencement), the Canadian subsidiary of Harris Stratex has the option to purchase the assets leased pursuant to the lease agreement for an amount equal to the greater of $1.00 and 103% of the net book value amount of all or that portion of the assets with respect to which the option is being exercised (subject to certain conditions).

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Tax Sharing Agreement

If the financial results of Harris Stratex are properly included in a Harris consolidated, combined, or unitary income or franchise tax return, Harris Stratex will consent to the inclusion of such results in the Harris tax return. Harris Stratex will reimburse Harris for any tax liability of Harris Stratex reflected in a Harris tax return, and Harris will reimburse Harris Stratex for use of any tax benefits of Harris Stratex that are used by Harris in its tax return. Additionally, Harris will reimburse Harris Stratex for pre-closing tax liabilities that are paid by Harris Stratex if those liabilities would not be assumed by Harris Stratex as part of the contribution transaction. Harris Stratex will also reimburse Harris for its use of any tax assets that are not assumed by Harris Stratex as part of the contribution transaction. These arrangements also apply to subsidiaries of Harris and Harris Stratex, although for purposes of the tax sharing agreement, Harris Stratex and its subsidiaries are not deemed to be subsidiaries of Harris.

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PRINCIPAL STOCKHOLDERS

The following table sets forth information regarding the beneficial ownership of Harris Stratex common stock as of February 6, 2007:

each person that will be a beneficial owner of more than 5% of Harris Stratex common stock;

each of the named executive officers of Harris Stratex;

each director or prospective director of Harris Stratex; and

all directors and named executive officers of Harris Stratex, taken together.

Beneficial ownership is determined under the rules of the Securities and Exchange Commission and generally includes voting or investment power over securities. Except in cases where community property laws apply or as indicated in the footnotes to this table, it is believed that each stockholder identified in the table possesses sole voting and investment power over all shares of Harris Stratex common stock shown as beneficially owned by that stockholder. Percentage of beneficial ownership is based on the 24,784,176 shares of Harris Stratex Class A and 32,850,965 shares of Class B common stock, which is a total of 57,635,141 shares outstanding as of February 6, 2007.

Name and Address of Beneficial Owner	Number of Shares of Class A Common Stock	Number of Shares of Class B Common Stock	Percentage of Voting Power of Class of Common Stock	Percentage of Voting Power of Common Stock
Stockholders Owning Approximately 5% or more:				
Harris Corporation 1025 West NASA Blvd Melbourne, Florida 32919		32,850,965	100%	57%
Kopp Investment Advisors, Inc. 7701 France Avenue South, Suite 500 Edina, Minnesota 55435	2,017,512 (1)		8.14%	3.5%
State of Wisconsin Investment Board P.O. Box 7842 Madison, WI 53707	2,136,533(2)		8.62%	3.7%
Sheila Baird Michael Kimelman 100 Park Avenue New York, NY 10017	1,388,634(3)		5.6%	2.41%
Directors:				
Guy M. Campbell				
Howard L. Lance				
Eric Evans				
William A. Hasler	16,189(4)		*	*
Clifford H. Higgerson	138,545(5)		*	*
Charles D. Kissner	607,053(6)		2.4%	1.04%

Dr. Mohsen Sohi			
Dr. James C. Stoffel			
Edward F. Thompson	15,000(7)	*	*
Non-Director Officers:			

Name and Address of Beneficial Owner	Number of Shares of Class A Common Stock	Number of Shares of Class B Common Stock	Percentage of Voting Power of Class of Common Stock	Percentage of Voting Power of Common Stock
Thomas H. Waechter	19,791(8)		*	*
Sarah A. Dudash				
Robert Kamenski	5,125(9)		*	*
Paul A. Kennard	157,070(10)		*	*
Juan Otero	32,018(11)			
All directors and executive officers as a group (14 individuals in total)	990,791(12)		3.88%	1.7%

* Less than 1%

(1) The number of shares of Harris Stratex Class A common stock beneficially owned was calculated based on the number of shares of Stratex common stock beneficially owned as reported in the Schedule 13G/A filed with the Securities and Exchange Commission on January 5, 2007, as adjusted for the one-for-four conversion ratio in the merger.

(2) The number of shares of Harris Stratex Class A common stock beneficially owned was

calculated based on the number of shares of Stratex common stock beneficially owned as reported in the Schedule 13G/A filed with the Securities and Exchange Commission on March 9, 2006, as adjusted for the one-for-four conversion ratio in the merger.

(3) The number of shares of Harris Stratex Class A common stock beneficially owned was calculated based on the number of shares of Stratex common stock beneficially owned as reported in the Schedule 13G filed with the Securities and Exchange Commission on February 1, 2006, as adjusted for the one-for-four conversion ratio in the merger.

(4) Includes 7,500 shares subject to options exercisable or other rights to purchase or acquire within

60 days of February 6, 2007.

(5) Includes 6,250 shares subject to options exercisable or other rights to purchase or acquire within 60 days of February 6, 2007.

(6) Includes 548,078 shares subject to options exercisable or other rights to purchase or acquire within 60 days of February 6, 2007.

(7) Includes 12,500 shares subject to options exercisable or other rights to purchase or acquire within 60 days of February 6, 2007.

(8) Includes 6,250 shares subject to options exercisable or other rights to purchase or acquire within 60 days of

February 6, 2007.

(9) Includes 3,750 shares subject to options exercisable or other rights to purchase or acquire within 60 days of February 6, 2007.

(10) Includes 133,155 shares subject to options exercisable or other rights to purchase or acquire within 60 days of February 6, 2007.

(11) Includes 22,919 shares subject to options exercisable or other rights to purchase or acquire within 60 days of February 6, 2007.

(12) Includes 740,402 shares subject to options exercisable or other rights to purchase or acquire within

60 days of
February 6,
2007.

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PLAN OF DISTRIBUTION

We are offering shares of Class A common stock upon the exercise of certain warrants originally issued by Stratex Networks, Inc., as assumed by us pursuant to that certain Warrant Assumption Agreement effective January 26, 2007.

The warrants are immediately exercisable and will expire five years after their initial issuance date in September 2004. Each warrant entitles the holder to purchase one share of Class A common stock at an initial exercise price of $11.80 per share. This exercise price will be adjusted if specific events occur. Harris Stratex does not have the right to call or otherwise redeem the warrants. The warrants are exercisable to purchase an aggregate of 539,195 shares of Class A common stock. The warrants are exercisable upon surrender of the warrant certificate on or prior to the expiration date at our principal office, with the form of election to purchase on the reverse side of the warrant certificate completed and executed as indicated, accompanied by either (1) full payment of the exercise price, in U.S. currency, by certified check or money order payable to the order of the Company, for the number of warrants being exercised or (2) by cashless exercise . The cashless exercise option allows a warrant holder to elect to pay the exercise price due upon exercise of the warrants using shares of Class A common stock instead of cash. In a cashless exercise, Harris Stratex will determine the fair market value of the shares of Class A common stock at the time of exercise, calculate the number of shares of Class A common stock that equals the exercise price due (the full number is issued at first) and deduct (repurchase from the newly issued shares of Class A common stock) that number of shares of Class A common stock from the number of warrant shares issued. To the extent that the warrant holders elect to use the warrants cashless exercise option, then Harris Stratex will issue fewer common shares than the total stated above. The exercise price and number of shares of Class A common stock issuable upon exercise of each warrant will be subject to adjustment in respect of events that may have a dilutive effect on its underlying share ownership interest.

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DETERMINATION OF OFFERING PRICE

The shares of Class A common stock offered hereby are issuable upon exercise of the warrants at a per share exercise price of $11.80, subject to adjustment, in accordance with the terms of the warrants.

DESCRIPTION OF HARRIS STRATEX CAPITAL STOCK

The following is a description of the material terms of Harris Stratex s capital stock as of the effective time of the combination of the Microwave Communications Division and Stratex and is qualified in its entirety by reference to (1) Harris Stratex s amended and restated certificate of incorporation, (2) Harris Stratex s amended and restated bylaws, and (3) the applicable provisions of the Delaware General Corporation Law. This description is not complete, and you should read the full text of these documents to fully understand the terms and conditions of Harris Stratex s capital stock.

Common Stock

Harris Stratex is authorized under its certificate of incorporation to issue up to 450,000,000 shares, of which 300,000,000 shares are designated as Class A common stock, par value $0.01 per share, and 100,000,000 shares are designated as Class B common stock, par value $0.01 per share. Except as otherwise provided in Harris Stratex s amended and restated certificate of incorporation, the Class A common stock and Class B common stock have the same rights and privileges and rank equally, share ratably and are identical in all respects. As of February 6, 2007, 24,784,176 shares of Class A common stock have been issued and 32,850,965 shares of Class B common stock have been issued. As of that time, 3,309,551 shares were subject to outstanding options or other rights to purchase or acquire.

Dividends

Subject to the rights of the holders of any series of Harris Stratex preferred stock that may be issued from time to time, the holders of Harris Stratex common stock are entitled to receive such dividends and distributions as may be declared on the common stock by the board of directors of Harris Stratex out of funds legally available for payment.

Voting

Except where otherwise required by Harris Stratex s certificate of incorporation or bylaws, the holders of Harris Stratex common stock vote together as a single class. Each share of Harris Stratex common stock entitles the holder to one vote on each matter upon which stockholders of the relevant class have the right to vote. However, Harris Stratex s amended and restated certificate of incorporation provides the holders of Class B common stock with certain sole and exclusive rights, as further described below. In particular, the holders of Class B common stock have the sole and exclusive right to elect or remove the Class B directors. Further, Harris Stratex s amended and restated certificate of incorporation cannot be amended or replaced to adversely affect the rights of holders of Class B common stock or to approve a new issuance of Class B common stock without the approval of the holders of a majority of Class B common stock.

Rights on Liquidation

Subject to the rights of the holders of any series of preferred stock of Harris Stratex that may be issued from time to time, in the event of any liquidation, dissolution or winding-up of Harris Stratex (whether voluntary or involuntary), the assets of Harris Stratex available for distribution to stockholders will be distributed in equal amounts per share to the holders of Class A common stock and the holders of Class B common stock, as if such classes constituted a single class. However, the holders of common stock will be entitled to participate in such a distribution only after Harris Stratex has paid in full all of its debts and after the holders of preferred stock of Harris Stratex have received their liquidation preferences in full. It is not expected that Harris Stratex will issue any preferred stock in the foreseeable future, although management of Harris Stratex continually reviews the optional capital structure for Harris Stratex.

Subdivision, Combinations and Mergers

If Harris Stratex splits, subdivides or combines the outstanding shares of either the Class A or the Class B common stock, the outstanding shares of the other class of Harris Stratex common stock also will be split, subdivided or combined in the same manner proportionately and on the same basis per share. In the event of any merger, statutory share exchange, consolidation or similar form of corporate transaction involving Harris Stratex (regardless of whether Harris Stratex is the surviving entity), the holders of Class A and Class B common stock will be entitled to receive the same per share consideration, if any.

Special Rights of Holders of Shares of Class B Common Stock

Exchange Rights

Voluntary

The holders of Class B common stock have the right at any time to exchange:

- any outstanding shares of Class A common stock held by the holder for an equal number of shares of Class B common stock or
- any outstanding shares of Class B common stock held by the holder for an equal number of shares of Class A common stock.

Mandatory Exchange Rights

Each share of Class B common stock automatically converts into one outstanding share of Class A common stock under the following circumstances:

- the holders of all of the outstanding shares of Class B common stock (assuming that all of the outstanding shares of Class A common stock which are then exchangeable for shares of Class B common stock have been exchanged as described under *Exchange Rights Voluntary* above) are collectively entitled to cast less than 10% of the total voting power; or
- such Class B common stock is transferred by a holder to any person who is not an affiliate of the holder or nominee of the holder or one of its affiliates unless such transfer is part of a transfer by the holder and its affiliates of all of the shares of Class B common stock then owned by them.

For purposes of the amended and restated certificate of incorporation of Harris Stratex, total voting power means, at any time, the total number of votes then entitled to be cast generally in the election of Class A directors by all holders of all classes of capital stock or securities of Harris Stratex then outstanding and entitled to vote generally in the election of Class A directors (including the holders of Class B common stock).

Board of Directors of Harris Stratex

If the Class B Common Stock Constitutes a Majority

At all times when the holders of all outstanding Class B common stock (assuming that all of the outstanding shares of Class A common stock which are then exchangeable for shares of Class B common stock have been exchanged as described under *Exchange Rights Voluntary* above) are collectively entitled to cast a majority of the total voting power:

- there will be nine directors of Harris Stratex;
- the holders of Class B common stock are permitted to elect five of the Harris Stratex directors separately as a class; and
- the quorum for action by the board of directors of Harris Stratex is a majority of the board of directors of Harris Stratex, which majority must include at least four Class B directors.

The remaining four directors of Harris Stratex will be Class A directors nominated by a nominating committee consisting solely of Class A directors then in office and elected by the holders of Class A and Class B common stock voting together as a single class (as described above).

In addition, at all times when Harris Stratex is required to have directors who satisfy the independence requirements for directors serving on an audit committee as prescribed by the NASDAQ rules, a sufficient number of the Class A directors must satisfy those requirements so that there are enough Class A directors, together with any Class B directors who are required to or otherwise satisfy those independence requirements, to constitute an audit committee of the board of directors of Harris Stratex which complies with the applicable NASDAQ rule.

If the Class B Common Stock Constitutes Less than a Majority

At all times when the holders of all outstanding Class B common stock (assuming that all of the outstanding shares of Class A common stock which are then exchangeable for shares of Class B common stock have been exchanged as described under *Exchange Rights Voluntary* above) are collectively entitled to cast less than a majority but equal to or greater than 10% of the total voting power, the holders of Class B common stock are permitted to elect a number of Class B directors equal to its percentage of total voting power times the total number of directors comprising the board of directors of Harris Stratex (rounding down to the next whole number of directors).

The remaining directors of Harris Stratex will be Class A directors nominated by a nominating committee meeting the requirements of the applicable NASDAQ rules and elected by the holders of Class A and Class B common stock voting together as a single class.

In addition, at all times when Harris Stratex is required to have directors who satisfy the applicable independence requirements prescribed by the NASDAQ rules, a sufficient number of the Class A directors must satisfy those requirements so that there are enough Class A directors, together with any Class B directors who are required to or otherwise satisfy those independence requirements, to cause Harris Stratex to comply with the applicable NASDAQ rules.

Removal and Vacancies

Holders of Class B common stock have the right to remove any Class B director with or without cause at any time for any reason and will have the right to elect any successor director to the fill the vacancies created by such removal. Any vacancy created by the resignation, death or incapacity of a Class B director will be filled by the other Class B directors then in office and, if none, by the holders of Class B common stock, voting separately as a class.

Only holders of Harris Stratex Class A common stock, voting separately as a class, are permitted to remove the Class A directors without cause or fill vacancies created by such removal, if not filled by the Class A directors then in office. Holders of Class A and Class B common stock, voting together as a single class, have the sole right to remove the Class A directors for cause and the sole right to elect successor directors to fill any vacancy caused by such removal. Any vacancy created by the resignation, death or incapacity of a Class A director will be filled by the remaining Class A directors then in office and, if none, by the holders of Class A and Class B common stock, voting separately as a class.

Freedom of Action and Corporate Opportunities

Other than opportunities offered to an individual who is a director or officer of both Harris Stratex and the holder of the Class B common stock in writing solely in that person s capacity as an officer or director of Harris Stratex, each holder of Class B common stock and its affiliates have the right to, and have no fiduciary duty or other obligation to Harris Stratex or any Harris Stratex stockholders not to, take any of the following actions:

- engage in the same or similar activities or lines of business as Harris Stratex or any of its subsidiaries or develop or market any products or services that compete, directly or indirectly, with those of Harris Stratex or any of its subsidiaries;

- invest or own any interest in, or develop a business relationship with, any entity or person engaged in the same or similar activities or lines of business as, or otherwise in competition with, Harris Stratex or any of its subsidiaries;

- do business with any client or customer of Harris Stratex or any of its subsidiaries; or

- employ or otherwise engage any former officer or employee of Harris Stratex or any of its subsidiaries.

Neither the holder of Class B common stock nor any of its affiliates nor any officer, director, employee or former employee of the holder or any of its affiliates that is not currently an employee of Harris Stratex or any of its subsidiaries (including any Class B directors) have any obligation, or be liable, to Harris Stratex, any of its subsidiaries or any of their stockholders for, or arising out of, the conduct described in the preceding paragraph or the exercise of Harris rights under the combination agreement or any related agreement, and none of these persons will be deemed to have acted (1) in bad faith, (2) in a manner inconsistent with the best interests of Harris Stratex, any of its subsidiaries or any of their stockholders or (3) in a manner inconsistent with, or opposed to, any fiduciary duty owed by them to Harris Stratex, any of its subsidiaries or any of their stockholders because of such conduct or the exercise of their rights as contemplated by the combination agreement and any related agreement.

If any holder of Class B common stock or any of its subsidiaries or any of their directors, officers or employees, including any such individuals who are also directors, officers or employees of Harris Stratex or any of its subsidiaries, acquires knowledge of a potential opportunity, transaction or matter which may be a corporate opportunity for both the holder or any of its subsidiaries and Harris Stratex, then each person or entity who has a relationship with the Class B holder and Harris Stratex as described above will have the right to, and none of them shall have any fiduciary duty or other obligation not to, pursue such corporate opportunity for itself or to direct the corporate opportunity to any of its affiliates or to any third party. Under the circumstances described in the immediately preceding sentence, no person or entity who has a relationship with the Class B holder and Harris Stratex as described above:

will have any duty to communicate, offer or present the corporate opportunity to Harris Stratex or any of its subsidiaries, directors, officers or employees;

will have any liability to Harris Stratex, any of its subsidiaries or any of their stockholders for breach of any fiduciary duty or other duty, as a stockholder, director, officer or employee of Harris Stratex or any of its subsidiaries or in any other capacity; or

will be deemed to have acted (1) in bad faith, (2) in a manner inconsistent with the best interests of Harris Stratex, any of its subsidiaries or any of their stockholders or (3) in a manner inconsistent with, or opposed to, any fiduciary duty owed by them to Harris Stratex, any of its subsidiaries or any of their stockholders because any person or entity who has a relationship with the Class B holder and Harris Stratex as described above pursues or acquires the corporate opportunity for itself, directs the corporate opportunity to any of its affiliates or any third party, or does not communicate information regarding the corporate opportunity to Harris Stratex or any of its subsidiaries, directors, officers or employees.

However, a corporate opportunity offered to a person who is a director or officer of both Harris Stratex and the holder will belong to Harris Stratex if the corporate opportunity is expressly offered to the person in writing solely in his or her capacity as a director or officer of Harris Stratex.

Preemptive Rights

Holders of Class B common stock have the right to preserve their proportionate interest in Harris Stratex by participating in any issuance of capital stock by Harris Stratex, but only when the holders of Class B common stock hold a majority of the total number of votes entitled to be cast generally in an election of the directors of Harris Stratex (other than an election of the Class B directors). If it elects to participate in the issuance, each holder of Class B common stock has the right to purchase up to that number of shares necessary to preserve its voting percentage at the same price and on the same terms and conditions otherwise being offered by Harris Stratex.

The foregoing preemptive right does not apply to any issuances pursuant to any stock option, restricted stock or employee benefit plan of Harris Stratex. However, at the end of each month, Harris Stratex will give the holders of Class B common stock written notice of all of the proposed issuances pursuant to any stock option, restricted stock or employee benefit plan, and each holder of Class B common stock will have the right within 15 days of receiving such notice to purchase for cash up to a sufficient number of shares of Class B common stock to prevent its total voting power from decreasing. The per share price for a purchase of Class B common stock pursuant to the monthly exercise notice will be the closing price of the Class A common stock on the trading day immediately preceding the date on which Harris Stratex received the notice of exercise.

Preferred Stock

Harris Stratex is authorized under its certificate of incorporation to issue up to 50,000,000 shares of preferred stock, par value $0.01 per share. As of February 6, 2007, no shares of Harris Stratex preferred stock have been issued and no such shares were subject to outstanding options and other rights to purchase or acquire. However, shares of preferred stock may be issued in one or more series from time to time by the board of directors, and the board is expressly authorized to fix by resolution or resolutions the designations and the powers, preferences and rights, and the qualifications, limitations and restrictions thereof, of the shares of each series of preferred stock.

Subject to the determination of the board of directors of Harris Stratex, the Harris Stratex preferred stock would generally have preference over Harris Stratex common stock with respect to the payment of dividends and the distribution of assets in the event of a liquidation or dissolution of Harris Stratex.

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LEGAL MATTERS

Bingham McCutchen LLP, has provided an opinion regarding the validity of the shares of Harris Stratex Class A common stock to be issued upon the exercise of warrants, as counsel for Harris Stratex.

EXPERTS

The combined financial statements of the Microwave Communications Division at June 30, 2006 and July 1, 2005, and for each of the three years in the period ended June 30, 2006, appearing in this prospectus have been audited by Ernst & Young LLP, independent registered public accounting firm, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

The consolidated financial statements and the related financial statement schedule of Stratex as of March 31, 2006 and 2005, and for each of the three years in the period ended March 31, 2006 and management s report on the effectiveness of internal control over financial reporting as of March 31, 2006, appearing in this prospectus have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their reports, that are appearing in this prospectus (which reports (1) express an unqualified opinion on the financial statements and financial statement schedule, (2) express an unqualified opinion on management s assessment regarding the effectiveness of internal control over financial reporting, and (3) express an adverse opinion on the effectiveness of internal control over financial reporting because of a material weakness) and are included in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

Harris Stratex has filed a registration statement on Form S-1 (Reg No. 333-140193), including exhibits and schedules under the Securities Act with the Securities and Exchange Commission with respect to the shares of Class A common stock offered under this prospectus. This prospectus, which forms a part of the registration statement, does not contain all of the information set forth in the registration statement, including its exhibits and schedules. You should refer to the registration statement, including its exhibits and schedules, for further information about Harris Stratex and the securities being offered hereby.

Harris Stratex also has filed a registration statement on Form S-4 (Reg No. 333-137980) (the S-4) under the Securities Act with the Securities and Exchange Commission with respect to the Harris Stratex Class A common stock issued in the combination of the Microwave Communications Division and Stratex. This prospectus, which forms a part of this registration statement on Form S-1, does not contain all of the information set forth in the S-4, including this registration statement s exhibits and schedules. You should refer to the S-4, including its exhibits and schedules, for further information about the combination of the Microwave Communications Division and Stratex.

Prior to the combination of the Microwave Communications Division and Stratex, Stratex filed annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any document that Stratex filed at the Securities and Exchange Commission s public reference room at 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Securities and Exchange Commission filings are also available to the public at the Securities and Exchange Commission s website at http://www.sec.gov. Information contained on any website referenced in this prospectus is not incorporated by reference in this prospectus.

Harris Stratex is subject to the information reporting requirements of the Exchange Act and we will file reports, proxy statements and other information with the SEC. Harris Stratex also intends to furnish its stockholders with annual reports containing our financial statements audited by an independent public accounting firm and quarterly reports containing its unaudited financial information.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors of Harris Corporation:

We have audited the accompanying combined balance sheets of The Microwave Communications Division of Harris Corporation and subsidiaries as of June 30, 2006 and July 1, 2005, and the related combined statements of operations, cash flows, and comprehensive income (loss) and division equity, for each of the three years in the period ended June 30, 2006. Our audits also included the financial statement schedule on page F-30. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of The Microwave Communications Division of Harris Corporation and subsidiaries at June 30, 2006 and July 1, 2005, and the combined results of their operations and their cash flows for each of the three years in the period ended June 30, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP
Certified Public Accountants
Jacksonville, Florida
November 21, 2006

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The Microwave Communications Division of Harris Corporation and Subsidiaries
COMBINED STATEMENTS OF OPERATIONS

	Fiscal Years Ended		
	2006	**2005**	**2004**
		(in thousands)	
Revenue from product sales and services			
Revenue from external product sales	**$ 299,052**	$ 260,205	$ 282,383
Revenue from product sales with parent	**6,546**	3,138	238
Total revenue from product sales	**305,598**	263,343	282,621
Revenue from services	**51,902**	47,084	47,195
	357,500	310,427	329,816
Cost of product sales and services			
Cost of external product sales	**(221,549)**	(180,639)	(214,119)
Cost of product sales with parent	**(7,407)**	(3,700)	(1,565)
Total cost of product sales	**(228,956)**	(184,339)	(215,684)
Cost of services	**(37,132)**	(31,314)	(26,352)
Cost of sales billed from parent	**(5,252)**	(4,293)	(3,897)
	(271,340)	(219,946)	(245,933)
Engineering, selling and administrative expenses	**(96,658)**	(81,747)	(90,537)
Engineering, selling and administrative expenses with parent	**(5,622)**	(6,017)	(6,583)
Total engineering, selling and administrative expenses	**(102,280)**	(87,764)	(97,120)
Corporate allocations expense	**(12,425)**	(6,189)	(6,770)
Interest income	**431**	905	
Interest expense	**(975)**	(966)	(140)
Loss before income taxes	**(29,089)**	(3,533)	(20,147)
Income tax expense	**(6,759)**	(245)	(86)
Net loss	**$ (35,848)**	$ (3,778)	$ (20,233)

See Notes to Combined Financial Statements

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The Microwave Communications Division of Harris Corporation and Subsidiaries
COMBINED BALANCE SHEETS

	June 30, 2006	July 1, 2005
	(in thousands)	
Assets		
Current Assets:		
Cash and cash equivalents	**$ 13,834**	$ 7,803
Receivables	**123,939**	114,544
Unbilled costs	**25,504**	17,565
Inventories	**71,858**	91,051
Total current assets	**235,135**	230,963
Other Assets:		
Plant and equipment	**51,770**	57,010
Goodwill	**28,260**	26,100
Identifiable intangible assets	**6,388**	6,225
Capitalized software	**9,171**	7,855
Non-current notes receivable	**3,800**	8,097
Non-current deferred income taxes	**9,616**	15,296
Other assets	**8,509**	11,423
	117,514	132,006
	$ 352,649	$ 362,969
Liabilities and Division Equity		
Current Liabilities:		
Short-term debt	**$ 160**	$ 1,021
Accounts payable	**42,135**	33,057
Compensation and benefits	**17,428**	13,920
Other accrued items	**19,057**	13,687
Advance payments and unearned income	**9,207**	6,791
Total current liabilities	**87,987**	68,476
Other Liabilities:		
Due to Harris Corporation	**12,642**	14,180
Total liabilities	**100,629**	82,656
Division Equity:		
Division equity	**253,400**	294,229
Accumulated other comprehensive income (loss)	**(1,380)**	(13,916)
Total division equity	**252,020**	280,313
	$ 352,649	$ 362,969

See Notes to Combined Financial Statements

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The Microwave Communications Division of Harris Corporation and Subsidiaries
COMBINED STATEMENTS OF CASH FLOWS

	Fiscal Years Ended		
	2006	**2005**	**2004**
		(in thousands)	
Operating Activities			
Net loss	**$ (35,848)**	$ (3,778)	$ (20,233)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	**15,689**	14,607	13,782
Provision for uncollectable amounts	4,161	1,023	3,178
Provision for excess and obsolete inventory	38,512	(1,074)	12,601
Gain on sale of land and building	**(1,844)**		
Non-current deferred income taxes	**5,680**		
(Increase) decrease in:			
Receivables	**(9,258)**	(861)	7,513
Unbilled costs and inventories	**(27,259)**	(14,929)	2,197
Increase (decrease) in:			
Accounts payable and accrued expenses	**17,956**	(4,473)	5,212
Advance payments and unearned income	**2,416**	(4,973)	(11,963)
Due to Harris Corporation	**(1,538)**	(797)	3,078
Other	**10,816**	11,014	23,227
Net cash provided by (used in) operating activities	**19,483**	(4,241)	38,592
Investing Activities			
Proceeds from sale of land and building	**4,598**		
Additions of plant and equipment	**(9,563)**	(9,310)	(11,830)
Additions of capitalized software	**(3,240)**	(10,107)	(2,849)
Net cash used in investing activities	**(8,205)**	(19,417)	(14,679)
Financing Activities			
Proceeds from short-term borrowings	**9,352**	4,381	2,895
Repayments of short-term borrowings	**(10,213)**	(9,147)	(27,478)
Net cash and other transfers (to) from Harris Corporation	**(4,981)**	29,655	(3,993)
Net cash provided by (used in) financing activities	**(5,842)**	24,889	(28,576)
Effect of exchange rate changes on cash and cash equivalents	**595**	1,275	(1,138)
Net increase (decrease) in cash and cash equivalents	**6,031**	2,506	(5,801)
Cash and cash equivalents, beginning of year	**7,803**	5,297	11,098

Cash and cash equivalents, end of year	**$ 13,834**	$ 7,803	$ 5,297

See Notes to Combined Financial Statements

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The Microwave Communications Division of Harris Corporation and Subsidiaries
COMBINED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
AND DIVISION EQUITY

		Accumulated Other Comprehensive Income (Loss) Net Unrealized Gain (Loss) From		
	Division Equity	Hedging Derivatives	Foreign Currency Translation	Total
	(in thousands)			
Balance at June 27, 2003	$ 292,578	$	$ (20,228)	$ 272,350
Net loss	(20,233)			(20,233)
Foreign currency translation			(1,687)	(1,687)
Net unrealized gain on hedging activities, net of $0 tax		80		80
Comprehensive loss				(21,840)
Net decrease in investment from Harris Corporation	(3,993)			(3,993)
Balance at July 2, 2004	268,352	80	(21,915)	246,517
Net income	(3,778)			(3,778)
Foreign currency translation			7,728	7,728
Net unrealized gain on hedging activities, net of $0 tax		191		191
Comprehensive income				4,141
Net increase in investment from Harris Corporation	29,655			29,655
Balance at July 1, 2005	294,229	271	(14,187)	280,313
Net loss	**(35,848)**			**(35,848)**
Foreign currency translation			**12,740**	**12,740**
Net unrealized loss on hedging activities, net of $0 tax		**(204)**		**(204)**
Comprehensive loss				**(23,312)**
Net decrease in investment from Harris Corporation	**(4,981)**			**(4,981)**
Balance at June 30, 2006	**$ 253,400**	**$ 67**	**$ (1,447)**	**$ 252,020**

See Notes to Combined Financial Statements

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The Microwave Communications Division of Harris Corporation and Subsidiaries
NOTES TO COMBINED FINANCIAL STATEMENTS
At June 30, 2006 and July 1, 2005 and
For Each of the Three years in the Period Ended June 30, 2006

1. Significant Accounting Policies

Nature of Operations The Microwave Communications Division of Harris Corporation and Subsidiaries (MCD or the Company) designs, manufactures and sells a broad range of microwave radios for use in worldwide wireless communications networks. Applications include cellular/mobile infrastructure connectivity; secure data networks; public safety transport for state, local and Federal government users; and right-of-way connectivity for utilities, pipelines, railroads and industrial companies. In general, wireless networks are constructed using microwave radios and other equipment to connect cell sites, fixed-access facilities, switching systems, land mobile radio systems and other similar systems.

Basis of Presentation The accompanying combined financial statements include the accounts of the Aftermarket Business, which consists of the accounts of the Microwave Communications Division of Harris Corporation and its subsidiaries. As used in these notes, the terms MCD, we, our and us refer to the combine operations of the Microwave Communications Division of Harris Corporation and its consolidated subsidiaries. Significant intercompany transactions and accounts have been eliminated. The combined financial statements are prepared in conformity with U.S. generally accepted accounting principles.

The accompanying historical financial statements are presented on a carve-out basis and reflect the assets, liabilities, revenues and expenses that were directly attributable to MCD as it was operated within Harris Corporation. MCD s combined statements of operations include all of the related costs of doing business, including an allocation of certain general corporate expenses of Harris Corporation, which were in support of MCD, including costs for finance, legal, treasury, purchasing, quality, environmental, safety, human resources, tax, audit and public relations departments and other corporate and infrastructure costs. MCD was allocated $12,425 thousand, $6,189 thousand and $6,770 thousand of these overhead costs related to Harris Corporation s shared functions for the years ended June 30, 2006, July 1, 2005, and July 2, 2004, respectively. These costs represent approximately 16.7%, 10.7% and 13.1%, respectively, of the total cost of these shared services in each of the years ended June 30, 2006, July 1, 2005, and July 2, 2004. These cost allocations were primarily based on a ratio of MCD sales to total Harris Corporation sales multiplied by the total Headquarters Expense of Harris Corporation. Included in corporate allocations expense for the year ended June 30, 2006, is a specifically identified amount of $5,400 thousand related to the settlement of a lawsuit related to MCD. Management believes that these allocations were made on a reasonable basis.

Use of Estimates These combined financial statements have been prepared in conformity with U.S. generally accepted accounting principles and require management to make estimates and assumptions. These assumptions 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 revenue and expenses during the reporting period. These estimates are based on experience and other information available prior to issuance of the financial statements. Materially different results can occur as circumstances change and additional information becomes known.

Fiscal Year Our fiscal year ends on the Friday nearest June 30. Fiscal 2006 and fiscal 2005 include 52 weeks, and fiscal 2004 includes 53 weeks.

Cash Equivalents Cash equivalents are temporary cash investments with a maturity of three or fewer months when purchased. These investments, including accrued interest, are carried at the lower of cost or market.

Accounts Receivable We record receivables at net realizable value, which includes an allowance for estimated uncollectible accounts to reflect any loss anticipated on the accounts receivable balances. We calculate the allowance based on our history of write-offs, level of past due accounts and economic status of the customers. See Note 3, Receivables for additional information.

Inventories Inventories are valued at the lower of cost (determined by average cost and first-in, first-out methods) or market. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and production requirements. See

Note 4, Inventories for additional information regarding inventories.

Plant and Equipment Plant and equipment are carried on the basis of cost. Depreciation of buildings, machinery and equipment is computed substantially by the straight-line method. The estimated useful lives of buildings range between 5 and 50 years. The estimated useful lives of machinery and equipment range between 3 and 10 years. See Note 5, Plant and Equipment for additional information regarding plant and equipment.

Capitalized Software Software to be sold, leased, or otherwise marketed is accounted for in accordance with Statement of Financial Accounting Standards Board Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* (FAS 86). Costs incurred to acquire or create a computer software product must be expensed when incurred as research and development until technological feasibility has been established for the product. Technological feasibility is normally established upon completion of a detailed program design or, in its absence, completion of a working model.

Capitalized software, accounted for under FAS 86, was $9,171 thousand at June 30, 2006 and $7,855 thousand at July 1, 2005. Total amortization expense related to these capitalized software amounts was $1,629 thousand in fiscal 2006, $1,483 thousand in fiscal 2005 and $480 thousand in fiscal 2004.

Income Taxes Historically, our operations have been included in the consolidated federal income tax returns filed by Harris Corporation. The provision for income taxes in the Combined Statement of Operations is calculated on a separate tax return basis as if we had operated as a stand-alone entity in fiscal 2006, 2005 and 2004. We follow the liability method of accounting for income taxes. We record the estimated future tax effects of temporary differences between the tax basis of assets and liabilities and amounts reported in our Combined Balance Sheets, as well as operating loss and tax credit carryforwards. We follow very specific and detailed guidelines in each tax jurisdiction regarding the recoverability of any tax assets recorded on the balance sheet and provide necessary valuation allowances as required. We regularly review our deferred tax assets for recoverability based on historical taxable income, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. See Note 15, Income Taxes, for additional information regarding income taxes.

Goodwill Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (Statement 142), indefinite-life identifiable intangible assets and goodwill are not amortized. Under the provisions of Statement 142, we are required to perform an annual (or under certain circumstances more frequent) impairment test of our goodwill. Goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit, which we define as our business segments, with its net book value or carrying amount including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. The fair value of the reporting unit is allocated to all of the assets and liabilities of that unit including any unrecognized intangible assets as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. See Note 6, Goodwill and Other Intangible Assets, for additional information regarding goodwill.

Impairment of Long-Lived Assets and Identifiable Intangible Assets We assess the recoverability of the carrying value of our long-lived assets and identifiable intangible assets with finite useful lives whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable. We evaluate the recoverability of such assets based upon the expectations of undiscounted cash flows from such assets. If the sum of the expected future undiscounted cash flows were less than the carrying amount of the asset, a loss would be recognized for the difference between the fair value and the carrying amount. See Note 5, Plant and Equipment, and Note 6, Goodwill and Other Intangible Assets, for additional information regarding long-lived assets and identifiable intangible assets.

Operating Leases We lease office and manufacturing facilities under various operating leases. These lease agreements generally include rent escalation clauses, and many include renewal periods at the Company s option. The Company recognizes scheduled rent increases on a straight-line basis over the lease term beginning with the date the Company takes possession of the leased space.

Other Accrued Items and Other Assets No accrued liabilities or expenses within the caption Other accrued items on our Combined Balance Sheets exceed 5% of our total current liabilities as of June 30, 2006 or as of July 1, 2005. No current assets other than those already disclosed on the Combined Balance Sheets exceed 5% of our total current assets as of June 30, 2006 or as of July 1, 2005. No assets within the caption Other assets on the Combined Balance Sheets exceed 5% of total assets as of June 30, 2006 or as of July 1, 2005.

Warranties On product sales we provide for future warranty costs upon product delivery. The specific terms and conditions of those warranties vary depending upon the product sold and country in which we do business. In the case of products sold by us, our warranties generally start from the delivery date and continue for two to three years, depending on the terms.

Because our products are manufactured, in many cases, to customer specifications and their acceptance is based on meeting those specifications, we historically have experienced minimal warranty costs. Factors that affect our warranty liability include the number of installed units, historical experience and management s judgment regarding anticipated rates of warranty claims and cost per claim. We assess the adequacy of our recorded warranty liabilities every quarter and make adjustments to the liability as necessary.

Network management software products generally carry a 30- to 90-day warranty from the date of acceptance. Our liability under these warranties is either to provide a corrected copy of any portion of the software found not to be in substantial compliance with the agreed-upon specifications, or to provide a full refund.

Our software license agreements generally include certain provisions for indemnifying customers against liabilities should our software products infringe a third party s intellectual property rights. To date, we have not incurred any material costs as a result of such indemnification and have not accrued any liabilities related to such obligations in our combined financial statements. See Note 7, Accrued Warranties, for additional information regarding warranties.

Foreign Currency Translation The functional currency for most international subsidiaries is the local currency. Assets and liabilities are translated at current rates of exchange and income and expense items are translated at the weighted average exchange rate for the year. The resulting translation adjustments are recorded as a separate component of equity.

Stock Options and Share-Based Compensation Prior to the July 2, 2005 start of our fiscal year 2006, we accounted for the share-based compensation granted under our stock incentive plans under the recognition and measurement provisions of APB 25, *Accounting for Stock Issued to Employees*, and related interpretations (APB 25). In accordance with APB 25 we used the intrinsic-value method of accounting for stock option awards to employees and accordingly did not recognize compensation expense for our stock option awards to employees in our Combined Statements of Operations prior to the start of our fiscal year 2006, as all option exercise prices were 100% of fair market value on the date the options were granted. Effective July 2, 2005, we implemented Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (Statement 123R) for all share-based compensation, including share-based compensation that was not vested as of the end of our fiscal year 2005. In accordance with Statement 123R we measure compensation cost for all share-based payments (including employee stock options) at fair value and recognize cost over the vesting period. See Note 2: Accounting Changes or Recent Pronouncements and Note 10: Stock Options and Share-Based Compensation, for additional information regarding stock options, performance shares and restricted shares including the impact of implementing Statement 123R on our results of operations and cash flows.

Related Party Transactions Harris Corporation provides information services, human resources, financial shared services, facilities, legal support, and supply chain management services to us. The charges for these services are billed to us primarily based on actual usage. These amounts are charged directly to MCD and are not part of the Corporate allocations expense that is included on the Combined Statements of Operations. The amount charged to us for these services was $10,874 thousand in fiscal 2006, $10,310 thousand in fiscal 2005, and $10,480 thousand in fiscal 2004, and is included in the Cost of product sales and Engineering, selling and administrative expenses captions on the Combined Statements of Operations.

There are other services Harris Corporation provides to us that are not directly charged to us. These functions and amounts are explained above under the subtitle Basis of Presentation. These amounts are included within Due to Harris Corporation on the Combined Balance Sheets. Additionally, we have other receivables and payables in the normal course of business with Harris Corporation. These amounts are netted within Due to Harris

Corporation on the Combined Balance Sheets. Total receivables from Harris Corporation were $7,484 thousand and $6,327 thousand at June 30, 2006 and July 1, 2005, respectively. Total payables to Harris Corporation were $20,126 thousand and $20,507 thousand at June 30, 2006 and July 1, 2005, respectively.

Harris Corporation is the primary source of our financing and equity activities. During fiscal 2006, Harris Corporation provided $2,824 thousand to recapitalize one of our subsidiaries and Harris Corporation s net investment in us was reduced by $7,805 thousand. During fiscal 2005, Harris Corporation provided $42,960 thousand to recapitalize some of our subsidiaries and Harris Corporation s net investment in us was reduced by $13,305 thousand. During fiscal 2004, Harris Corporation provided $2 thousand to capitalize a new subsidiary and Harris Corporation s net investment in us was reduced by $3,995 thousand.

Additionally, we have loans from Harris Corporation to fund our international entities and we also provide excess cash at various locations to Harris Corporation. We recognize interest income and expense on these loans. We recognized interest income of $291 thousand, $198 thousand and none in fiscal year 2006, 2005 and 2004, respectively. We recognized interest expense of $488 thousand, $679 thousand and $140 thousand in fiscal year 2006, 2005 and 2004, respectively.

We have sales to and purchases from other entities of Harris Corporation from time to time. These transactions have been recorded at cost to the buying entity and the selling entity recognizes a normal profit. Total sales to other entities of Harris Corporation were $7,162 thousand, $3,538 thousand and $239 thousand in fiscal 2006, 2005 and 2004, respectively. We recognized profit associated with these related party sales of $616 thousand, $400 thousand and $1 thousand in fiscal year 2006, 2005 and 2004, respectively. We also recognized costs associated with these related party purchases of $245 thousand, $162 thousand and $1,326 thousand in fiscal 2006, 2005 and 2004, respectively.

Revenue Recognition Revenue primarily relates to product sales (other than for long-term contracts) and service arrangements, which are recognized when persuasive evidence of an arrangement exists, the fee is fixed or determinable, collectibility is probable, delivery of a product has occurred and title has transferred or services have been rendered. Further, if an arrangement other than a long-term contract requires the delivery or performance of multiple deliverables or elements under a bundled sale, we determine whether the individual elements represent separate units of accounting under the requirements of Emerging Issues Task Force Issue 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21). If the separate elements meet the requirements listed in EITF 00-21, we recognize the revenue associated with each element separately. If the elements within a bundled sale are not considered separate units of accounting, the delivery of an individual element is considered not to have occurred if there are undelivered elements that are essential to the functionality. Unearned income on service contracts is amortized by the straight-line method over the term of the contracts. Also, if contractual obligations related to customer acceptance exist, revenue is not recognized for a product or service unless these obligations are satisfied.

Revenue recognition from long-term contracts is recorded on a percentage-of-completion basis, generally using the cost-to-cost method of accounting where sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. Recognition of profit on long-term fixed-price contracts requires estimates of: the total contract value; the total cost at completion; and the measurement of progress towards completion. Revenue and profits on cost-reimbursable contracts are recognized as allowable costs are incurred on the contract and become billable to the customer, in an amount equal to the allowable costs plus the profit on those costs. Contracts are combined when specific aggregation criteria stated in the American Institute of Certified Public Accountant s Statement of Position No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (SOP 81-1), are met. Aggregation criteria generally include closely interrelated activities performed for a single customer within the same economic environment. Contracts generally are not segmented. If contracts are segmented, they meet the segmenting criteria stated in SOP 81-1. Amounts representing contract change orders, claims or other items are included in sales only when they can be reliably estimated and realization is probable. Incentives or penalties and awards applicable to performance on contracts are considered in estimating sales and profit rates and are recorded when there is sufficient information to assess anticipated contract performance. Incentive provisions, which increase earnings based solely on a single significant event, are generally not recognized until the event occurs. When adjustments in contract value or estimated costs are determined, any changes from prior estimates are reflected in earnings in the current period. Anticipated losses on contracts or programs in progress are charged to earnings when identified.

Revenue recognition for internally developed capitalized software is in accordance with Statement of Position 97-2, *Software Revenue Recognition* (SOP 97-2). Typically, our capitalized software sales do not have acceptance criteria in the contracts and proper documentation of Vendor Specific Objective Evidence (VSOE) is obtained before revenue is allocated to the various elements of the arrangement in accordance with SOP 97-2.

Royalty income is recognized on the basis of terms specified in the contractual agreements.

Retirement Benefits As of June 30, 2006, we provide retirement benefits to substantially all employees primarily through Harris Corporation s defined contribution retirement plan, which has profit sharing, matching and savings elements. Contributions by us to the retirement plan are based on profits and employees savings with no other funding requirements. We may make additional contributions to the plan at our discretion. Retirement benefits also include an unfunded limited healthcare plan for U.S.-based retirees and employees on long-term disability. We accrue the estimated cost of these medical benefits, which are not material, during an employee s active service life.

Retirement plan expense amounted to $8,434 thousand in fiscal 2006, $7,057 thousand in fiscal 2005 and $6,819 thousand in fiscal 2004.

Financial Guarantees and Commercial Commitments Guarantees are contingent commitments issued to guarantee the performance of a customer to a third party in borrowing arrangements, such as commercial paper issuances, bond financings and similar transactions. The terms of the guarantees are equal to the remaining term of the related debt, which are limited to one year or less. The maximum potential amount of future payments we could be required to make under our guarantees at June 30, 2006 is $392 thousand. At June 30, 2006, there are no guarantees accrued for in our Combined Balance Sheets. We also hold insurance policies with third parties to mitigate the risk of loss on a portion of these guarantees. We have entered into commercial commitments in the normal course of business including surety bonds, standby letter of credit agreements and other arrangements with financial institutions and customers primarily relating to the guarantee of future performance on certain contracts to provide products and services to customers and to obtain insurance policies with our insurance carriers. At June 30, 2006, we had commercial commitments of $31,361 thousand.

Financial Instruments and Risk Management Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (Statement 133), requires us to recognize all derivatives on the Combined Balance Sheets at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative s change in fair value is immediately recognized in earnings.

As part of our risk management program we use a combination of foreign currency options and foreign currency forward contracts to hedge against risks associated with anticipated cash flows that are probable of occurring in the future and cash flows that are fixed or firmly committed. These derivatives have only nominal intrinsic value at the time of purchase and have a high degree of correlation to the anticipated cash flows they are designated to hedge. Hedge effectiveness is determined by the correlation of the anticipated cash flows and the maturity dates of the derivatives used to hedge these cash flows. We do not hold or issue derivative financial instruments for trading purposes.

We account for our instruments used to hedge against the currency risk and market fluctuation risk associated with anticipated or forecasted cash flows that are probable of occurring in the future as cash flow hedges. In accordance with Statement 133, such financial instruments are marked-to-market using forward prices and fair value quotes with the offset to other comprehensive income, net of hedge ineffectiveness. The foreign currency call options and forward contracts are subsequently recognized as a component of Cost of product sales on the Combined Statement of Operations when the underlying net cash flows are realized. Unrealized losses are recorded in Other accrued items on the Combined Balance Sheets with the offset to other comprehensive income, net of hedge ineffectiveness. Unrealized gains are recorded as Other assets on the Combined Balance Sheets with the offset to other comprehensive income, net of hedge ineffectiveness.

We are exposed to credit losses in the event of non-performance by counterparties to these financial instruments, but we do not expect any of the counterparties to fail to meet their obligations. To manage credit risks, we select counterparties based on credit ratings, limit our exposure to a single counterparty under defined guidelines and monitor the market position with each counterparty. In the event of the termination of a derivative designated as a hedge, the settlement would be charged to the Combined Statements of Operations as a component of Non-operating income (loss).

2. Accounting Changes or Recent Pronouncements

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, *Inventory Costs an amendment of Accounting Research Bulletin 43, Chapter 4* (Statement 151). Statement 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. Paragraph 5 of Accounting Research Bulletin (ARB) 43, Chapter 4 Inventory Pricing, previously stated that ...under certain circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current-period charges... Statement 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. In addition, Statement 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. Statement 151 is effective for fiscal years beginning after June 15, 2005. We implemented the provisions of

Statement 151 during the first quarter of fiscal 2006, and it did not have a material impact on our financial position, results of operations or cash flows.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment* (Statement 123R), which requires all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value and to recognize cost over the vesting period. In March 2005, the SEC released SEC Staff Accounting Bulletin No. 107, *Share-Based Payment* (SAB 107). SAB 107 provides the SEC staff position regarding the application of Statement 123R, including interpretive guidance related to the interaction between Statement 123R and certain SEC rules and regulations, and provides the staff s views regarding the valuation of share-based payment arrangements for public companies. In April 2005, the SEC announced that companies may implement Statement 123R at the beginning of their next fiscal year after June 15, 2005, or December 15, 2005 for small business issuers. We implemented the provisions of Statement 123R and SAB 107 in the first quarter of fiscal 2006 using the modified-prospective method, and it did not have a material impact on our financial position. See Note 10, Stock Options and Share-Based Compensation for further information and the required disclosures under Statement 123R and SAB 107, including the impact of the implementation on our results of operations and cash flows.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* (Statement 154), which replaces APB Opinion No. 20, *Accounting Changes* and FASB Statement of Financial Accounting Standards No. 3, *Reporting Accounting Changes in Interim Financial Statements.* Statement 154 changes the requirements for the accounting for and reporting of a change in accounting principle. Statement 154 applies to all voluntary changes in accounting principles and applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. Statement 154 requires retroactive application to prior period financial statements for a change in accounting principle. Previously, a change in accounting principle was recognized by including the change in the net income in the period of the change. Statement 154 is effective for fiscal years ending after December 15, 2005. We implemented the provisions of Statement 154 in the first quarter of fiscal 2006, and it did not have a material impact on our financial position, results of operations or cash flows.

In November 2005, the FASB issued FSP FAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* (FSP 123R-3). FSP 123R-3 provides a simplified alternative method to calculate the beginning pool of excess tax benefits against which excess future deferred tax assets (that result when the compensation cost recognized for an award exceeds the ultimate tax deduction) could be written off under Statement 123R. The guidance in FSP 123R-3 was effective on November 10, 2005. We may make a one-time election to adopt the transition method described in FSP 123R-3 before November 10, 2006. We are currently evaluating the available transition alternatives of FSP 123R-3. We currently have implemented the provisions of Statement 123R following the guidance for calculating the pool of excess tax benefits described in paragraph 81 of Statement 123R and the guidance related to reporting cash flows described in paragraph 68 of Statement 123R. If we elect the alternative method described in FSP 123R-3, the effect of applying the transition method described in FSP 123R-3 must be reported as a change in accounting principle in accordance with Statement 154 and the financial results for periods subsequent to the adoption of Statement 123R must be retroactively restated. We will not be required, however, to justify the preferability of our election, if we elect the transition method described in FSP 123R-3, and we are free to choose either approach to the calculation of the pool of excess tax benefits. We do not believe the adoption of this FSP 123R-3 will have a material impact on our financial position, results of operations or cash flows.

In February 2006, the FASB issued FSP FAS 123(R)-4, *Classification of Options and Similar Instruments Issued as Employee Compensation that Allow for Cash Settlement upon the Occurrence of a Contingent Event* (FSP 123R-4). FSP 123R-4 addresses the classification of options and similar instruments issued as employee compensation that allow for cash settlement upon the occurrence of a contingent event. A cash settlement feature that can be exercised only upon the occurrence of a contingent event that is outside the employee s control does not meet the conditions in paragraphs 32 and A229 of Statement 123R until it becomes probable that the event will occur. The guidance in FSP 123R-4 was effective on February 3, 2006. We implemented the provisions of

FSP 123R-4 during the third quarter of fiscal 2006 and it did not have a material impact on our financial position, results of operations or cash flows.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. We are currently evaluating the impact this interpretation will have on our financial statements. This interpretation will be effective for us beginning July 1, 2007.

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3. Receivables

Receivables are summarized below:

	2006	2005
	(In thousands)	
Accounts receivable	**$ 122,208**	$ 115,080
Notes receivable due within one year net	**9,784**	6,770
	131,992	121,850
Less allowances for collection losses	**(8,053)**	(7,306)
	$ 123,939	$ 114,544

The provision for allowance for collection losses amounted to $4,161 thousand in fiscal 2006, $1,024 thousand in fiscal 2005 and $2,729 thousand in fiscal 2004. These expenses are included in the Engineering, selling and administrative expenses caption on the Combined Statements of Operations.

4. Inventories

Inventories are summarized below:

	2006	2005
	(in thousands)	
Finished products	**$ 17,111**	$ 15,311
Work in process	**34,385**	21,243
Raw materials and supplies	**38,646**	87,353
	90,142	123,907
Inventory reserves	**(18,284)**	(32,856)
	$ 71,858	$ 91,051

During the second quarter of 2006, we had a $34,907 thousand write-down of inventory related to product discontinuance.

5. Plant and Equipment

Plant and equipment are summarized below:

	2006	2005
	(in thousands)	
Land	**$ 585**	$ 1,578
Buildings	**21,947**	26,003
Machinery and equipment	**91,660**	109,735
	114,192	137,316
Less allowances for depreciation	**(62,422)**	(80,306)
	$ 51,770	$ 57,010

Depreciation expense related to plant and equipment was $12,575 thousand, $11,789 thousand and $11,723 thousand in fiscal 2006, fiscal 2005, and fiscal 2004, respectively.

During 2006, we recognized a gain of $1,844 thousand from the sale of land and building that is included in the Engineering, selling and administrative expenses caption on the Combined Statements of Operations.

6. Goodwill and Other Intangible Assets

Goodwill for our North America microwave segment was $1,890 thousand at fiscal 2006 and fiscal 2005. Goodwill for our International microwave segment was $26,370 thousand and $24,210 thousand at fiscal 2006 and fiscal 2005, respectively. There was no goodwill in our NetBoss® segment. Changes in the carrying amount of goodwill for the fiscal years ended June 30, 2006 and July 1, 2005, are as follows:

	2006	2005
	(in thousands)	
Balance at beginning of year	**$ 26,100**	$ 24,472
Translation adjustments	**2,160**	1,628
	$ 28,260	$ 26,100

We have other identifiable intangible assets related primarily to technology acquired through acquisitions. The unamortized other identifiable intangible assets, included in Identifiable intangible assets on our Combined Balance Sheets, were $6,388 thousand at June 30, 2006 and $6,225 thousand at July 1, 2005. Accumulated amortization related to other identifiable intangibles was $6,390 thousand at June 30, 2006 and $5,151 thousand at July 1, 2005. Our other identifiable intangible assets are being amortized over their useful economic lives, which range from 2 to 17 years. The weighted average useful life of our other identifiable intangible assets is 15.3 years. Amortization expense related to other identifiable intangible assets was $1,239 thousand in fiscal 2006, $868 thousand in fiscal 2005 and $824 thousand in fiscal 2004. The estimated amortization expense for the five fiscal years following fiscal 2006 is: $1,249 thousand in fiscal 2007, $860 thousand in fiscal 2008, $770 thousand in fiscal 2009, $694 thousand in fiscal 2010, $694 thousand in fiscal 2011, and $2,121 thousand thereafter.

7. Accrued Warranties

Changes in our warranty liability, which is included as a component of Other accrued items on the Combined Balance Sheets, during fiscal 2006 and 2005, are as follows:

	2006	2005
	(in thousands)	
Balance as of the beginning of the year	**$ 3,796**	$ 4,165
Warranty provision for sales made during the year	**3,560**	3,757
Settlements made during the year	**(3,631)**	(4,325)
Other adjustments to the liability including foreign currency translation during the year	**196**	199
Balance as of the end of the year	**$ 3,921**	$ 3,796

8. Short-Term Debt

Short-term debt of $160 thousand at June 30, 2006 and $1,021 thousand at July 1, 2005 consists solely of notes payable to banks in both years. The weighted average interest rate for bank notes was 6.8% at June 30, 2006 and 9.0% at July 1, 2005.

We have uncommitted short-term lines of credit aggregating $20,196 thousand from various international banks, $20,036 thousand of which was available on June 30, 2006. These lines provide for borrowings at various interest rates, typically may be terminated upon notice, may be used on such terms as mutually agreed to by the banks and us and are reviewed annually for renewal or modification.

9. Restructuring Charges

During fiscal 2006, we recorded $3,691 thousand of restructuring charges. In order to reduce expenses and increase operational efficiency, we implemented a restructuring plan in the second quarter of fiscal 2006 which included moving manufacturing at our Montreal, Canada location to our San Antonio, Texas manufacturing plant. As part of the restructuring plan, we reduced the workforce by 110 employees and recorded restructuring charges for employee severance benefits of $2,262 thousand and building lease obligations and transition costs of $1,429 thousand in fiscal 2006. In connection with this restructuring, we also recorded $1,095 thousand for fixed asset write-offs.

We did not record any restructuring charges in fiscal 2005.

In fiscal 2004, we recorded $6,742 thousand of restructuring charges. We reduced the workforce by 95 employees and recorded restructuring charges for employee severance and benefits of $5,439 thousand. Additionally, we recorded $685 thousand for the impairment of two lease obligations and $618 thousand for legal fees and other costs. In connection with this restructuring, we also recorded $506 thousand for fixed asset write-offs.

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The following table summarizes the activity relating to restructuring charges for the three years ended June 30, 2006:

	Severance and Benefits	Facilities and Other	Total
		(in thousands)	
Balance at June 27, 2003	$ 1,317	$ 478	$ 1,795
Provision in fiscal 2004	5,439	1,303	6,742
Cash payments in fiscal 2004	(1,459)	(478)	(1,937)
Balance at July 2, 2004	5,297	1,303	6,600
Provision in fiscal 2005			
Cash payments in fiscal 2005	(4,979)	(1,303)	(6,282)
Balance at July 1, 2005	318		318
Provision in fiscal 2006	**2,262**	**1,429**	**3,691**
Cash payments in fiscal 2006	**(724)**	**(1,123)**	**(1,847)**
Balance at June 30, 2006	**$ 1,856**	**$ 306**	**$ 2,162**

10. Stock Options and Share-Based Compensation

As of June 30, 2006, Harris Corporation had three shareholder-approved stock incentive plans for employees. Harris Corporation currently has the following types of share-based awards outstanding under these plans that MCD employees participate in: stock options, performance share awards, performance share unit awards and restricted stock awards. We believe that such awards more closely align the interests of our employees with those of our shareholders. Certain share-based awards provide for accelerated vesting if there is a change in control (as defined under our stock incentive plans). Shares of common stock reserved for future awards under our stock incentive plans were 26,664,427 as of June 30, 2006.

The compensation cost related to our share-based awards that was charged against income was $1,678 thousand for the year ended June 30, 2006. There was no income tax benefit included in net income for share-based compensation arrangements for the year ended June 30, 2006. The $1,678 thousand of compensation cost related to share-based compensation arrangements was included in the Engineering, selling and administrative expenses captions in the Combined Statements of Operations. None of the compensation cost related to share-based compensation arrangements was capitalized as part of inventory or fixed assets as of June 30, 2006.

The following table illustrates the pro forma effect on net income (loss) for fiscal 2005 and fiscal 2004 assuming we had applied the fair value recognition provisions of Statement 123R to all previously granted share-based awards after giving consideration to potential forfeitures during such periods. The fair value of each option grant is estimated at the grant date using the Black-Scholes-Merton option-pricing model based on the assumptions listed below under Stock Options. The estimated fair value of options granted is amortized to expense over their vesting period, which is generally three years.

	2005	2004
	(in thousands)	
Net loss, as reported	$ (3,778)	$ (20,233)
The share-based employee compensation cost included in net income (loss) as reported, net of $0 tax benefit	780	161
	(1,154)	(739)

Deduct: Total share-based employee compensation expense determined under the fair value based method for all awards, net of $0 related tax benefit		
Pro forma net loss	$ (4,152)	$ (20,811)

The impact of applying the provisions of Statement 123R and SAB 107 during fiscal 2006 was as follows:

	2006 (in thousands)
Net loss, as reported	**$ (35,848)**
The share-based employee compensation cost included in net loss as reported, net of $0 related tax benefit	**1,678**
Deduct: Total share-based employee compensation cost determined under the provisions of APB 25, net of $0 related tax benefit	**(1,604)**
Pro forma net loss	**$ (35,774)**

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Stock Options

The following information relates to stock options that have been granted under our shareholder-approved stock incentive plans. Option exercise prices are 100% of fair market value on the date the options are granted. Options may be exercised for a period set at the time of grant, which generally ranges from seven to ten years after the date of grant, and they generally become exercisable in installments, which are typically 50% one year from the grant date, 25% two years from the grant date and 25% three years from the grant date. A significant number of options granted by us in both fiscal 2005 and 2006 are subject to a vesting schedule in which they are 50% exercisable prior to the end of such fiscal year, a period of approximately ten months from the grant date.

Management prepared the valuation of stock options based on the method and assumptions provided herewith. The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option-pricing model which uses assumptions noted in the following table. Expected volatility is based on implied volatility from traded options on our stock, historical volatility of our stock price over the last ten years and other factors. The expected term of the options is based on historical observations of our stock over the past ten years, considering average years to exercise for all options exercised, average years to cancellation for all options cancelled and average years remaining for outstanding options, which is calculated based on the weighted-average vesting period plus the weighted-average of the difference between the vesting period and average years to exercise and cancellation. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury curve in effect at the time of grant.

	2006	**2005**	**2004**
Expected dividends	**0.9%**	0.7%	1.0%
Expected volatility	**36.1%**	35.2%	37.1%
Risk-free interest rates	**4.1%**	3.0%	1.9%
Expected term (years)	**3.35**	4.00	4.00

A summary of stock option activity under our stock incentive plans is as follows:

	2006		**2005**		**2004**	
	Shares	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**
Stock options outstanding at the beginning of the year	**399,006**	**$17.88**	491,084	$15.29	713,506	$12.66
Stock options forfeited or expired	**(13,024)**	**$29.54**	(48,532)	$15.93	(29,396)	$15.87
Stock options granted	**87,500**	**$37.16**	96,258	$24.53	169,700	$17.70
Stock options exercised	**(79,598)**	**$16.19**	(139,804)	$14.03	(362,726)	$12.48
Stock options outstanding at the end of the year	**393,884**	**$22.12**	399,006	$17.88	491,084	$15.29
Stock options exercisable at the end of the year	**278,440**	**$20.08**	265,546	$16.75	254,098	$13.67

The weighted average remaining contractual term for stock options that were outstanding and exercisable as of June 30, 2006 was 6.0 years and 5.9 years, respectively. The aggregate intrinsic value for stock options that were outstanding or exercisable as of June 30, 2006 was $7,637 thousand and $5,967 thousand, respectively.

The weighted-average grant-date fair value was $10.27 per share for options granted during fiscal 2006. The total intrinsic value of options exercised during fiscal 2006 was $1,438 thousand at the time of exercise.

A summary of the status of our nonvested stock options at June 30, 2006, and changes during fiscal 2006 are as follows:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested stock options at July 2, 2005	133,460	$ 6.11
Stock options granted	**87,500**	**$ 10.27**
Stock options vested	**(105,516)**	**$ 7.84**
Nonvested stock options at June 30, 2006	**115,444**	**$ 7.68**

As of June 30, 2006, there was $887 thousand of total unrecognized compensation cost related to nonvested stock options granted under our stock incentive plans. This cost is expected to be recognized over a weighted-average period of 1.5 years. The total fair value of stock options that vested during fiscal 2006 was approximately $827 thousand.

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Restricted Stock Awards

The following information relates to awards of restricted stock awards that have been granted to employees under our stock incentive plans. The restricted stock shares are not transferable until vested and the restrictions lapse upon the achievement of continued employment over a specified time period.

The fair value of each restricted stock award grant is based on the closing price of our stock on the date of grant and is amortized to expense over its vesting period. At June 30, 2006, there were 40,000 shares of restricted stock awards outstanding.

A summary of the status of our restricted stock at June 30, 2006, and changes during fiscal 2006 are as follows:

	Shares	Weighted-Average Grant Price
Restricted stock outstanding at July 2, 2005	34,000	$ 18.30
Restricted stock granted	**6,000**	**$ 37.19**
Restricted stock vested		$
Restricted stock forfeited		$
Restricted stock outstanding at June 30, 2006	**40,000**	**$ 21.13**

As of June 30, 2006, there was $231 thousand of total unrecognized compensation cost related to restricted stock awards under our stock incentive plans. This cost is expected to be recognized over a weighted-average period of 1.7 years. There were no shares of restricted stock that vested during fiscal 2006. The weighted-average grant date price of the 6,000 shares of restricted stock granted during fiscal 2006 was $37.19.

Performance Share Awards

The following information relates to awards of performance share awards and performance share units that have been granted to employees under our stock incentive plans. Generally, performance share and performance share unit awards are subject to performance criteria such as meeting predetermined earnings and revenue targets for a three-year plan period. These awards also generally vest at the expiration of the same three-year period. The final determination of the number of shares to be issued in respect of an award is determined by our Board of Directors, or a committee of our Board.

The fair value of each performance share award is based on the closing price of our stock on the date of grant and is amortized to expense over its vesting period, if achievement of the performance measures is considered probable. At June 30, 2006 there were 52,300 performance shares awards outstanding.

The fair value of performance share units, which is distributed in cash, is equal to the most probable estimate of intrinsic value at the time of distributions and is amortized to compensation expense over the vesting period. At June 30, 2006, we had 2,100 shares of performance share units.

A summary of the status of our performance shares at June 30, 2006, and changes during fiscal 2006, are as follows:

	Shares	Weighted-Average Grant Price
Performance shares outstanding at July 2, 2005	37,000	$ 22.71
Performance shares granted	**20,900**	**$ 31.71**
Performance shares vested		$
Performance shares forfeited	**(5,600)**	**$ 25.01**
Performance shares outstanding at June 30, 2006	**52,300**	**$ 26.06**

As of June 30, 2006, there was $593 thousand of total unrecognized compensation cost related to performance share awards under our stock incentive plans. This cost is expected to be recognized over a weighted-average period of 1.8 years. There were no performance shares that vested during fiscal 2006. The weighted-average grant date price of the 20,900 performance shares granted during fiscal 2006 was $31.71.

In fiscal 2006 we issued an aggregate of 79,598 shares under the terms of our stock incentive plans, which is net of shares withheld for tax purposes.

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Under our domestic retirement plans, most employees may select an option to invest in Harris common stock at 70% of current market value limited to the lesser of (a) 1% of their compensation and (b) 20% of a participant s total contribution to the plan, which is matched by us. The discount from fair market value on common stock purchased by employees under the domestic retirement plans is charged to compensation expense in the period of the related purchase.

11. Research and Development

Company-sponsored research and product development costs are expensed as incurred. These costs were $18,865 thousand in fiscal 2006, $19,183 thousand in fiscal 2005 and $20,760 thousand in fiscal 2004.

Customer-sponsored research and development costs are incurred pursuant to contractual arrangements and are accounted for principally by the percentage-of-completion method. There was no customer-sponsored research and development in fiscal 2006, fiscal 2005 or fiscal 2004.

12. Interest Expense

Total interest expense was $975 thousand in fiscal 2006, $966 thousand in fiscal 2005 and $140 thousand in fiscal 2004. Interest attributable to funds used to finance major long-term projects can be capitalized as an additional cost of the related asset. No interest was capitalized in fiscal 2006, fiscal 2005 or fiscal 2004. Interest paid was $971 thousand in fiscal 2006, $901 thousand in fiscal 2005, and $67 thousand in fiscal 2004.

13. Lease Commitments

Total rental expense amounted to $3,977 thousand in fiscal 2006, $3,931 thousand in fiscal 2005, and $3,866 thousand in fiscal 2004. Future minimum rental commitments under leases with an initial lease term in excess of one year, primarily for land and buildings, amounted to approximately $6,554 thousand at June 30, 2006. These commitments for the years following fiscal 2006 are: fiscal 2007 $3,649 thousand; fiscal 2008 $1,896 thousand; fiscal 2009 $987 thousand; and fiscal 2010 $22 thousand.

14. Derivative Instruments and Hedging Activity

We use foreign exchange contracts and options to hedge both balance sheet and off-balance sheet future foreign currency commitments. Generally, these foreign exchange contracts offset foreign currency denominated inventory and purchase commitments from suppliers; accounts receivable from, and future committed sales to, customers; and intercompany loans. We believe the use of foreign currency financial instruments should reduce the risks that arise from doing business in international markets. At June 30, 2006, we had open foreign exchange contracts with a notional amount of $19,370 thousand, of which $7,130 thousand were classified as cash flow hedges and $12,240 thousand were classified as fair value hedges. This compares to total foreign exchange contracts with a notional amount of $34,530 thousand as of July 1, 2005, of which $26,897 thousand were classified as cash flow hedges and $7,633 thousand were classified as fair value hedges. At June 30, 2006, contract expiration dates range from less than one month to 11 months with a weighted average contract life of less than a month.

More specifically, the foreign exchange contracts classified as cash flow hedges are primarily being used to hedge currency exposures from anticipated cash flow expenses related to our Mexican office. As of June 30, 2006, we estimated that a pre-tax loss of $67 thousand would be reclassified into earnings from comprehensive income within the next 11 months related to these cash flow hedges.

The net gain included in our earnings in fiscal 2006, 2005 and 2004 representing the amount of fair value and cash flow hedges ineffectiveness was not material. No amounts were recognized in our earnings in fiscal 2006, 2005, and 2004 related to the component of the derivative instruments gain or loss excluded from the assessment of hedge effectiveness. In addition, no amounts were recognized in our earnings in fiscal 2006, 2005 and 2004 related to hedged firm commitments that no longer qualify as fair value hedges. All of these derivatives were recorded at their fair value on the balance sheet in accordance with Statement 133.

15. Income Taxes

The provisions for income taxes are summarized as follows:

	2006	2005	2004
		(in thousands)	
Current expense:			
United States (federal, state, and local)	$	$	$
International	**1,079**	245	86
	1,079	245	86
Deferred expense:			
United States (federal, state, and local)			
International	**5,680**		
	5,680		
	$ 6,759	$ 245	$ 86

The components of deferred income tax assets (liabilities) are as follows:

	2006		2005	
	Current	Non-Current	Current	Non-Current
		(in thousands)		
Inventory valuations	**$ 6,029**	**$**	$ 5,088	$
Accruals	**2,650**		2,920	
Depreciation		**726**		(419)
International research and development expense deferrals		**17,700**		17,700
Tax credit carryforwards		**17,306**		14,754
Tax loss carryforwards		**36,159**		28,205
All other net	**(1,771)**		(2,544)	
	6,908	**71,891**	5,464	60,240
Valuation allowance	**(6,908)**	**(62,275)**	(5,464)	(44,944)
	$	**$ 9,616**	$	$ 15,296

A reconciliation of the statutory United States income tax rate to the effective income tax rate follows:

	2006	2005	2004
Statutory U.S. income tax rate	**35.0%**	35.0%	35.0%
U.S. valuation allowances	**(35.0)**	(35.0)	(35.0)
State taxes			
International income (loss)	**(23.2)**	(6.9)	(0.4)
Effective income tax rate	**(23.2)%**	(6.9)%	(0.4)%

United States income taxes have not been provided on $1,478 thousand of undistributed earnings of international subsidiaries because of our intention to indefinitely reinvest these earnings. The determination of unrecognized deferred U.S. tax liability for the undistributed earnings of international subsidiaries is not practicable. Tax loss carryforwards as of June 30, 2006 have expiration dates ranging between one year and no expiration in certain instances. The amount of domestic, international and state and local tax loss carryforwards as of June 30, 2006 was $103,274 thousand. Pre-tax income (loss) of international subsidiaries was $(21,463) thousand in fiscal 2006, $11,435 thousand in fiscal 2005, and $(29,598) thousand in fiscal 2004. Income taxes paid were $1,079 thousand in fiscal 2006, $245 thousand in fiscal 2005, and $86 thousand in fiscal 2004. The valuation allowance increased $18,775 thousand from $50,408 thousand in fiscal 2005 to $69,183 thousand in fiscal 2006. The valuation allowance has been established for financial reporting purposes, to offset certain domestic and foreign deferred tax assets due to uncertainty regarding our ability to realize them in the future.

16. Business Segments

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (FAS 131), established annual and interim reporting standards for an enterprise s operating segments and related disclosures about geographic information and major customers. Operating segment information for fiscal 2006, 2005 and 2004 is presented in accordance with FAS 131. We are organized into three operating segments, around the markets we serve: North America microwave region, International microwave region and the NetBoss product line. Our North America microwave region designs, manufactures, sells and services microwave radio products, primarily for

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cellular network providers and private network users within North America. Our International microwave region designs, manufactures, sells and services microwave radio products, primarily for cellular network providers and private network users outside of North America. Our NetBoss product line develops, designs, produces, sells and services network management systems, primarily for cellular network providers and private network users. The President of MCD has been identified as the Chief Operating Decision-Maker (CODM) as defined by FAS 131. Resources are allocated to each of these segments using information based on their operating income (loss). Information related to assets, capital expenditures and depreciation and amortization for the operating segments is not part of the discrete financial information provided to and reviewed by the CODM.

The accounting policies of our operating segments are the same as those described in Note 1: Significant Accounting Policies. We evaluate each segment s performance based on its revenue and operating income (loss) , which we define as cost of goods sold less period costs.

	2006	2005 (in thousands)	2004
Revenue			
North America	**$ 168,094**	$ 159,829	$ 154,133
International	**172,313**	127,221	156,251
NetBoss®	**17,093**	23,377	19,432
	$ 357,500	$ 310,427	$ 329,816

	2006(1)	2005 (in thousands)	2004(2)
Loss Before Income Taxes			
Segment Operating Income (Loss):			
North America microwave	**$ 16,912**	$ 10,257	$ 3,628
International microwave	**(34,090)**	(11,938)	(17,521)
NetBoss®	**1,058**	4,398	656
Corporate allocations expense	**(12,425)**	(6,189)	(6,770)
Net interest expense	**(544)**	(61)	(140)
Loss before income taxes	**$ (29,089)**	$ (3,533)	$ (20,147)

(1) The operating loss in the International microwave segment in fiscal 2006 included $39,641 thousand in inventory write-downs and other charges associated with decisions made

in fiscal 2006 regarding product discontinuances and the planned shutdown of manufacturing activities at our Montreal, Canada plant.

(2) North America microwave s operating income and International microwave s operating loss includes $2,758 thousand and $4,490 thousand, respectively, of expenses related to cost-reduction measures and fixed asset write downs.

Revenues for geographic regions comprising more than 5% of our sales from unaffiliated customers for fiscal 2006, 2005, and 2004 are as follows:

	2006	% of Total	2005	% of Total	2004	% of Total
			(in thousands)			
United States	**$ 143,882**	**40.2%**	$ 154,484	49.8%	$ 141,638	42.9%
Canada	**29,891**	**8.4%**	15,475	5.0%	17,365	5.3%
Nigeria	**81,326**	**22.8%**	36,136	11.6%	77,457	23.5%
Other	**102,401**	**28.6%**	104,332	33.6%	93,356	28.3%
Total	**$ 357,500**	**100.0%**	$ 310,427	100.0%	$ 329,816	100.0%

We had revenue from a single external customer that exceeded 10.0% of total revenues during fiscal 2006 and fiscal 2004. During fiscal 2006, the customer was in Nigeria and accounted for 15.1% of total revenues. During fiscal 2004, the customer was in Nigeria and accounted for 15.2% of total revenues. There was no single customer in fiscal 2005 that accounted for more than 10.0% of total revenues.

Long-lived assets by location at June 30, 2006 and July 1, 2005 were as follows:

	2006	2005
	(in thousands)	
United States	**$ 48,320**	$ 51,675
Canada	**48,750**	51,884
Brazil	**4,985**	5,586
France	**3,798**	4,257
Other	**2,032**	3,249
Total	**$ 107,885**	$ 116,651

17. Legal Proceedings

From time to time, as a normal incident of the nature and kind of businesses in which we are engaged, various claims or charges are asserted and litigation commenced against us arising from or related to: product liability; personal injury; patents, trademarks or trade secrets; labor and employee disputes; commercial or contractual disputes; the sale or use of products containing asbestos; breach of warranty; or environmental matters. Claimed amounts may be substantial but may not bear any reasonable relationship to the merits of the claim or the extent of any real risk of court or arbitral awards. We have recorded accruals for losses related to those matters that we consider to be probable and that can be reasonably estimated. Gain contingencies, if any, are recognized when they are realized and legal costs are generally expensed when incurred. While it is not feasible to predict the outcome of these matters with certainty, and some lawsuits, claims or proceedings may be disposed or decided unfavorably to us, based upon available information, in the opinion of management, settlements and final judgments, if any, would not have a material adverse effect on our financial position, results of operations or cash flows.

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The Microwave Communications Division of Harris Corporation and Subsidiaries
CONDENSED COMBINED STATEMENTS OF OPERATIONS (unaudited)

	Three Months Ended	
	September 29, 2006	September 30, 2005
	(in thousands)	
Revenue from product sales and services		
Revenue from external product sales and services	**$ 93,067**	$ 74,895
Revenue from product sales and services with parent	**488**	429
Total revenue from product sales and services	**93,555**	75,324
Cost of product sales and services		
Cost of external product sales and services	**(59,122)**	(50,854)
Cost of product sales and services with parent	**(2,889)**	(1,742)
Total cost of product sales and services	**(62,011)**	(52,596)
Engineering, selling and administrative external expenses	**(22,811)**	(18,134)
Engineering, selling and administrative expenses with parent	**(1,581)**	(1,406)
Total engineering, selling and administrative expenses	**(24,392)**	(19,540)
Corporate allocations expense	**(1,621)**	(1,536)
Interest income	**138**	174
Interest expense	**(130)**	(161)
Income before income taxes	**5,539**	1,665
Income tax expense	**(408)**	(268)
Net income	**$ 5,131**	$ 1,397

See Notes to Condensed Combined Financial Statements (unaudited)

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The Microwave Communications Division of Harris Corporation
and Subsidiaries
CONDENSED COMBINED BALANCE SHEETS (unaudited)

	September 29, 2006	September 30, 2005
	(in thousands)	
Assets		
Current Assets:		
Cash and cash equivalents	**$ 14,386**	$ 6,542
Receivables	**123,815**	117,077
Unbilled costs	**22,049**	23,002
Inventories	**76,221**	92,928
Total Current Assets	**236,471**	239,549
Other Assets		
Plant and equipment	**49,493**	52,807
Goodwill	**28,285**	27,030
Identifiable intangible assets	**6,078**	7,047
Non-current notes receivable	**5,542**	5,852
Non-current deferred income taxes	**9,616**	15,296
Other assets	**18,428**	19,737
	117,442	127,769
	$ 353,913	$ 367,318
Liabilities and Division Equity		
Current Liabilities:		
Short-term debt	**$ 100**	$ 75
Accounts payable	**47,196**	36,296
Compensation and benefits	**11,410**	9,137
Other accrued items	**18,764**	17,444
Advance payments and unearned income	**13,235**	7,239
Total current liabilities	**90,705**	70,191
Other Liabilities		
Due to Harris Corporation	**3,074**	6,749
Total Liabilities	**93,779**	76,940
Division Equity:		
Division equity	**261,285**	298,473
Accumulated other comprehensive loss	**(1,151)**	(8,095)
Total division equity	**260,134**	290,378
	$ 353,913	$ 367,318

See Notes to Condensed Combined Financial Statements (unaudited)

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The Microwave Communications Division of Harris Corporation
CONDENSED COMBINED STATEMENTS OF CASH FLOWS (unaudited)

	Three Months Ended September 29, 2006	Three Months Ended September 30, 2005
Operating Activities		
Net income	**$ 5,131**	$ 1,397
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	**3,299**	1,385
Gain on sale of land and building		(1,844)
(Increase) decrease in:		
Receivables	**(1,619)**	(287)
Unbilled costs and inventories	**(907)**	(7,314)
Increase (decrease) in:		
Accounts payable and accrued expenses	**(1,250)**	2,213
Advance payments and unearned income	**4,028**	448
Due to Harris Corporation	**(9,568)**	(7,431)
Other	**(96)**	4,022
Net cash (used in) operating activities	**(982)**	(7,411)
Investing Activities		
Proceeds from sale of land and building		4,598
Additions of plant and equipment	**(237)**	(441)
Additions of capitalized software	**(1,117)**	(910)
Net cash (used in) provided by investing activities	**(1,354)**	3,247
Financing Activities		
Decrease in short term debt	**(60)**	(946)
Net cash and other transfers from Harris Corporation	**2,677**	2,847
Net cash provided by financing activities	**2,617**	1,901
Effect of exchange rate changes on cash and cash equivalents	**271**	1,002
Net increase (decrease) in cash and cash equivalents	**552**	(1,261)
Cash and cash equivalents, beginning of period	**13,834**	7,803
Cash and cash equivalents, end of period	**$ 14,386**	$ 6,542

See Notes to Condensed Combined Financial Statements (unaudited)

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The Microwave Communications Division of Harris Corporation
CONDENSED COMBINED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) AND DIVISION EQUITY (unaudited)

	Division Equity	Accumulated Other Comprehensive Income (Loss) Hedging Derivatives	Net Unrealized Gain (Loss) From Foreign Currency Translation	Total
		(in thousands)		
Balance at July 1, 2005	$ 294,229	$ 271	$ (14,187)	$ 280,313
Net income	1,397			1,397
Foreign currency translation			6,116	6,116
Net unrealized loss on hedging activities, net of $0 tax		(295)		(295)
Comprehensive income				7,218
Net increase in investment from Harris Corporation	2,847			2,847
Balance at September 30, 2005	$ 298,473	$ (24)	$ (8,071)	$ 290,378
Balance at June 30, 2006	$ 253,400	$ 67	$ (1,447)	$ 252,020
Net income	**5,131**			**5,131**
Foreign currency translation			**267**	**267**
Net unrealized loss on hedging activities, net of $0 tax		**(38)**		**(38)**
Comprehensive income				**5,360**
Net increase in investment from Harris Corporation	**2,754**			**2,754**
Balance at September 29, 2006	**$ 261,285**	**$ 29**	**$ (1,180)**	**$ 260,134**

See Notes to Condensed Combined Financial Statements (unaudited)

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The Microwave Communications Division of Harris Corporation and Subsidiaries
NOTES TO CONDENSED COMBINED FINANCIAL STATEMENTS (unaudited)
At September 29, 2006 and September 30, 2005 and
For the Three Months Ended September 29, 2006 and September 30, 2005

1. Significant Accounting Policies

Nature of Operations The Microwave Communications Division of Harris Corporation and Subsidiaries (MCD or the Company) designs, manufactures and sells a broad range of microwave radios for use in worldwide wireless communications networks. Applications include cellular/mobile infrastructure connectivity; secure data networks; public safety transport for state, local and Federal government users; and right-of-way connectivity for utilities, pipelines, railroads and industrial companies. In general, wireless networks are constructed using microwave radios and other equipment to connect cell sites, fixed-access facilities, switching systems, land mobile radio systems and other similar systems.

Basis of Presentation The accompanying combined financial statements include the accounts of the Aftermarket Business, which consists of the accounts of the Microwave Communications Division of Harris Corporation and its subsidiaries. As used in these notes, the terms MCD, we, our and us refer to the combine operations of the Microwave Communications Division of Harris Corporation and its consolidated subsidiaries. Significant intercompany transactions and accounts have been eliminated. The combined financial statements are prepared in conformity with U.S. generally accepted accounting principles for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all information and footnotes necessary for a complete presentation of financial position, results of operations and changes in cash flows in conformity with U.S. generally accepted accounting principles. In the opinion of management, such financial statements reflect all adjustments (consisting only of normal, recurring adjustments) considered necessary for a fair presentation of financial position, results of operations and cash flows for such periods. The results for the quarter ended September 29, 2006 are not necessarily indicative of the results that may be expected for the full fiscal year or any subsequent period. The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

The accompanying historical financial statements are presented on a carve-out basis and reflect the assets, liabilities, revenues and expenses that were directly attributable to MCD as it was operated within Harris Corporation. MCD s combined statements of operations include all of the related costs of doing business, including an allocation of certain general corporate expenses of Harris Corporation, which were in support of MCD, including costs for finance, legal, treasury, purchasing, quality, environmental, safety, human resources, tax, audit and public relations departments and other corporate and infrastructure costs. MCD was allocated $1,621 thousand and $1,536 thousand of these overhead costs related to Harris Corporation s shared functions for the first three months of fiscal 2007 and 2006, respectively. These costs represent approximately 9.9% and 9.9%, respectively, of the total cost of these shared services in each of the first three months of fiscal 2007 and 2006, respectively. These cost allocations were primarily based on a ratio of MCD sales to total Harris Corporation sales multiplied by the total Headquarters Expense of Harris Corporation. Management believes that these allocations were made on a reasonable basis.

Related Party Transactions Harris Corporation provides information services, human resources, financial shared services, facilities, legal support, and supply chain management services to us. The charges for these services are billed to us primarily based on actual usage.

These amounts are charged directly to MCD and are not part of the Corporate allocations expense that is included on the Combined Statements of Operations. The amount charged to us for these services was $4,470 thousand in the first three months of fiscal 2007 and $3,148 thousand in the first three months of fiscal 2006, and is included in the Cost of product sales and Engineering, selling and administrative expenses captions on the Combined Statements of Operations.

There are other services Harris Corporation provides to us that are not directly charged to us. These functions and amounts are explained above under the subtitle Basis of Presentation. These amounts are included within Due to Harris Corporation on the Combined Balance Sheets. Additionally, we have other receivables and payables in the normal course of business with Harris Corporation. These amounts are netted within Due to Harris Corporation on the Combined Balance Sheets. Total receivables from Harris Corporation were $6,847 thousand and $5,189 thousand at September 29, 2006 and September 30, 2005, respectively. Total payables to Harris Corporation were $9,921 thousand and $11,939 thousand at September 29, 2006 and September 30, 2005, respectively.

Harris Corporation is the primary source of our financing and equity activities. During the first three months of fiscal 2007, Harris Corporation s net investment in us was increased by $2,754 thousand. During the first three months of fiscal 2006, Harris Corporation s net investment in us was increased by $2,847 thousand.

Additionally, we have loans from Harris Corporation to fund our international entities and we also provide excess cash at various locations to Harris Corporation. We recognize interest income and expense on these loans. We recognized interest income of $100 thousand and $72 thousand in the first three months of fiscal 2007 and 2006, respectively. We recognized interest expense of $116 thousand and $99 thousand in the first three months of fiscal 2007 and 2006, respectively.

We have sales to and purchases from other entities of Harris Corporation from time to time. These transactions have been recorded at cost to the buying entity and the selling entity recognizes a normal profit. Total sales to other entities of Harris Corporation were $554 thousand and $429 thousand in the first three months of fiscal 2007 and 2006, respectively. We recognized profit associated with these related party sales of $66 thousand and none in the first three months of fiscal 2007 and 2006, respectively. We also recognized costs associated with these related party purchases of $1,039 thousand and none in the first three months of fiscal 2007 and 2006, respectively.

2. Accounting Changes or Recent Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (Statement 157). Statement 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. Statement 157 applies under other accounting pronouncements that require fair value measurement in which the FASB concluded that fair value was the relevant measurement, but does not require any new fair value measurements. Statement 157 will be effective for us beginning in fiscal 2009. We are currently evaluating the impact Statement 157 will have on our financial position, results of operations and cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (Statement 158), which amends FASB Statements No. 87, Employers Accounting for Pensions; No. 88, Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits; No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions; and No. 132(R), Employers Disclosures about Pension and Other Postretirement Benefits. Statement 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through the comprehensive income of a business entity. Statement 158 also requires an employer to measure the funded status of a plan as of the date of the employer s year-end balance sheet, with limited exceptions. The portion of Statement 158 that requires the recognition of overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability will be effective for us as of June 29, 2007. The portion of Statement 158 that requires an employer to measure the funded status of a plan as of the date of the employer s year-end balance sheet will be effective for us in fiscal 2009. We are currently evaluating the impact Statement 158 will have on our financial position, results of operations and cash flows.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 expresses the SEC s views regarding the process of quantifying misstatements in financial statements. The view of the SEC is that the effects of prior year errors in the balance sheet must be taken into account for the current year income statement financial reporting. We implemented the provisions of SAB 108 during the first quarter of fiscal 2007 and it did not have a material impact on our financial position, results of operations or cash flows.

3. Receivables

Receivables are summarized below:

	September 29,	September 30,

	2006	2005
	(in thousands)	
Accounts receivable	**$ 125,148**	$ 114,918
Notes receivable due within one year net	**6,428**	8,873
	131,576	123,791
Less allowances for collection losses	**(7,761)**	(6,714)
	$ 123,815	$ 117,077

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4. Inventories

Inventories are summarized below:

	September 29, 2006	September 30, 2005
	(in thousands)	
Finished products	**$ 13,350**	$ 11,061
Work in process	**34,792**	21,231
Raw materials and supplies	**43,954**	93,786
	92,096	126,078
Inventory reserves	**(15,875)**	(33,150)
	$ 76,221	$ 92,928

5. Plant and Equipment

Plant and equipment are summarized below:

	September 29, 2006	September 30, 2005
	(in thousands)	
Land	**$ 585**	$ 585
Buildings	**21,948**	22,373
Machinery and equipment	**91,390**	110,986
	113,923	133,944
Less allowances for depreciation	**(64,430)**	(81,137)
	$ 49,493	$ 52,807

Depreciation expense related to plant and equipment was $2,514 thousand and $633 thousand in the first three months of fiscal 2007 and fiscal 2006, respectively.

During the first three months ended September 30, 2005, we recognized a gain of $1,844 thousand from the sale of land and building that is included in the Engineering, selling and administrative expenses caption on the Condensed Combined Statements of Operations (unaudited).

6. Accrued Warranties

Changes in our warranty liability, which is included as a component of Other accrued items on the Condensed Combined Balance Sheets (unaudited), during the first three months of fiscal 2007 and 2006, are as follows:

	Three Months Ended	
	September 29, 2006	September 30, 2005
	(in thousands)	
Balance as of the beginning of the period	**$ 3,921**	$ 3,796
Warranty provision for sales made during the period	**455**	822
Settlements made during the period	**(498)**	(816)

Other adjustments to the liability including foreign currency translation during the period				72
Balance as of the end of the period	**$**	**3,878**	$	3,874

7. Stock Options and Share-Based Compensation

As of September 29, 2006, Harris Corporation had three shareholder-approved stock incentive plans for employees. Harris Corporation currently has the following types of share-based awards outstanding under these plans that MCD employees participate in: stock options, performance share awards, performance share unit awards and restricted stock awards. We believe that such awards more closely align the interests of our employees with those of our shareholders. The compensation cost related to our share-based awards to MCD employees that was charged against pre-tax income was $581 thousand for the quarter ended September 29, 2006 compared to $453 thousand for the quarter ended September 30, 2005. The number of shares granted to MCD employees during the three months ended September 29, 2006 under these plans were 87,800 stock option grants; 18,600 performance share awards; 2,400 performance share unit awards and 18,000 restricted stock awards.

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8. Business Segments

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (FAS 131), established annual and interim reporting standards for an enterprise s operating segments and related disclosures about geographic information and major customers. Operating segment information for the first three months of fiscal 2007 and 2006 is presented in accordance with FAS 131. We are organized into three operating segments, around the markets we serve: North America microwave region, International microwave region and the NetBoss product line. Our North America microwave region designs, manufactures, sells and services microwave radio products, primarily for cellular network providers and private network users within North America. Our International microwave region designs, manufactures, sells and services microwave radio products, primarily for cellular network providers and private network users outside of North America. Our NetBoss product line develops, designs, produces, sells and services network management systems, primarily for cellular network providers and private network users. The President of MCD has been identified as the Chief Operating Decision-Maker (CODM) as defined by FAS 131. Resources are allocated to each of these segments using information based on their operating income (loss). Information related to assets, capital expenditures and depreciation and amortization for the operating segments is not part of the discrete financial information provided to and reviewed by the CODM.

The accounting policies of our operating segments are the same as those described in Note 1: Significant Accounting Policies of our Combined Financial Statements beginning on page F-7. We evaluate each segment s performance based on its revenue and operating income (loss) , which we define as cost of goods sold less period costs.

	Three Months Ended	
	September 29, 2006	**September 30, 2005**
	(in thousands)	
Revenue		
North America	**$ 49,829**	$ 45,580
International	**39,271**	25,749
NetBoss	**4,455**	3,995
	$ 93,555	$ 75,324
Income Before Income Taxes		
Segment Operating Income (Loss):		
North America microwave	**$ 1,912**	$ 6,442
International microwave	**4,964**	(3,311)
NetBoss	**276**	57
Corporate allocations expense	**(1,621)**	(1,536)
Net interest income	**8**	13
Income before income taxes	**$ 5,539**	$ 1,665

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SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS
THE MICROWAVE COMMUNICATIONS DIVISION OF
HARRIS CORPORATION AND SUBSIDIARIES

Col. A	Col. B	Col. C Additions		Col. D	Col. E
Description	Balance at Beginning of Period	(1) Charged to Costs and Expenses	(2) Charged to Other Accounts Describe	Deductions Describe	Balance at End of Period
			(In thousands)		
Year ended June 30, 2006:					
Amounts Deducted From Respective Asset Accounts:				$ (279)(A) 3,693(B)	
Allowances for collection losses	$ 7,306	$ 4,161	$	$ 3,414	$ 8,053
				$ (567)(A) 53,651(C)	
Allowances for inventory valuation	$ 32,856	$ 38,512	$	$ 53,084	$ 18,284
Allowances for deferred tax assets	$ 50,408	$ 18,775	$	$	$ 69,183
Year ended July 1, 2005:					
Amounts Deducted From Respective Asset Accounts:				$ (482)(A) 500(B)	
Allowances for collection losses	$ 6,301	$ 1,023	$	$ 18	$ 7,306
				$ 1,915(A) (2,075)(C)	
Allowances for inventory valuation	$ 33,770	$ (1,074)	$	$ (160)	$ 32,856
Allowances for deferred tax assets	$ 35,948	$ 14,100	$	$	$ 50,048
Year ended July 2, 2004:					
Amounts Deducted From Respective Asset Accounts:				$ (26)(A) 2,906(B)	
Allowances for collection losses	$ 6,003	$ 3,178	$	$ 2,880	$ 6,301
				$ (9)(A)	

					(1,092)(C)	
Allowances for inventory valuation	$ 20,068	$ 12,601	$	$	(1,101)	$ 33,770
Allowances for deferred tax assets	$ 29,562	$ 6,386	$	$		$ 35,948

Note A Foreign currency translation gains and losses.
Note B Uncollectible accounts charged off, less recoveries on accounts previously charged off.
Note C Obsolescence and excess inventory charged off.

HARRIS STRATEX NETWORKS, INC.
UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL DATA

The following unaudited pro forma condensed consolidated statements of operations for the three months ended September 30, 2006 and for the twelve months ended June 30, 2006 assume the purchase business combination between the Microwave Communications Division and Stratex occurred on July 1, 2006 and July 1, 2005, respectively. The following unaudited pro forma condensed consolidated balance sheet assumes the purchase business combination had been completed on September 30, 2006.

In accordance with the terms of the combination agreement, Harris and Stratex created a new Delaware corporation named Harris Stratex for the purpose of combining the Microwave Communications Division with Stratex. On January 26, 2007, Merger Sub, a wholly owned subsidiary of Harris Stratex merged with and into Stratex, with Stratex continuing as the surviving corporation. Simultaneously with the merger of Stratex and Merger Sub, Harris contributed substantially all the assets comprising its Microwave Communications Division, including $32.1 million in cash, to Harris Stratex. In addition, Harris allocated, as appropriate and reasonably practicable, its liabilities between its Microwave Communications Division and any other businesses or divisions of Harris and, Harris Stratex assumed those liabilities of Harris that primarily resulted from or primarily arose out of the Microwave Communications Division. The liabilities of the Microwave Communications Division that were assumed by Harris Stratex in the contribution transaction included the $90.7 million of liabilities at September 29, 2006 identified on the Condensed Combined Balance Sheets of the Microwave Communications Division beginning on page F-3 of this prospectus. The $3.1 million of liabilities at September 29, 2006 due to Harris identified on the Condensed Combined Balance Sheets of the Microwave Communications Division beginning on page F-3 of this prospectus were canceled in connection with the contribution transaction. In addition, Harris Stratex assumed the contingent liabilities of the Microwave Communication Division, which by their nature were not quantifiable or identifiable, in accordance with the third sentence of this paragraph. There are no loss contingencies that were at least a reasonable possibility that an allocable loss or additional loss was incurred by the Microwave Communications Division as of the date of the business combination/contribution transaction.

In the merger, each share of Stratex common stock was automatically converted into one-fourth of a share of Harris Stratex Class A common stock. This exchange ratio had the same effect as if Stratex had effected a one-for-four reverse split of its outstanding common stock immediately prior to the merger. In exchange for its contribution of the Microwave Communications Division to Harris Stratex, Harris Stratex issued to Harris 32,850,965 shares of Harris Stratex Class B common stock.

The merger and the contribution transaction will be treated as a purchase business combination for accounting purposes with the Microwave Communications Division being the acquirer, and, therefore, Stratex s assets acquired and liabilities assumed will be recorded at their estimated fair value. For purposes of the pro forma financial statements, it was assumed that Stratex s common stock price is $4.00 per share and that approximately 100 million shares of Stratex s common stock (based on the treasury stock method using a price per share of $20.80) were outstanding at the date of completion of the merger and the contribution transaction. Using these assumptions, approximately 32.7 million shares of Harris Stratex Class B common stock were issued in exchange for the assets of the Microwave Communications Division and cash. We have assumed that an aggregate 56.6 million shares of Harris Stratex Class A common stock were issued (including the 32.7 million shares of Harris Stratex Class B common stock issued to Harris which are convertible at any time into shares of Harris Stratex Class A common stock) and $17.7 million in cash was paid to Harris Stratex by Harris so that the net assets of the Microwave Communications Division included $32.1 million in cash after intercompany balances between the Microwave Communications Division and Harris are paid prior to the completion of the transactions.

The allocations of the purchase price to Stratex s assets, including intangible assets, and liabilities were only preliminary allocations based on estimates of fair values and will change when actual fair values are determined. Among the provisions of Statement of Financial Accounting Standards No. 141, Business Combinations , or SFAS 141, criteria have been established for determining whether intangible assets should be recognized separately from goodwill. Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets , or

SFAS 142, provides, among other guidelines, that goodwill and intangible assets with indefinite lives will not be amortized, but rather are tested for impairment on at least an annual basis. Management of both MCD and Stratex believe that certain trade names owned by Stratex, including Stratex, have indefinite lives based upon an analysis utilizing the criteria in SFAS 142.

The accompanying unaudited pro forma condensed consolidated statements of operations do not include any revenue or cost saving synergies which may be achievable subsequent to the closing of the purchase business combination.

The unaudited pro forma condensed consolidated balance sheet as of September 30, 2006 assumes that the purchase business combination took place on that date with the Microwave Communications Division as the accounting acquirer of Stratex at the estimated fair value in accordance with SFAS 141. The unaudited pro forma condensed consolidated statements of operations for the three months ended September 30, 2006 and for the fiscal year ended June 30, 2006 assume that the purchase business combination took place on July 1, 2006 and July 1, 2005, respectively. The Harris Stratex fiscal year will end on the closest Friday to June 30th. The accompanying unaudited pro forma condensed consolidated statement of operations for the three months ended September 30, 2006 and for the year ended June 30, 2006 combines the pro forma three months ended September 30, 2006 and the pro forma twelve months ended June 30, 2006, respectively, for both the Microwave Communications Division and Stratex. Reclassifications have been made to the historical financial statements of the Microwave Communications Division and Stratex to conform to the presentation expected to be used by Harris Stratex.

The pro forma condensed consolidated financial data shown under this heading is unaudited, is presented for informational purposes only, is not necessarily indicative of the financial position or results of operations that would actually have occurred had the merger, the combination transaction or the related transactions been consummated as of the dates or at the beginning of the periods presented, nor is it necessarily indicative of future operating results or financial position. The information presented below should be read together with the historical consolidated financial statements of Stratex and MCD, including the related notes, beginning on page F-41 of this prospectus, in the case of Stratex, and beginning on page F-3 of this prospectus, in the case of MCD, as well as with *Management s Discussion and Analysis of Financial Condition and Results of Operations of MCD* beginning on page 21 of this prospectus and *Management s Discussion and Analysis of Financial Condition and Results of Operations of Stratex* beginning on page 36 of this prospectus. See also *Risk Factors* beginning on page 3 and *Information Regarding Forward-Looking Statements* included elsewhere in this prospectus.

The services the Microwave Communications Division received from Harris that will continue after the combination of the Microwave Communications Division and Stratex are covered by transition service arrangements. Currently, the Microwave Communications Division reflects these items in the Combined Financial Statements of the Microwave Communications Division beginning on page F-3 of this prospectus as related party transactions with Harris; therefore, no pro forma adjustment is made to reflect these arrangements.

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HARRIS STRATEX NETWORKS, INC.
UNAUDITED PRO FORMA
CONDENSED CONSOLIDATED BALANCE SHEET

	Historical Stratex at September 30, 2006	Historical MCD as of September 29, 2006	Pro Forma Adjustments	Harris Stratex Networks, Inc. Pro Forma
		(in thousands)		
ASSETS				
Current Assets				
Cash and cash equivalents and short-term investments	$ 55,715	$ 14,386	$ 17,714(A)	$ 87,815
Receivables	51,369	123,815		175,184
Inventories and unbilled costs	38,980	98,270	11,137(B)	148,387
Other current assets	13,821			13,821
Total current assets	159,885	236,471	28,851	425,207
Other Assets				
Plant and equipment	23,479	49,493		72,972
Goodwill		28,285	235,676(C)	263,961
Identifiable intangible assets		6,078	130,200(C)	136,278
Non-current deferred taxes		9,616	(9,616)(D)	
Other assets	790	23,970		24,760
	24,269	117,442	356,260	497,971
	$ 184,154	$ 353,913	$ 385,111	$ 923,178
LIABILITIES AND STOCKHOLDERS AND DIVISION EQUITY				
Current Liabilities				
Short-term debt	$ 11,250	$ 100	$ 1,420(E)	$ 12,770
Accounts payable	40,330	47,196		87,526
Other accrued liabilities	29,692	43,409	1,795(F)	74,896
Total current liabilities	81,272	90,705	3,215	175,192
Other Liabilities				
Non-current deferred income taxes			39,060(G)	39,060
Long-term debt	16,667		5,680(D)	22,347
Due to Harris Corporation		3,074	(3,074)(H)	
Restructuring and other long-term liabilities	13,225			13,225
Total liabilities	111,164	93,779	44,881	249,824
Stockholders and division equity	72,990	260,134	340,230(I)	673,354

	$ 184,154	$ 353,913	$ 385,111	$ 923,178

(A) Adjustment of $17.7 million made to bring balance of cash in the Microwave Communications Division to $32.1 million as of the transaction date per the terms of the combination agreement.

(B) Step up Stratex finished goods inventory to fair market value assuming a gross margin rate of 30% of revenue and selling costs and related profit equal to 10% of revenue.

(C) Allocation of the purchase price of Stratex determined as follows (amounts in thousands):

Market price of Stratex stock(1)	$ 400,148
Estimated acquisition costs	9,000
Total purchase price to be allocated	$ 409,148

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Allocation of purchase price based on fair market value		**Estimated Useful Life**
Identifiable intangible assets:		
Developed technology non-legacy products	$ 77,500	10 years
Developed technology legacy products	1,900	2 years
Customer relationships	5,400	8 years
Backlog	900	1 year
Tradename Eclipse	16,000	10 years
Tradename Legacy Products	200	2 years
Tradename Stratex	28,300	Indefinite
Total identifiable intangible assets	130,200	
Net tangible assets(2)	43,272	
Goodwill	235,676	
Total purchase price allocation	$ 409,148	

This purchase price allocation is preliminary for all assets and liabilities being acquired by Harris Stratex.

(D) Adjustment is to eliminate deferred tax assets on the Microwave Communications Division s historical Combined Balance Sheet because Harris will retain 100% of these assets at the time of the transaction and they will not become part of Harris Stratex.

(E) Adjustment to record capital lease obligation related to the equipment lease between Harris

Stratex Networks Canada ULC and Harris Canada, Inc. For more information regarding this lease obligation, see Certain Relationships and Related Transactions Lease Agreement (Equipment and Machinery) beginning on page 77 of this prospectus.

(F) Adjustment to reduce deferred revenue of Stratex, which is classified as other accrued liabilities on the Consolidated Balance Sheet, by $2.0 million because Harris Stratex is not expected to have future obligations to deliver product or perform services on the contracts or agreements related to this deferred revenue after the closing date of the transaction and increased by $3.8 million for payout of the single trigger employment agreements. No amount of excise tax reimbursement is included because the calculated amount was not available.

(G) Adjustment is for the establishment of a deferred tax liability related to the future amortization of identifiable intangible assets in accordance with Statement of Financial Accounting Standard No. 109 Accounting for Income Taxes.

(H) Elimination of due to Harris Corporation balance against stockholders and division equity.

(I) Adjustment made to reflect the $17.7 million cash contribution made by Harris as discussed in footnote A. above; elimination of deferred taxes noted in D. above; adjustment to record capital lease obligation noted in E. above; elimination of due to Harris Corporation balance of $3.1 million noted in G.

above; and
$336.2 million to
record the net
assets of Stratex
at fair value in
accordance with
FAS 141(3).

(1) Total market price of Stratex common stock equal to the price of a share of Stratex common stock as of September 19, 2006 ($4.00) X diluted shares of Stratex common stock outstanding per the Stratex September 30, 2006 Balance Sheet (100.0 million shares).

(2) Stratex net tangible assets are calculated as follows:

Historical net assets reported	$ 72,990
Inventory step-up	11,137
Deferred revenue reduction	2,039
Single trigger employment agreement payouts	(3,834)
Less deferred tax liability related to identifiable intangible assets	(39,060)
Adjusted net assets	$ 43,272

(3) Adjustment to stockholders equity to record the net assets of Stratex at fair value in accordance with FAS 141 is calculated as follows:

Market price of Stratex common stock (see footnote 1 above)	$ 400,148
Acquisition costs	9,000
Less historical Stratex net assets reported	(72,990)
	$ 336,158

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HARRIS STRATEX NETWORKS, INC.
UNAUDITED PRO FORMA
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

	Historical Stratex for the Twelve Months Ended June 30, 2006	Historical MCD for the Twelve Months Ended June 30, 2006	Pro Forma Adjustments	Harris Stratex Networks, Inc. Pro Forma
		(in thousands)		
Revenue from product sales and services	$ 242,257	$ 357,500	$	$ 599,757
Cost of product sales and services	(171,397)	(271,340)	(8,700)(J)	(451,437)
Engineering, selling and administrative expenses	(63,131)	(102,280)	(7,115)(K)	(172,526)
Corporate allocations expense		(12,425)	(L)	(12,425)
Interest income	1,548	431		1,979
Interest expense	(2,304)	(975)		(3,279)
Other expenses, net	(1,748)			(1,748)
Income (loss) before provision for income taxes	5,225	(29,089)	(15,815)	(39,679)
Provisions for income taxes	(1,534)	(6,759)		(8,293)
Net income (loss)	$ 3,691	$ (35,848)	$ (15,815)	$ (47,972)
Net income (loss) per common share				
Basic	$ 0.04			$ (0.85)
Diluted	$ 0.04			$ (0.85)
Basic weighted average shares outstanding	95,725		(M)	56,569
Diluted weighted average shares outstanding	99,510		(M)	56,569

(J) Adjustment made to reflect $8.7 million amortization of developed technology identifiable intangible assets.

(K)

Adjustment made to reflect $3.3 million amortization of identifiable intangible assets, other than developed technology, and $3.8 million of stock-based compensation expense, which represents the expense that would have been recognized by Stratex had they implemented the provisions of Statement of Financial Accounting Standard No. FAS 123R *Share-Based Payment*, or FAS 123R, as of July 1, 2005, which is when the Microwave Communications Division was required to implement FAS 123R.

(L) The services related to these costs include audit fees, external legal fees, internal legal costs and CEO and staff costs. It is believed that the stand-alone financial results of Stratex currently include many of these costs, which makes a portion of these MCD costs redundant. It is also believed that some of the costs that are included in the stand-alone financial results of Stratex may increase for the combined company.

(M) Adjustment to shares reflect one-to-four conversion of Stratex shares to Harris Stratex Networks, Inc. and the issuance of 32.7 million shares of Harris Stratex shares (calculated as 56% of all the outstanding stock of Harris Stratex) to Harris in return for net assets of the Microwave Communications Division.

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HARRIS STRATEX NETWORKS, INC.
UNAUDITED PRO FORMA
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

	Historical Stratex for the Three Months Ended September 30, 2006	Historical MCD for the Three Months Ended September 29, 2006	Pro Forma Adjustments	Harris Stratex Networks, Inc. Pro Forma
Revenue from product sales and services	$ 67,279	$ 93,555		$ 160,834
Cost of product sales and services	(46,512)	(62,011)	$ (2,175)(N)	(110,698)
Engineering, selling and administrative expenses	(18,924)	(24,392)	(594)(O)	(43,910)
Corporate allocations expense		(1,621)	(P)	(1,621)
Interest income	693	138		831
Interest expense	(601)	(130)		(731)
Other expenses, net	(360)			(360)
Income (loss) before provision for income taxes	1,575	5,539	(2,769)	4,345
Provision for income taxes	(23)	(408)		(431)
Net income (loss)	$ 1,552	$ 5,131	$ (2,769)	$ 3,914
Basic net income per share	$ 0.02			$ 0.07
Diluted net income per share	$ 0.02			$ 0.07
Basic weighted average shares outstanding	97,634		(Q)	57,046
Diluted weighted average shares outstanding	100,037		(Q)	57,046

(N) Adjustment made to reflect $2.2 million amortization of developed technology identifiable intangible assets.

(O) Adjustment made to reflect $0.6 million amortization of identifiable intangible assets, other than developed technology.

(P) The services related to these costs include audit fees, external legal fees, internal legal costs, external reporting costs and CEO and staff costs. It is believed that the stand-alone financial results of Stratex currently include many of these costs, which makes a portion of these MCD costs redundant. It is also believed that some of the costs that are included in the stand-alone financial results of Stratex may increase for the combined company.

(Q) Adjustment to shares reflect one-to-four conversion of Stratex shares to Harris Stratex and the issuance of 32.7 million shares of Harris Stratex (calculated as 56% of all outstanding stock of Harris Stratex) to Harris in return for net assets of the Microwave Communications Division.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Stratex Networks, Inc.
San Jose, California

We have audited the accompanying consolidated balance sheets of Stratex Networks, Inc. and subsidiaries (the Company) as of March 31, 2006 and 2005, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended March 31, 2006. 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 conducted our audits in accordance with the standards of the Public Company Oversight Board (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 provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Stratex Networks, Inc. and subsidiaries as of March 31, 2006 and 2005, and the results of their operations, stockholders equity and cash flows for each of the three years in the period ended March 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of March 31, 2006, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated June 14, 2006 expressed an unqualified opinion on management s assessment of the effectiveness of the Company s internal control over financial reporting and an adverse opinion on the effectiveness of the Company s internal control over financial reporting because of a material weakness.

/s/ DELOITTE & TOUCHE LLP
San Jose, California
June 14, 2006

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Management s Report on Internal Control over Financial Reporting

Our management, with the participation of our CEO and CFO, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Our internal controls are designed to provide reasonable assurance to our management and members of our Board of Directors regarding the preparation and fair presentation of published financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP).

Our management performed an assessment of our internal controls over financial reporting as of March 31, 2005 and identified the following two material weaknesses in internal control over financial reporting existing as of March 31, 2005. For the March 31, 2005 reporting period, management concluded that the Company 1) did not maintain effective controls over the determination of revenue recognition for a non-routine complex revenue transaction and 2) did not have enough review procedures on the financial closing and reporting process. Management believes that in fiscal 2006 we have remediated the weakness related to revenue recognition due to the expansion of internal review and clarification of internal policies which have been distributed to finance personnel worldwide. With respect to the weakness related to inadequate review of the financial statements of the foreign operations and the period-end financial closing and reporting process for the Company s consolidated operations, we have identified, developed and began to implement a number of measures to strengthen our internal control in this area. These measures included: hiring additional finance personnel, expanding financial statement reviews, establishing internal audit with a focus on the adequacy of internal controls over financial reporting and expanding the review of manual journal entries.

However, as a result of our assessment of our financial controls over financial reporting as of March 31, 2006, we have concluded that we have not remediated the material weakness in internal controls over the review of the financial statements of the foreign operations and the period-end financial closing and reporting process for the Company s consolidated operations. We are taking further steps in fiscal 2007, including the increasing of staff in corporate finance, adding finance staffing at several foreign subsidiaries and expanded subsidiary financial reporting with a goal of having this material weakness remediated by the third quarter of fiscal 2007. We will continue reviewing our internal controls over the financial close and reporting process, and will implement additional controls as needed.

Deloitte & Touche LLP, an independent registered public accounting firm, has issued a report on management s assessment of our internal control over financial reporting. That report appears below.

Changes in Internal Control over Financial Reporting

In connection with our implementation of the provisions of Section 404 of Sarbanes-Oxley of 2002, we have made and will continue to make various improvements to our system of internal controls. We continue to review, revise and improve the effectiveness of our internal controls. To improve the effectiveness of the Company s internal controls and address the material weaknesses referred to in the previous section under the caption Management s Report on Internal Control over Financial Reporting , we hired an internal audit manager in the first quarter of fiscal 2006, a new controller in the fourth quarter of fiscal 2006, a finance manager at our subsidiary in France in the fourth quarter of fiscal 2006 and finance managers to oversee the finance functions of our Poland and South America operations in the first quarter of fiscal 2007. In addition, we have implemented an expanded policy related to revenue recognition and we are in the process of recruiting an additional accountant to the Corporate staff to assist in the consolidation and review process. With the staff additions, we will further revise our financial review procedures. Other than as described above, there has been no change in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected or is likely to materially affect our internal control over financial reporting.

Inherent Limitation on the Effectiveness of Internal Controls

The effectiveness of any system of internal control over financial reporting, including Stratex s, is subject to inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct, including fraud, completely. Accordingly, any system of internal control over financial reporting, including Stratex s, can only provide reasonable, not absolute assurances. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. We intend to continue to monitor and upgrade our internal controls as necessary or appropriate for our business, but cannot assure you that such improvements will be sufficient to provide us with effective internal control over financial reporting.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Stratex Networks, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting, that Stratex Networks, Inc. and subsidiaries (the Company) did not maintain effective internal control over financial reporting as of March 31, 2006, because of the effect of the material weakness identified in management s assessment based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The material weakness described in the following paragraph has been identified and included in management s assessment:

The Company s controls over the review of the financial statements of the foreign operations and the period-end financial closing and reporting process for the Company s consolidated operations are inadequate and constitute a material weakness in the design of internal control over financial reporting. Specifically, the Company lacks sufficient resources with the appropriate level of technical accounting expertise within the accounting function and therefore was unable to accurately perform certain of the designed controls over the March 31, 2006 financial closing and reporting process, evidenced by a significant number of adjustments which were necessary to present the financial statements for the year ended March 31, 2006 in accordance with generally accepted accounting principles. Based on the misstatements identified and the significance of the financial closing and reporting process to the preparation of reliable financial statements, there is a more than remote likelihood that a material misstatement of the interim and annual financial statements would not have been prevented or detected.

This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements and financial statement schedule as of and for the year ended March 31, 2006 of the Company and this report does not affect our report on such financial statements and financial statement schedule.

In our opinion, management s assessment that the Company did not maintain effective internal control over financial reporting as of March 31, 2006, is fairly stated, in all material respects, based on the criteria established in Internal Control Integrated Framework

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issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of March 31, 2006, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended March 31, 2006 of the Company and our report dated June 14, 2006 expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP
San Jose, California
June 14, 2006

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STRATEX NETWORKS, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2006	March 31, 2005
	(in thousands, except per share amounts)	
Assets		
Current Assets:		
Cash and cash equivalents	$ 44,414	$ 32,860
Short-term investments	13,272	15,831
Accounts receivable, net of allowance of $2,140 in 2006 and $2,769 in 2005	42,003	35,084
Inventories	43,867	36,780
Other current assets	12,620	10,572
Total current assets	156,176	131,127
Property and Equipment:		
Machinery and equipment	77,930	79,156
Land and buildings	7,550	7,550
Furniture and fixtures	6,686	5,575
Leasehold improvements	1,556	1,537
	93,722	93,818
Accumulated depreciation and amortization	(69,673)	(65,590)
Net property and equipment	24,049	28,228
Other assets	605	1,276
Total Assets	$ 180,830	$ 160,631
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 38,725	$ 34,472
Short-term debt	11,250	6,250
Accrued liabilities	31,136	27,701
Total current liabilities	81,111	68,423
Long-term debt	22,291	13,542
Restructuring and other long-term liabilities	15,085	18,643
Total liabilities	118,487	100,608
Commitments and Contingencies (Note 9)		

Stockholders Equity:		
Preferred stock, $.01 par value; 5,000 shares authorized; none outstanding		
Common stock, $.01 par value; 150,000 shares authorized, 96,931 and 94,918 shares issued and outstanding at March 31, 2006 and 2005, respectively	969	948
Additional paid-in capital	489,370	485,382
Accumulated deficit	(416,022)	(413,725)
Accumulated other comprehensive loss	(11,974)	(12,582)
Total stockholders equity	62,343	60,023
Total Liabilities and Stockholders Equity	$ 180,830	$ 160,631

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

STRATEX NETWORKS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years ended March 31,		
	2006	2005	2004
	(in thousands, except per share amounts)		
Net Sales	$230,892	$180,302	$157,348
Cost of sales	167,303	151,398	129,689
Inventory and other valuation charges (benefit)		2,581	(498)
Gross profit	63,589	26,323	28,157
Operating Expenses:			
Research and development	14,475	16,661	17,151
Selling, general and administrative	46,792	44,379	39,273
Amortization of intangible assets		1,581	790
Restructuring charges		7,423	5,488
Total operating expenses	61,267	70,044	62,702
Income (loss) from operations	2,322	(43,721)	(34,545)
Other Income (Expense):			
Interest income	1,111	737	886
Interest expense	(2,227)	(1,662)	(160)
Other expenses, net	(1,927)	(845)	(1,116)
Total other expense, net	(3,043)	(1,770)	(390)
Loss before provision for income taxes	(721)	(45,491)	(34,935)
Provision for income taxes	1,576	455	2,133
Net Loss	$ (2,297)	$ (45,946)	$ (37,068)
Basic and diluted net loss per share	$ (0.02)	$ (0.51)	$ (0.44)
Shares used to compute basic and diluted net loss per share	95,600	89,634	83,364

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

STRATEX NETWORKS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Years ended March 31, 2004, 2005 and 2006					
	Common Shares	Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders Equity
				(in thousands)		
Balances March 31, 2003	**82,748**	**$ 827**	**$ 457,147**	**$ (330,711)**	**$ (14,463)**	**$ 112,800**
Components of comprehensive income:						
Net loss				(37,068)		(37,068)
Change in unrealized holding gain					20	20
Translation adjustment					1,081	1,081
Total comprehensive loss						(35,967)
Shares issued to Tellumat (Pty) Ltd for acquisition of net assets of Plessey Broadband Wireless	730	7	2,950			2,957
Stock issued for options and purchase plan	570	6	1,386			1,392
Balances March 31, 2004	**84,048**	**$ 840**	**$ 461,483**	**$ (367,779)**	**$ (13,362)**	**$ 81,182**
Components of comprehensive income:						
Net loss				(45,946)		(45,946)
Change in unrealized holding loss					(58)	(58)
Translation adjustment					838	838
Total comprehensive loss						(45,166)
Sale of common stock, net of cash and non-cash (warrants) expenses of $1.4 million and $4.1	10,327	103	22,850			22,953

million, respectively (See note 11)											
Stock issued for options and purchase plan	543		5		1,049						1,054
Balances March 31, 2005	**94,918**	**$**	**948**	**$**	**485,382**	**$**	**(413,725)**	**$**	**(12,582)**	**$**	**60,023**
Components of comprehensive loss:											
Net loss							(2,297)				(2,297)
Change in unrealized holding loss									31		31
Translation adjustment									577		577
Total comprehensive loss											(1,689)
Stock issued for options and purchase plan	1,117		6		2,488						2,494
Restricted Stock Awards	896		15		1,500						1,515
Balances March 31, 2006	**96,931**	**$**	**969**	**$**	**489,370**	**$**	**(416,022)**	**$**	**(11,974)**	**$**	**62,343**

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

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STRATEX NETWORKS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended March 31,		
	2006	2005	2004
		(in thousands)	
Cash Flows From Operating Activities:			
Net loss	$ (2,297)	$ (45,946)	$ (37,068)
Adjustments to reconcile net loss to net cash used for operating activities:			
Non-cash stock compensation charges	1,515		
Depreciation and amortization	7,418	11,460	9,470
Non-cash restructuring charges		928	
Changes in assets and liabilities:			
Accounts receivable	(6,445)	(530)	(3,721)
Inventories	(6,385)	(1,461)	(6,662)
Other assets	(1,227)	1,176	2,035
Accounts payable	4,154	(5,597)	14,960
Accrued liabilities	3,697	5,998	(3,416)
Long-term liabilities	(3,559)	(1,662)	(3,039)
Net cash used for operating activities	(3,129)	(35,634)	(27,441)
Cash Flows From Investing Activities:			
Purchase of available-for-sale securities	(82,185)	(83,275)	(220,983)
Proceeds from sale of available-for-sale securities	84,753	95,723	248,812
Purchase of property and equipment	(3,532)	(7,435)	(10,532)
Purchase of net assets of Plessey Broadband Wireless, a division of Tellumat (Pty) Ltd.			(2,578)
Net cash provided by (used for) investing activities	(964)	5,013	14,719
Cash Flows From Financing Activities:			
Borrowings from banks	33,000	25,000	
Repayment of bank borrowings	(19,250)	(5,208)	
Proceeds from sale of common stock	2,495	24,007	1,392
Net cash provided by financing activities	16,245	43,799	1,392
Effect of exchange rate changes on cash	(598)	(1,944)	(1,080)
Net increase (decrease) in cash and cash equivalents	11,554	11,234	(12,410)
Cash and cash equivalents at beginning of year	32,860	21,626	34,036
Cash and cash equivalents at end of year	$ 44,414	$ 32,860	$ 21,626

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

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STRATEX NETWORKS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

Supplemental Statements of Cash Flows Disclosures. Cash paid for interest and income taxes for each of the three fiscal years presented in the consolidated statements of cash flows was as follows:

	Years ended March 31,		
	2006	2005	2004
		(in thousands)	
Interest paid	**$1,097**	$1,781	$103
Income taxes paid	**$1,430**	$ 199	$274

Supplemental Schedule of Non Cash Financing Activities:

	2006	2005	2004
		(in thousands)	
Non-cash purchase consideration for the acquisition of Plessey Broadband Wireless, a division of Tellumat (Pty) Ltd. through the issuance of common stock	**$**	$	$2,957
Issuance of common stock warrants (See Note 11)	**$**	$4,122	$

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Note 1. Description of Business

The Company designs, manufactures and markets advanced wireless solutions for mobile applications and broadband access to enable the development of complex communications networks worldwide. The Company s microwave radio products deliver data and voice across a full spectrum of network frequencies and capacities. The Company s business is global in nature, supported by a worldwide sales and support organization. Stratex Networks, Inc., formerly known as DMC Stratex Networks, Inc. and Digital Microwave Corporation, was founded in January 1984.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation. The consolidated financial statements include the accounts of Stratex Networks, Inc. and its wholly owned subsidiaries. Intercompany accounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to current year presentation.

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, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Cash and Cash Equivalents. The Company generally considers all highly liquid debt instruments with a remaining maturity of three months or less at the time of purchase, to be cash equivalents. Auction rate preferred securities are classified as short-term investments. Cash and cash equivalents consisted of cash, money market funds, and short-term securities as of March 31, 2006 and March 31, 2005. As of March 31, 2006, we had $0.4 million of cash received in advance from one of our customers which was restricted.

Short-Term Investments. The Company invests its excess cash in high-quality and easily marketable instruments to ensure cash is readily available for use in current operations. Accordingly, all marketable securities are classified as available-for-sale in accordance with the provisions of the Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115). At March 31, 2006, the Company s available-for-sale securities had contractual maturities ranging from 1 month to 6 months, with a weighted average maturity of 28 days.

All investments are reported at fair market value with the related unrealized holding gains and losses reported as a component of stockholders equity. The realized gains on the sale of securities during fiscal 2006, 2005 and 2004 were insignificant. Realized gains (losses) are included in other expenses, net in the accompanying consolidated statement of operations.

The following is a summary of available-for-sale short-term investments as of March 31, 2006:

	2006		
	Cost	**Fair Value**	**Unrealized Holding Loss**
		(in thousands)	
Corporate notes	$ 2,083	$ 2,083	$
Corporate and Government bonds	3,605	3,589	(16)
Auction rate preferred notes	7,600	7,600	
Total	$13,288	$13,272	$ (16)

The following is a summary of available-for-sale short-term investments as of March 31, 2005:

	2005		
	Cost	Fair Value (in thousands)	Unrealized Holding Loss
Corporate notes	$ 749	$ 749	$
Corporate and Government bonds	9,578	9,532	(46)
Auction rate preferred notes	5,550	5,550	
Total	$15,877	$15,831	$ (46)

Inventories. Inventories are stated at the lower of cost (first-in, first-out) or market, where cost includes material, labor, and manufacturing overhead. Inventories consisted of:

	March 31, 2006	March 31, 2005
	(in thousands)	
Raw materials	$ 9,012	$11,065
Work-in-process		488
Finished goods	34,855	25,227
	$43,867	$36,780

In fiscal 2005, the Company recorded inventory valuation charges of $2.6 million for excess inventories not expected to be sold. There were no inventory valuation charges recorded in fiscal 2006.

Property and Equipment. Property and equipment is stated at cost. Depreciation and amortization are calculated using the straight-line method over the shorter of the estimated useful lives of the assets (ranging from three to five years for equipment and furniture, and forty years for buildings) or the lease term. Depreciation and amortization are reported in the applicable captions in the statement of operations based on the functional area that utilizes the related equipment and facilities. Any depreciation related to production facilities is therefore recorded as a component of cost of sales.

Other Assets. Included in other assets as of March 31, 2006 are long-term deposits of $0.4 million for premises leased by the Company and $0.2 million for long-term accounts receivable. The long-term accounts receivable is due to the extended terms of credit granted by the Company to one of its customers in order to position itself favorably in certain markets. Included in other assets as of March 31, 2005 are long-term deposits of $0.4 million for premises leased by the Company and $0.9 million for long-term accounts receivable.

Accumulated Other Comprehensive Income. SFAS No. 130, Reporting Comprehensive Income, (SFAS 130) establishes standards for reporting and display of comprehensive income (loss) and its components. SFAS 130 requires companies to report comprehensive income (loss), which includes unrealized holding gains and losses and other items that have previously been excluded from net income (loss) and reflected instead in stockholders equity. The Company s comprehensive loss consists of net loss plus the effect of unrealized holding gains or losses on investments classified as available-for-sale and foreign currency translation adjustments.

The accumulated balances for each component of accumulated other comprehensive income (loss) are as follows:

	March 31, 2006	March 31, 2005
	(in thousands)	

Unrealized holding loss on available-for-sale-securities	$ (16)	$ (46)
Cumulative foreign exchange translation adjustment	(11,958)	(12,536)
Accumulated other comprehensive loss	$ (11,974)	$ (12,582)

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Foreign Currency Translation. The functional currency of the Company s subsidiaries located in the United Kingdom and New Zealand is the U.S. dollar. Accordingly, all of the monetary assets and liabilities of these subsidiaries are remeasured into U.S. dollars at the current exchange rate as of the applicable balance sheet date, and all non-monetary assets and liabilities are remeasured at historical rates. Income and expenses are remeasured at the average exchange rate prevailing during the period. Gains and losses resulting from the remeasurement of these subsidiaries financial statements are included in the consolidated statements of operations. The Company s other international subsidiaries use their respective local currency as their functional currency. Assets and liabilities of these subsidiaries are translated at the local current exchange rates in effect at the balance sheet date, and income and expense accounts are translated at the average exchange rates during the period. The resulting translation adjustments are included in accumulated other comprehensive loss.

Determination of the functional currency is dependent upon the economic environment in which an entity operates as well as the customers and suppliers the entity conducts business with. Changes in the facts and circumstances may occur and could lead to a change in the functional currency of that entity.

Gains and losses resulting from foreign exchange transactions and the costs of foreign currency contracts are included in other income (expense) in the accompanying consolidated statements of operations. Net foreign exchange losses of $1.8 million, $0.6 million and $0.8 million were recorded in fiscal 2006, fiscal 2005 and fiscal 2004, respectively.

Derivative Financial Instruments. In accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities (SFAS 133), all derivatives are recorded on the balance sheet at fair value.

We manufacture and sell products internationally subjecting us to currency risk. Derivatives are employed to eliminate, reduce, or transfer selected foreign currency risks that can be identified and quantified. The primary business objective of this hedging program is to minimize the gains and losses resulting from exchange rate changes. The Company s policy is to hedge forecasted and actual foreign currency risk with forward contracts that expire within twelve months. Foreign currency contracts to hedge exposures are not available in certain currencies, such as the Nigerian Naira. Specifically, the Company hedges foreign currency risks relating to firmly committed backlog, open purchase orders and non-functional currency monetary assets and liabilities. Derivatives hedging non-functional currency monetary assets and liabilities are recorded on the balance sheet at fair value and changes in fair value are recognized currently in earnings.

Additionally, the Company hedges forecasted non-U.S. dollar sales and non-U.S. dollar purchases. In accordance with SFAS 133, hedges of anticipated transactions are designated and documented at inception as cash flow hedges and are evaluated for effectiveness, excluding time value, at least quarterly. The Company records effective changes in the fair value of these cash flow hedges in accumulated other comprehensive income (OCI) until the revenue is recognized or the related purchases are recognized in cost of sales, at which time the changes are reclassified to revenue and cost of sales, respectively. All amounts accumulated in OCI at the end of the year will be reclassified to earnings within the next 12 months.

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The following table summarizes the activity in OCI, with regard to the changes in fair value of derivative instruments, for fiscal 2006 and fiscal 2005 (in thousands):

	Twelve Months Ended March 31, 2006 Gains/(Losses)	Twelve Months Ended March 31, 2005 Gains/(Losses)
Beginning balance as of April 1	$ 90	$ 23
Net changes	(772)	644
Reclassifications to revenue	573	(526)
Reclassifications to cost of sales	2	(51)
Ending balance as of March 31	$ (107)	$ 90

A loss of $0.2 million in each of the fiscal years ending 2005 and 2004, and a loss of $0.1 million in fiscal 2006 was recognized in other income and expense related to the exclusion of time value from effectiveness testing. The gain/loss resulting from forecasted transactions that did not occur in fiscal 2006, fiscal 2005 and fiscal 2004 was insignificant.

Revenue Recognition. The Company recognizes revenue pursuant to Staff Accounting Bulletin No. 104 (SAB 104)   Revenue Recognition . Accordingly, revenue is recognized when all four of the following criteria are met: (i) persuasive evidence that the arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectibility is reasonably assured.

Revenues from product sales are generally recognized when title and risk of loss passes to the customer, except when product sales are combined with significant post-shipment installation services. Under this exception, revenue is deferred until such services have been performed. Installation service revenue is recognized when the related services are performed.

When sales are made under payment terms beyond the normal credit terms, revenue is recognized only when cash is collected from the customer unless the sale is covered by letters of credit or other bank guarantees. Revenue from service obligations under maintenance contracts is deferred and recognized on a straight-line basis over the contractual period, which is typically one year.

In fourth quarter of fiscal 2006, the Company entered into a four year agreement with Alcatel to license certain Eclipse software and products to Alcatel. Alcatel will pay the Company a license fee based on the dollar value of Alcatel s quarterly purchases from the Company s contract manufacturers. There is a minimum quarterly license fee that will be recognized as revenue in the fiscal quarter it is invoiced. License fees beyond the quarterly minimum will be recognized as revenue in the quarter when they are invoiced, due and payable.

Included in the agreement are certain additional support services that may be provided by the Company to Alcatel. In accordance with Emerging Issues Task Force (EITF) 00-21   Revenue Arrangements with Multiple Deliverables the Company determined that revenue related to these services should be recognized separately from the license fee and accordingly will be recognized when the services are performed.

Research and Development. All research and development costs are expensed as incurred.

Stock-Based Compensation. The Company accounts for its employee stock option plans in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25,   Accounting for Stock Issued to Employees . Accordingly, no compensation is recognized for employee stock options granted with exercise prices greater than or equal to the fair value of the underlying common stock at date of grant. If the exercise price is less than the market value at the date of grant, the difference is recognized as deferred compensation expense, which is amortized over the vesting period of the options.

In accordance with the disclosure requirements of SFAS No. 123, as amended by SFAS No. 148, if the Company had elected to recognize compensation cost based on the fair market value of the options granted at grant date as prescribed, income and earnings per share would have been reduced to the pro forma amounts indicated in the table below.

	Years ended March 31,		
	2006	2005	2004
	(in thousands, except per share amounts)		
Net loss as reported	$ (2,297)	$ (45,946)	$ (37,068)
Less: Stock-based compensation expense determined under fair value method for all awards, net of related tax effects	(4,954)	(11,630)	(9,961)
Net loss pro forma	$ (7,251)	$ (57,576)	$ (47,029)
Basic and diluted loss per share as reported	$ (0.02)	$ (0.51)	$ (0.44)
Basic and diluted loss per share pro forma	$ (0.08)	$ (0.64)	$ (0.56)

For purposes of pro forma disclosure under SFAS No. 123, the estimated fair value of the options is assumed to be amortized to expense over the options vesting period, using the multiple option method. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Years ended March 31,		
	2006	2005	2004
Expected dividend yield	0.0%	0.0%	0.0%
Expected stock volatility	96.2%	96.8%	96.6%
Risk-free interest rate	3.9 4.6%	2.7 3.9%	2.2 3.3%
Expected life of options from vest date	1.8 years	1.5 years	1.7 years
Forfeiture rate	Actual	Actual	Actual

The fair value of each share granted under the employee stock purchase plan is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Years ended March 31,		
	2006	2005	2004
Expected stock volatility	55.7%	75.7%	89.6%
Risk-free interest rate	2.9%	1.6%	1.0%
Expected life of options from vest date	0.3 years	0.3 years	0.2 years

The weighted average fair value of stock options granted during fiscal 2006, fiscal 2005 and fiscal 2004 was $2.04, $1.53 and $3.05 respectively.

Loss Per Share. Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share are computed by dividing net income by the weighted average number of shares of common stock and potentially dilutive securities outstanding during the period. Net loss per share is computed using only the weighted average number of shares of common stock outstanding during the period, as the inclusion of potentially dilutive securities would be anti-dilutive.

As of March 31, 2006, there were 1,531,176 weighted-average options outstanding to purchase shares of common stock that were not included in the computation of diluted earnings per share because they were anti-dilutive as a result of the net loss incurred in fiscal 2006. As of March 31, 2005, there were 870,000 weighted-average options outstanding to purchase shares of common stock that were not included in the computation of diluted earnings per share because they were anti-dilutive as a result of the net loss incurred in fiscal 2005. As of March 31, 2004, there were 2,399,000 weighted-average options outstanding to purchase shares of common stock that were not included in the computation of diluted earnings per share because they were anti-dilutive as a result of the net loss incurred in fiscal 2004.

Income Taxes. The Company accounts for income taxes under an asset and liability approach. Deferred income taxes reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes, and such amounts recognized for income tax reporting purposes, and operating loss and other tax credit carry forwards measured by applying currently enacted tax laws. Valuation allowances are provided when necessary to reduce net deferred tax assets to an amount that is more likely than not to be realized in the future.

Recent Accounting Pronouncements. In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No.155, Accounting for Certain Hybrid Financial Instruments (SFAS 155) an amendment to SFAS 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS 155, provides the framework for fair value remeasurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation as well as establishes a requirement to evaluate interests in securitized financial assets to identify interests. SFAS 155 further amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The SFAS 155 guidance also clarifies which interest-only strips and principal-only strips are not subject to the requirement of SFAS 133 and concentrations of credit risk in the form of subordination are not embedded derivatives. This statement is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. SFAS 155 is not expected to have a material impact on the Company s consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections (SFAS No. 154). SFAS No.154 replaces APB Opinion No. 20, Accounting Changes , and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements , and changes the requirements of the accounting for and reporting of a change in accounting principle. SFAS No. 154 also provides guidance on the accounting for and reporting of error corrections. The provisions of this statement are applicable for accounting changes and error corrections made in fiscal years beginning after December 15, 2005. The adoption of this standard is not expected to have a material impact on the Company s results of operations or financial condition.

In March 2005, FASB issued Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. Interpretation No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of the fiscal year ending after December 15, 2005. The adoption of this standard did not have a material impact on the Company s results of operations or financial condition.

In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 107, which provides guidance on the implementation of Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment (see discussion below). In particular, SAB No. 107 provides key guidance related to valuation methods (including assumptions such as expected volatility and expected term), the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123(R), the modification of employee share options prior to the adoption of SFAS No. 123(R), the classification of compensation expense, capitalization of compensation cost related to share-based payment arrangements, first-time adoption of SFAS No. 123(R) in an interim period, and disclosures in Management s Discussion and Analysis subsequent to the adoption of SFAS No. 123(R). SAB No. 107 became effective on March 29, 2005. The Company will apply the principles of SAB No. 107 in conjunction with its adoption of SFAS 123(R).

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment (SFAS No. 123(R)). This statement replaces SFAS No. 123, Accounting for Stock-Based Compensation , and supersedes APB No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) requires all stock-based compensation to be recognized as an expense in the financial statements and that such cost be measured

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according to the fair value of stock options. SFAS No. 123(R) was to be effective for quarterly periods beginning after June 15, 2005, which is the Company s first quarter of fiscal 2006. In April 2005, the SEC delayed the required compliance date for certain public companies to fiscal years beginning after June 15, 2005. Accordingly, the Company will be required to comply with SFAS No. 123(R) in fiscal 2007. While the Company currently provides the pro forma disclosures required by SFAS No. 148, Accounting for Stock-Based Compensation -Transition and Disclosure, on a quarterly basis (see Note 2 Stock-Based Compensation), it is currently evaluating the impact this statement will have on its consolidated financial statements.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4 (SFAS No. 151). SFAS No. 151 requires all companies to recognize a current-period charge for abnormal amounts of idle facility expense, freight, handling costs and wasted materials. This statement also requires that the allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for fiscal years beginning after June 15, 2005. The Company does not expect the adoption of this statement to have a material impact on its consolidated financial statements.

Note 3. Acquired Intangible Assets

The Company recorded expense on amortization of intangible assets of $1.6 million and $0.8 million in fiscal 2005 and fiscal 2004, respectively. In fiscal 2004, the Company acquired the net assets of Plessey Broadband Wireless, a division of Tellumat (Pty) Ltd. (Tellumat) located in Cape Town, South Africa. As part of the purchase agreement the Company acquired $2.4 million of intangible assets. This $2.4 million of intangible assets has been assigned to intellectual property and was estimated to have a useful life of 18 months. In the third quarter of fiscal 2005, the Company accelerated amortization of the intangible assets due to the shut down of the Cape Town operations and redesign of the product acquired from Plessey Broadband Wireless. The Company amortized the entire balance of intangible assets in fiscal 2005.

Note 4. Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments and trade receivables. The Company has cash investment policies that limit the amount of credit exposure to any one financial institution and restrict placement of investments to financial institutions evaluated as highly creditworthy. Investments, under the Company s policy, must have a rating, at the time of purchase, of A1 or P1 for short-term paper and a rating of A or better for long-term notes or bonds. Accounts receivable concentrated with certain customers primarily in the telecommunications industry and in certain geographic locations may subject the Company to concentration of credit risk. The following table summarizes the number of our significant customers as a percentage of our accounts receivable balance at March 31, 2006 and March 31, 2005, along with the percentage of accounts receivable balance they individually represent. No other customer accounted for more than 10% of the accounts receivable balance at the dates indicated.

	March 31, 2006	March 31, 2005
Number of significant customers	2	
Percentage of accounts receivable balance	12%,10%	

The following table summarizes the number of our significant customers, each of which accounted for more than 10% of our revenues, along with the percentage of revenues they individually represent.

	Years ended March 31,		
	2006	2005	2004
Number of significant customers	1	1	1
Percentage of net sales	10%	21%	19%

The Company actively markets and sells products in Europe, the Americas, Asia, Africa and the Middle East. The Company performs on-going credit evaluations of its customers financial conditions and generally requires no collateral, although sales to Asia, Africa and the Middle East are primarily paid through letters of credit.

Note 5. Other Current Assets

Other current assets include the following :

	March 31,	
	2006	2005
	(in thousands)	
Receivables from suppliers	$ 3,074	$ 2,566
Non-trade receivables	947	851
Prepaid expenses	4,165	3,529
Prepaid insurance	395	340
Income tax and VAT refund	3,795	2,976
Other	244	310
	$12,620	$10,572

Prepaid expenses as of March 31, 2006 and March 31, 2005 also included installation costs of $0.8 million and $1.3 million, respectively, incurred for customers, which are being deferred because revenue related to these costs was not yet recognized.

Note 6. Accrued Liabilities

Accrued liabilities include the following:

	March 31,	
	2006	2005
	(in thousands)	
Customer deposits	$ 2,103	$ 1,822
Accrued payroll and benefits	2,628	2,250
Accrued commissions	4,660	2,117
Accrued warranty	4,395	5,340
Accrued restructuring	3,373	4,902
Accrual for customer discount	4,359	3,688
Deferred revenue	3,193	1,279
Other	6,425	6,303
	$ 31,136	$ 27,701

The accrual for customer discount of $4.4 million and $3.7 million as of March 31, 2006 and March 31, 2005, respectively is for discount on certain volume levels reached by a customer.

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Note 7. Long term debt

On May 27, 2004 the Company borrowed $25 million on a long-term basis against its $35 million credit facility with a commercial bank. This $25 million loan is payable in equal monthly installments of principal plus interest over a period of four years. This loan bears interest at a fixed interest rate of 6.38% per annum. As of March 31, 2006 the Company has repaid $11.5 million of the loan.

In February 2006, the Company increased the amount of its credit facility with the bank from $35 million to $50 million and extended the facility for an additional one year term to April 30, 2008. The Company also borrowed an additional $20 million on a long-term basis under the facility with the bank on March 1, 2006. This loan is payable in equal monthly installments of principal plus interest over a period of four years. The loan is at a fixed interest rate of 7.25%. As of March 31, 2006, no principal had been repaid under the new term loan.

As part of the credit facility agreement, there is a tangible net worth covenant and a liquidity ratio covenant. As of March 31, 2006 the Company was in compliance with these financial covenants of the loan.

At March 31, 2006, future long-term debt payment obligations were as follows:

Years ending March 31, (in thousands)	
2007	$ 11,250
2008	11,250
2009	6,041
2010	5,000
Total	$ 33,541

At the end of March 2006, the Company had $10.7 million of credit available against our $50 million revolving credit facility with a commercial bank as mentioned above. Per the amended agreement, the total amount of revolving credit available was expanded to $50 million less the outstanding balance of the term debt portion and any usage under the revolving credit portion. As of March 31, 2006, the balance of the long-term debt portion of our credit facility was $33.5 million and there were $5.8 million in outstanding standby letters of credit as of that date which are defined as usage under the revolving credit portion of the facility.

Note 8. Restructuring charges.

The Company did not record any restructuring charges in fiscal 2006.

In fiscal 2005, the Company recorded $7.4 million of restructuring charges. In order to reduce expenses and increase operational efficiency, the Company implemented a restructuring plan in the third quarter of fiscal 2005 which included the decision to shut down operations in Cape Town, South Africa, outsource the manufacturing at the New Zealand and Cape Town, South Africa locations and spin off the sales and service offices in Argentina, Colombia and Brazil to independent distributors. As part of the restructuring plan, the Company reduced the workforce by 155 employees and recorded restructuring charges for employee severance and benefits of $3.8 million in fiscal 2005. The Company also recorded $2.3 million for building lease obligations, $0.8 million for fixed asset write-offs and $0.5 million for legal and other costs.

In fiscal 2004, the Company recorded $5.5 million of restructuring charges. The Company reduced the workforce by 34 employees and recorded restructuring charges for employee severance and benefits of $0.9 million. The remaining $4.6 million of restructuring charges was for building lease obligations, which were vacated in fiscal 2002 and fiscal 2003.

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During fiscal 2003 and fiscal 2002, the Company announced several restructuring programs. These restructuring programs included the consolidation of excess facilities. Due to these actions, the Company recorded restructuring charges of $19.0 million in fiscal 2003 and $8.6 million in fiscal 2002 for vacated building lease obligations.

The following table summarizes the activity relating to restructuring charges for the three years ended March 31, 2006 (in millions):

	Severance and Benefits	Facilities and Other	Total
Balance as of March 31, 2003	$ 1.5	$22.7	$24.2
Provision in fiscal 2004	0.9	4.6	5.5
Cash payments	(1.3)	(5.6)	(6.9)
Balance as of March 31, 2004	1.1	21.7	22.8
Provision in fiscal 2005	3.8	3.6	7.4
Cash payments	(3.8)	(4.0)	(7.8)
Non-cash expense		(0.6)	(0.6)
Reclassification of related rent accruals		1.2	1.2
Balance as of March 31, 2005	1.1	21.9	23.0
Provision in fiscal 2006			
Cash payments	(1.2)	(3.6)	(4.8)
Reclassification	0.3	(0.6)	(0.3)
Balance as of March 31, 2006	$ 0.2	$17.7	$17.9
Current portion	$ 0.2	$ 3.2	$ 3.4
Long-term portion		14.5	14.5

The remaining accrual balance of $17.9 million as of March 31, 2006, is expected to be paid out in cash. The Company expects $3.4 million of the remaining accrual balance ($0.2 million of severance and benefits, $0.3 million of legal and other costs and $2.9 million of vacated building lease obligations) to be paid out in fiscal 2007 and vacated building lease obligations of $14.5 million to be paid out during fiscal 2008 through fiscal 2012.

Note 9. Commitments and Contingencies

The Company leases certain property and equipment, as well as its headquarters and manufacturing facilities, under non-cancelable operating leases that expire at various periods through 2012. At March 31, 2006, future minimum payment obligations under these leases were as follows:

	Years ending March 31, (in thousands)	
2007	$	6,403
2008		6,654
2009		6,787
2010		6,913
2011		5,766
2012 and beyond		855
Future minimum lease payments (a)	$	33,378

(a) Future minimum lease payments

include $17.4 million of lease obligations that have been accrued as restructuring charges as of March 31, 2006.

Rent expense under operating leases was $2.3 million for the year ended March 31, 2006, $4.0 million for the year ended March 31, 2005, and $4.5 million for the year ended March 31, 2004.

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Legal Contingencies. The Company is a party to various legal proceedings that arise in the normal course of business. In the opinion of management, the ultimate disposition of these proceedings will not have a material adverse effect on its consolidated financial position, liquidity, or results of operations.

Contingencies in Manufacturing and Suppliers. Purchases for materials are highly dependent upon demand forecasts from the Company s customers. Due to the uncertainty in demand from its customers, and in the telecommunications market in general, the Company may have to change, reschedule, or cancel purchases or purchase orders from its suppliers. These changes may lead to vendor cancellation charges on these purchase commitments. As of end of March 2006, the Company had purchase commitments of $42 million.

Warranty. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with its sales, recorded as a component of cost of sales. The Company s standard warranty is generally for a period of 27 months from the date of sale if the customer uses the Company s or approved installers to install the products, otherwise it is 15 months from the date of sale. The warranty accrual represents the best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date.

The changes in the warranty reserve balances are as follows:

	Years ended March 31,		
	2006	2005	2004
		(in thousands)	
Balance at the beginning of the year	$ 5,340	$ 4,277	$ 4,219
Additions related to current period sales	5,202	7,282	7,416
Warranty costs incurred in the current period	(5,330)	(5,227)	(7,207)
Adjustments to accruals related to prior period sales	(817)	(992)	(151)
Balance at the end of the year	$ 4,395	$ 5,340	$ 4,277

Note 10. Income Taxes

The Company provides for income taxes using an asset and liability approach, under which deferred income taxes are provided based upon enacted tax laws and rates applicable to periods in which the taxes become payable.

The domestic and foreign components of loss before provision for income taxes were as follows:

	Years ended March 31,		
	2006	2005	2004
		(in thousands)	
Domestic	**$ (1,732)**	$ (34,780)	$ (29,897)
Foreign	**1,011**	(10,711)	(5,038)
	$ (721)	$ (45,491)	$ (34,935)

The provision for income taxes consisted of the following:

	Years ended March 31,		
	2006	2005	2004
		(in thousands)	
Current:			
Federal	**$**	$	$
State	**8**	80	46
Foreign	**1,568**	375	344
Total current	**1,576**	455	390

Deferred- foreign			1,743
	$ 1,576	$ 455	$ 2,133

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The provision for income taxes differs from the amount computed by applying the statutory Federal income tax rate as follows:

	Years ended March 31,		
	2006	2005	2004
		(in thousands)	
Expected tax benefit	**$ (252)**	$ (15,808)	$ (12,227)
State taxes, net of Federal benefit	**8**	(565)	335
Change in valuation allowance	**(1,854)**	10,202	16,775
Foreign taxes	**1,568**	375	344
Other	**2,107**	6,251	(3,094)
	$ 1,576	$ 455	$ 2,133

The major components of the net deferred tax asset consisted of the following:

	March 31,	
	2006	2005
	(in thousands)	
Inventory write offs	**$ 13,469**	$ 10,585
Restructuring reserves	**6,810**	8,610
Warranty reserves	**1,483**	1,763
Bad debt reserves	**763**	1,007
Net operating loss carry forwards	**151,821**	147,370
Tax credits	**12,096**	12,650
Impairment of investments	**1,128**	8,404
Depreciation reserves	**426**	(300)
Other	**11,166**	5,137
	199,162	195,226
Less: Valuation allowance	**(199,162)**	(195,226)
Net deferred tax asset	**$**	$

The valuation allowance provides a reserve against deferred tax assets that may expire or go unutilized. In accordance with SFAS No. 109, Accounting for Income Taxes , the Company believes it is more likely than not that it will not fully realize these benefits and, accordingly, has continued to provide a valuation allowance for them. The valuation allowance increased by approximately $3.9 million during the year ended March 31, 2006.
At March 31, 2006, the Company had U.S. Federal and State net operating loss carry forwards available to offset future taxable income, if any, of approximately $396.0 million and $78.9 million, respectively. The net operating losses expire in various years through 2026. The Company also had Federal and State capital loss carry forwards available to offset future capital gains, if any, of approximately $19.4 million and $7.3 million, respectively. The capital loss carry forwards expire in various years through 2011. Tax credits include approximately $9.2 million of Federal minimum tax and State research credits that carry forward indefinitely. The remaining tax credits of $5.1 million are Federal and State credits that expire in various years through 2026. The Internal Revenue Code contains provisions that may limit the net operating loss and credit carry forwards to be used in any given year upon the occurrence of certain events, including a significant change in ownership interest.
Undistributed earnings of the Company s foreign subsidiaries are considered to be indefinitely reinvested and accordingly, no provision for federal and state income taxes has been provided thereon. Upon distribution of those

earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to various foreign countries.

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Note 11. Common Stock

Stock Option Plans. The Company grants options to employees under several stock option plans. The Company s 1984 Stock Option Plan (the 1984 Plan) provides for the grant of both incentive and nonqualified stock options to its key employees and certain independent contractors. Upon the adoption of its 1994 Stock Incentive Plan (the 1994 Plan), the Company terminated future grants under the 1984 Plan. The 1994 Stock Incentive Plan terminated in July 2004.

In April 1996, the Company adopted the 1996 Non-Officer Employee Stock Option Plan (the 1996 Plan). The 1996 Plan authorizes 1,000,000 shares of Common Stock to be reserved for issuance to non-officer key employees as an incentive to continue to serve with the Company. The 1996 Plan will terminate on the date on which all shares available have been issued.

In November 1997, the Company adopted the 1998 Non-Officer Employee Stock Option Plan (the 1998 Plan), which became effective on January 2, 1998. The 1998 Plan authorizes 500,000 shares of Common Stock to be reserved for issuance to non-officer key employees as an incentive to continue to serve with the Company. The 1998 Plan will terminate on the date on which all shares available have been issued.

The 1999 Stock Incentive Plan (the 1999 Incentive Plan), approved by the Company s stockholders in August 1999, provides for the issuance of stock options covering up to 2,500,000 shares of its Common Stock. In August 2001, the stockholders approved the reservation for issuance of 4,000,000 additional shares of Common Stock under the 1999 Incentive Plan. The 1999 Incentive Plan enables the Company to grant options as needed to retain and attract talented employees. Options generally vest over four years and expire after 10 years. The 1999 Plan will terminate on the date on which all shares available have been issued.

In August 2002, the shareholders approved the 2002 Stock Incentive Plan, which provides for the issuance of stock options and grants of the Company s common stock covering up to 10,000,000 shares of its common stock. The purposes of the plan are to give the Company s employees and others who perform substantial services for the Company an incentive, through ownership of its common stock. The plan permits the grant of awards to the Company s directors, officers, consultants and other employees. The awards may be granted subject to vesting schedules and restrictions on transfer. The 2002 Stock Incentive Plan also contains two separate equity incentive programs, (i) a non-employee director option program under which option grants will be made at specified intervals to non-employee directors of the Company s board of directors and (ii) a non-employee director stock program under which non-employee directors of the Company s board may elect to apply all or a portion of their annual retainer and meeting fees to the purchase of shares of the Company s common stock. The 2002 Stock Incentive Plan will terminate in August 2009, unless previously terminated by the Company s board of directors.

At March 31, 2006, the Company had reserved 5,762,578 shares for future issuance under all stock option plans for which there were options available for grant.

In accordance with the provisions of SFAS No. 123 (SFAS 123), the Company has applied Accounting Principles Board Opinion No. 25, (APB 25), and related interpretations in accounting for its stock option plans, and has disclosed the summary of the pro forma effects on reported net loss and loss per share information for fiscal 2005, 2004, and 2003, based on the fair market value of the options granted at the grant date as prescribed by SFAS 123. See Note 2 for the pro forma disclosure required under SFAS 123.

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The following table summarizes the Company s stock option activity under all of its stock option plans:

	2006		2005		2004	
	Shares	**Weighted Average Exercise Price**	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
			(shares in thousands)			
Options outstanding at beginning of year	**11,819**	**$** 6.01	13,175	$ 5.85	12,258	$ 8.57
Granted	**1,473**	2.04	192	2.43	4,581	4.60
Exercised	**(823)**	2.32	(122)	2.06	(189)	2.18
Expired or canceled	**(1,111)**	6.28	(1,426)	4.40	(3,475)	14.02
Options outstanding at end of year	**11,358**	**$** 5.74	11,819	$ 6.01	13,175	$ 5.85
Exercisable at end of year	**9,243**		6,955		4,488	
Weighted average fair value of options granted	**$ 2.04**		$ 1.53		$ 3.05	

The following summarizes the stock options outstanding at March 31, 2006:

	Options Outstanding			Options Exercisable	
Actual Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
		(shares in thousands)			
$0.23 1.72	1,117	6.07	$ 1.70	1,103	$ 1.71
1.74 2.01	1,343	3.51	1.99	1,123	2.01
2.02 2.05	1,860	3.71	2.05	1,479	2.05
2.11 4.38	2,976	4.80	4.13	1,579	4.07
4.51 5.36	1,149	2.88	5.20	1,046	5.22
5.38 7.25	1,485	4.35	6.44	1,485	6.44
9.00 21.69	810	2.06	12.79	809	12.79
30.06 37.00	618	4.11	30.15	618	30.15
$0.23 37.00	11,358	4.11	$ 5.74	9,243	$ 6.23

Employee Stock Purchase Plans. The Company has an Employee Stock Purchase Plan which was adopted in June 1999 (the 1999 Purchase Plan) under which all employees, subject to certain restrictions, may purchase Common Stock under the Purchase Plan through payroll withholding at a price per share of 85% of the fair market value at the beginning or end of the purchase period, as defined under the terms of the 1999 Purchase Plan. As of March 31, 2006 there were approximately 0.9 million shares reserved for issuance under this plan.

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The following table summarizes shares sold under the 1999 Purchase Plan at the end of each period indicated.

	Years ending March 31, (shares)
2000	93,189
2001	111,441
2002	318,227
2003	409,044
2004	343,222
2005	364,883
2006	293,627
	1,933,633

Restricted Stock Plan. On June 15, 2005, the Company granted 906,575 of shares of Common Stock to its employees under its 2002 Stock Incentive Plan. Per the plan the shares vest a minimum of one third annually for the next three fiscal years. In addition, the vesting schedule is subject to certain acceleration and adjustments if any or all of the performance goals defined in the Restricted Stock Award Agreement (the agreement) are achieved.

In fiscal 2006, all the shares (net of forfeitures) granted under this plan vested due to achievement of certain performance goals. The following table summarizes shares vested upon achievement of certain performance goals defined in the agreement and related compensation expenses at the end of each period indicated.

	Three Months Ending, (In thousands, except per share)				
	March 31, 2006	December 31, 2005	September 30, 2005	June 30 2005	Total
Number of shares vested	35,293	178,435	543,945	133,838	891,511
Price per share at date of grant	$ 1.70	$ 1.70	$ 1.70	$ 1.70	$ 1.70
Compensation expense	$ 59	$ 303	$ 925	$ 228	$ 1,515

On March 31, 2006, the Company granted an additional 637,544 shares of Common Stock to its employees under its 2002 Stock Incentive Plan. Per the plan a minimum of 50% of shares will vest by March 31, 2008. In addition, the vesting schedule is subject to certain acceleration and adjustments if any or all of the performance goals defined in the Restricted Stock Award Agreement (the agreement) are achieved during the period beginning April 1, 2006 and ending March 31, 2007 (the Performance Period). If more than 50% of the shares vest based upon achievement of the performance goals for the Performance Period then any shares which have not vested based upon achievement of the performance goals for the Performance Period shall automatically be forfeited and no additional shares will vest on March 31, 2008.

Stock Warrants. During fiscal 2005, the Company raised $22.9 million cash (net of expenses of $1.4 million) by issuing 10,327,120 shares of common stock at a price of $2.36 per share. In connection with the closing of this sale of shares on September 24, 2004, the Company issued 2,581,780 warrants to purchase up to 2,581,780 shares of the Company s common stock at an exercise price of $2.95 per share as an incentive to invest in the Company. The warrants expire five years from the date of issue. The Company allocated $4.1 million of the sales price to the warrants based on the relative fair value of the warrants. The value of the warrants was determined using the Black-Scholes option-pricing model and the following weighted average assumptions: contractual term of five years from date of grant, risk free interest rate of 3.36%, volatility of 96.74%, and expected dividend yield of 0%.

Note 13. Benefit plans

The Company has certain defined contribution plans for which the expense amounted to $0.4 million in each of fiscal 2006, fiscal 2005, and fiscal 2004. The Company s contributions to the savings plan are based upon a certain percentage of the employees elected contributions.

Note 14. Operating Segment and Geographic Information

SFAS No. 131 Disclosures about Segments of an Enterprise and Related Information (SFAS 131) establishes annual and interim reporting standards for an enterprise s operating segments and related disclosures about products, geographic information, and major customers. Operating segment information for fiscal 2006, 2005, and 2004 is presented in accordance with SFAS 131.

The Company is organized into two operating segments: Products and Services. The Chief Executive Officer (CEO) has been identified as the Chief Operating Decision-Maker as defined by SFAS 131. Resources are allocated to each of these groups using information on their revenues and operating profits before interest and taxes.

The Products operating segment includes the Eclipse , XP4 , Altium®, DXR® and Velox digital microwave systems for digital transmission markets. The Company began commercial shipments of a new wireless platform consisting of an Intelligent Node Unit and a radio element, which combined are called Eclipse (Eclipse), in January 2004. The Company designs and develops the above products in Wellington, New Zealand and San Jose, California. Prior to June 30, 2002, the Company manufactured the XP4 and Altium family of digital microwave radio products in San Jose, California. In June 2002, the Company entered into an agreement with Microelectronics Technology Inc. (MTI), a Taiwanese company, for outsourcing of the Company s XP4 and Altium products manufacturing operations. In the third quarter of fiscal 2005, the Company outsourced its DXR manufacturing operations in New Zealand to GPC in Australia and Velox manufacturing operations in Cape Town, South Africa to Benchmark Electronics in Thailand.

The Services operating segment includes, but is not limited to, installation, repair, spare parts, network design, path surveys, integration, and other revenues. The Company maintains regional service centers in Lanarkshire, Scotland and Clark Field, Pampanga, Philippines.

Operating segments generally do not sell products to each other, and accordingly, there are no significant inter-segment revenues to be reported. The Company does not allocate interest and taxes to operating segments. The accounting policies for each reporting segment are the same.

	Years ended March 31,		
	2006	2005	2004
	(in thousands)		
Products			
Revenues	$198,188	$151,616	$129,093
Operating loss	(3,692)	(47,064)	(39,987)
Services and other			
Revenues	32,704	28,686	28,255
Operating income	6,014	3,343	5,442
Total			
Revenues	$230,892	$180,302	$157,348
Operating income (loss)	2,322	(43,721)	(34,545)

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Revenues by product from unaffiliated customers for fiscal 2006, 2005, and 2004 are as follows:

	2006	2005	2004
		(in thousands)	
Eclipse	$134,479	$ 39,599	$ 3,348
XP4	19,417	64,125	57,497
DXR	14,777	16,120	23,917
Altium	19,730	23,985	39,613
Other products	9,785	7,787	4,718
Total Products	$198,188	$151,616	$129,093
Total Services and other	32,704	28,686	28,255
Total Revenue	$230,892	$180,302	$157,348

Revenues by geographic region from unaffiliated customers fiscal 2006, 2005, and 2004 are as follows:

	Years ended March 31, (In Thousands)					
	2006	% of Total	2005	% of Total	2004	% of Total
United States	$ 11,235	5%	$ 11,446	6%	$ 6,294	4%
Other Americas	23,676	10%	23,839	13%	18,890	12%
Russia	15,684	7%	35,456	20%	14,689	9%
Poland	25,905	11%	10,811	6%	5,896	4%
Other Europe	32,766	14%	22,144	12%	30,269	19%
Middle East	26,498	12%	17,520	10%	16,416	11%
Nigeria	19,090	8%	10,081	6%	25,705	16%
Other Africa	18,034	8%	16,963	9%	9,824	6%
Bangladesh	22,301	10%	1,637	1%		
Other Asia/Pacific	35,703	15%	30,405	17%	29,365	19%
Total Revenues	$230,892	100%	$180,302	100%	$157,348	100%

Long-lived assets consisted primarily of property and equipment at March 31, 2006 and 2005. Net property and equipment by location was as follows:

	2006	2005
	(in thousands)	
United States	$ 3,698	$ 4,774
United Kingdom	14,193	15,778
New Zealand	3,648	4,630
Other foreign countries	2,510	3,046
Net property and equipment	$24,049	$28,228

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Stratex Networks, Inc.
San Jose, California

We have audited the consolidated balance sheets of Stratex Networks, Inc. and subsidiaries as of March 31, 2006 and 2005 and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended March 31, 2006, management s assessment of the effectiveness of the Company s internal control over financial reporting as of March 31, 2006, and the effectiveness of the Company s internal control over financial reporting as of March 31, 2006, and have issued our reports thereon dated June 14, 2006; such consolidated financial statements and reports are included in this registration statement. Our report on internal control over financial reporting dated June 14, 2006 expresses an adverse opinion on the effectiveness of the Company s internal control over financial reporting because of a material weakness. Our audits also included the consolidated financial statement schedule of the Company appearing in this registration statement. This consolidated financial statement schedule is the responsibility of the Company s management. Our responsibility is to express an opinion based on our audits. In our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ DELOITTE & TOUCHE LLP
San Jose, California
June 14, 2006

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SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS
STRATEX NETWORKS, INC.
Allowance for Doubtful Accounts

Description of Year	Balance at Beginning of Year	Charged to Costs and Expenses	Deductions/ Write-off	Balance at End of Year
		(In thousands)		
Year Ended March 31, 2006	$ 2,769	$ 548	$(1,177)	$ 2,140
Year Ended March 31, 2005	$ 2,373	$1,067	$ (671)	$ 2,769
Year Ended March 31, 2004	$ 6,395	$ 33	$(4,055)	$ 2,373

FINANCIAL STATEMENTS
STRATEX NETWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands except per share amounts)
(Unaudited)

	September 30, 2006	March 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,167	$ 44,414
Restricted cash	2,608	
Short-term investments	20,940	13,272
Accounts receivable, net of allowance of $1,818 on September 30, 2006 and $2,140 on March 31, 2006	51,369	42,003
Inventories	38,980	43,867
Other current assets	13,821	12,620
Total current assets	159,885	156,176
Property and equipment, net	23,479	24,049
Other assets	790	605
Total assets	$ 184,154	$ 180,830
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 40,330	$ 38,725
Short-term debt	11,250	11,250
Accrued liabilities	29,692	31,136
Total current liabilities	81,272	81,111
Long-term debt (Note 3)	16,667	22,291
Restructuring and other long-term liabilities	13,225	15,085
Total liabilities	111,164	118,487
Commitments and contingencies (Note 5)		
Stockholders equity:		
Preferred stock, $.01 par value; 5,000 shares authorized; none outstanding		
Common stock, $.01 par value; 150,000 shares authorized; 98,049 and 96,931 issued and outstanding at September 30, 2006 and March 31, 2006, respectively	974	969
Additional paid-in-capital	496,462	489,370

Accumulated deficit		(412,648)		(416,022)
Accumulated other comprehensive loss		(11,798)		(11,974)
Total stockholders equity		72,990		62,343
Total liabilities and stockholders equity	$	184,154	$	180,830

See accompanying Notes to Condensed Consolidated Financial Statements.

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STRATEX NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Six Months Ended September 30, 2006	Six Months Ended September 30, 2005
Net sales:		
Product	$ 116,918	$ 95,629
Service	16,598	15,797
Total Net Sales	133,516	111,426
Cost of sales		
Product	79,143	70,202
Service	13,734	13,455
Total Cost of Sales	92,877	83,657
Gross profit	40,639	27,769
Operating Expenses		
Research and development	8,883	7,404
Selling, general and administrative	27,600	24,176
Total operating expenses	36,483	31,580
Operating income (loss)	4,156	(3,811)
Other income (expense):		
Interest income	1,350	481
Interest expense	(1,179)	(1,257)
Other expense, net	(695)	(1,067)
Total other expense	(524)	(1,843)
Income (loss) before provision for income taxes	3,632	(5,654)
Provision for income taxes	257	773
Net income (loss)	$ 3,375	$ (6,427)
Basic income (loss) per share	$ 0.03	$ (0.07)
Diluted income (loss) per share	0.03	(0.07)

Basic weighted average shares outstanding	97,405	95,059
Diluted weighted average shares outstanding	100,537	95,059

See accompanying Notes to Condensed Consolidated Financial Statements.

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STRATEX NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended September 30,	
	2006	2005
Cash flows from operating activities:		
Net income (loss)	$ 3,375	$ (6,427)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Non-cash stock compensation charges	5,572	1,152
Depreciation and amortization	3,300	3,326
Changes in assets and liabilities		
Restricted Cash	(2,608)	
Accounts receivable	(9,324)	2,320
Inventories	5,103	2,413
Other assets	(1,795)	(1,070)
Accounts payable	1,588	(890)
Accrued liabilities	(1,393)	3,997
Long term liabilities	(1,860)	(1,727)
Net cash provided by operating activities	1,958	3,094
Cash flows from investing activities:		
Purchase of short-term investments	(67,062)	(46,189)
Proceeds from sale of short -term investments	59,415	51,356
Purchase of property and equipment	(2,668)	(1,699)
Net cash provided by (used in) investing activities	(10,315)	3,468
Cash flows from financing activities:		
Repayment of bank borrowings	(5,625)	(3,125)
Proceeds from sales of common stock	1,525	297
Net cash used in financing activities	(4,100)	(2,828)
Effect of exchange rate changes on cash	210	(800)
Net increase (decrease) in cash and cash equivalents	(12,247)	2,934
Cash and cash equivalents at beginning of period	44,414	32,860
Cash and cash equivalents at end of period	$ 32,167	$ 35,794
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 535	$ 599

Income taxes paid	$ 537	$ 494

See accompanying Notes to Condensed Consolidated Financial Statements.

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STRATEX NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The condensed consolidated financial statements include the accounts of Stratex Networks, Inc. and its wholly-owned subsidiaries (the Company). Intercompany accounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to current year presentation in segment disclosures.

While the accompanying financial information furnished is unaudited, the financial statements included in this report reflect all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair presentation of the results of operations for the interim periods covered and of the financial condition of the Company at the date of the interim balance sheet. The results for interim periods are not necessarily indicative of the results for the entire year. The condensed consolidated financial statements should be read in connection with the Company s financial statements beginning on page F-41 of this prospectus.

CASH AND CASH EQUIVALENTS

The Company considers all highly liquid debt instruments purchased with a remaining maturity of three months or less at the time of purchase, to be cash equivalents. Auction rate preferred securities are classified as short-term investments. Cash and cash equivalents consisted of cash, money market funds, and short-term securities as of September 30, 2006 and March 31, 2006. As of September 30, 2006, $2.6 million of cash was restricted as guarantee for deferred local tax payments related to the Company s recent imports in United Kingdom.

SHORT-TERM INVESTMENTS

The Company invests its excess cash in high-quality marketable instruments to ensure that cash is readily available for use in its current operations. Accordingly, all of the marketable securities are classified as available-for-sale in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 115. The Company views its available-for-sale portfolio as available for use in its current operations. Accordingly, the Company has classified all investments in marketable securities as short-term, even though the stated maturity date may be one year or more beyond the current balance sheet date. All investments are reported at fair market value with the related unrealized holding gains and losses reported as a component of accumulated other comprehensive loss.

Unrealized holding gains on the portfolio as of September 30, 2006 were insignificant. At September 30, 2006, the available-for-sale securities had contractual maturities ranging from 1 month to 12 months, with a weighted average maturity of 48 days.

INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out) or market, where cost includes material, labor and manufacturing overhead. Inventories consist of (in thousands):

	September 30, 2006	March 31, 2006
Raw materials	$ 7,925	$ 9,012
Finished goods	31,055	34,855
	$ 38,980	$ 43,867

STRATEX NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

OTHER CURRENT ASSETS

Other current assets included the following (in thousands):

	September 30, 2006	March 31, 2006
Receivable from suppliers	$ 2,012	$ 3,074
Non-trade receivables	855	947
Prepaid expenses	2,755	2,987
Deferred costs	2,304	1,178
Prepaid insurance	1,056	395
Income tax and VAT refund	4,627	3,795
Other	212	244
	$ 13,821	$ 12,620

DEPRECIATION AND AMORTIZATION

Depreciation and amortization are reported in the applicable captions in the statement of operations based on the functional area that utilizes the related equipment and facilities. Any depreciation related to production facilities is therefore recorded as a component of cost of sales.

OTHER LONG -TERM ASSETS

Included in other assets as of September 30, 2006 are long-term deposits of $0.4 million for premises leased by the Company and $0.4 million for long-term accounts receivable. The long-term accounts receivable is due to the extended credit terms granted by the Company to some of its customers.

As of March 31, 2006, other assets included deposits of $0.4 million for premises leased by the Company and $0.2 million for long-term accounts receivable.

ACCRUED LIABILITIES

Accrued liabilities included the following (in thousands):

	September 30, 2006	March 31, 2006
Customer deposits	$ 1,800	$ 2,103
Accrued payroll and benefits	2,931	2,628
Accrued commissions	4,560	4,660
Accrued warranty	3,710	4,395
Accrued restructuring	3,713	3,373
Customer discounts	4,422	4,359
Deferred revenue	2,039	3,193
Other	6,517	6,425
	$ 29,692	$ 31,136

The accrual for customer discounts of $4.4 million each as of September 30, 2006 and March 31, 2006, was for a discount on certain volume levels reached by a customer.

CURRENCY TRANSLATION

The functional currency of the Company s subsidiaries located in the United Kingdom and New Zealand is the U.S. dollar. Accordingly, all of the monetary assets and liabilities of these subsidiaries are remeasured into U.S. dollars at the current exchange rate as of the applicable balance sheet date, and all non-monetary assets and liabilities are remeasured at historical rates. Sales and expenses are remeasured at the average exchange rate prevailing during the period. Gains and losses resulting from the remeasurement of the

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STRATEX NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

subsidiaries financial statements are included in the consolidated statements of operations in other income (expense). The Company s other international subsidiaries use their local currency as their functional currency. Assets and liabilities of these subsidiaries are translated at the current exchange rates in effect at the balance sheet date, and income and expense accounts are translated at the average exchange rates during the period. The resulting translation adjustments are included in accumulated other comprehensive loss in the accompanying financial statements.

DERIVATIVE FINANCIAL INSTRUMENTS

In accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities (SFAS 133), all derivatives are recorded on the balance sheet at fair value.

We manufacture and sell products internationally subjecting us to currency risk. Derivatives are employed to eliminate, reduce, or transfer selected foreign currency risks that can be identified and quantified. The Company s policy is to hedge forecasted and actual foreign currency risk with forward contracts that expire within twelve months. Specifically, the Company hedges foreign currency risks relating to firmly committed backlog, open purchase orders and non-functional currency monetary assets and liabilities. In accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities (SFAS 133), all derivatives are recorded on the balance sheet at fair value. Changes in the fair value of derivatives that do not qualify, or are not effective as hedges, must be recognized currently in earnings. Derivatives hedging non-functional currency monetary assets and liabilities are recorded on the balance sheet at fair value and changes in fair value are recognized currently in earnings.

The Company hedges forecasted non-U.S. dollar sales and purchases. In accordance with SFAS 133, we designate and document the forward contracts as cash flow hedges which are evaluated for effectiveness, excluding time value, at least quarterly. The Company records effective changes in the fair value of these cash flow hedges in accumulated other comprehensive income (OCI) until the revenue is recognized or the related purchases are recognized in cost of sales, at which time the changes are reclassified to revenue and cost of sales, respectively. All amounts accumulated in OCI at the end of the quarter will be reclassified to earnings within the next twelve months. The Company records any ineffectiveness, including the excluded time value of the hedge, in other income and expense.

The following table summarizes the activity in OCI with regard to the changes in fair value of derivative instruments for the first half of fiscal 2007 and fiscal 2006 (in thousands):

	Six Months Ended September 30, 2006 Gains/ (Losses)	Six Months Ended September 30, 2005 Gains/ (Losses)
Beginning balance on April 1	$(107)	90
Net changes	(345)	(1,082)
Reclassifications to revenue	425	782
Reclassifications to cost of sales		2
Ending balance on September 30	$ (27)	(208)

An insignificant amount of loss was recognized in other income and expense in the first half of fiscal 2007 and the first half of fiscal 2006 related to the exclusion of time value from effectiveness testing. There was no gain/loss arising from ineffectiveness resulting from forecasted transactions that did not occur.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments and trade receivables. The Company has cash investment policies that limit the amount of credit exposure to any one financial institution and restrict placement of investments to financial institutions evaluated as highly creditworthy. Investments, under the Company s

STRATEX NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

policy, must have a rating, at the time of purchase, of A1 or P1 for short-term paper and a rating of A or better for long-term notes or bonds.

Accounts receivable concentrated with certain customers primarily in the telecommunications industry and in certain geographic locations may subject the Company to concentration of credit risk.

The following table summarizes the number of the Company s significant customers as a percentage of our accounts receivable balance at September 30, 2006 and March 31, 2006 along with the percentage of accounts receivable balance they individually represent. No other customer accounted for more than 10% of the accounts receivable balance at the dates indicated.

	September 30, 2006	March 31, 2006
Number of significant customers	2	2
Percentage of accounts receivable	18%, 18%	12%, 10%

The following table summarizes the number of the Company s significant customers, each of whom accounted for more than 10% of our revenues, along with the percentage of revenues they individually represent.

	Six Months Ended September 30, 2006	Six Months Ended September 30, 2005
Number of significant customers	1	2
Percentage of net sales	13%	11%,10%

The Company actively markets and sells products in Russia, Africa, Asia, Europe, the Middle East and the Americas. The Company performs ongoing credit evaluations of its customers financial conditions and generally requires no collateral, although sales to Asia, Eastern Europe and the Middle East are primarily backed by letters of credit. The Company can discount the accounts receivable backed by certain letters of credit. The discount from the face amount of accounts receivable is accounted for as interest expense and has been included in other income (expense) on the income statement.

REVENUE RECOGNITION

The Company recognizes revenue pursuant to Staff Accounting Bulletin No. 104 (SAB 104) Revenue Recognition . Accordingly, revenue is recognized when all four of the following criteria are met: (i) persuasive evidence that the arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectibility is reasonably assured.

In accordance with SAB 104, revenues from product sales are generally recognized when title and risk of loss passes to the customer and the above criteria are met, except when product sales are combined with significant post-shipment installation services. Under this exception, revenue is deferred until such services have been performed. Installation service revenue is recognized when the related services are performed. When sales are made under payment terms beyond the normal credit terms, revenue is recognized only when cash is collected from the customer unless the sale is covered by letters of credit or other bank guarantees. Revenue from service obligations under maintenance contracts is deferred and recognized on a straight-line basis over the contractual period, which is typically one year.

In the fourth quarter of fiscal 2006, the Company entered into a four year agreement with Alcatel to license certain Eclipse software and products to Alcatel. Alcatel will pay us a license fee based on the dollar value of Alcatel s quarterly purchases from our contract manufacturers. There is a minimum quarterly license fee during the early quarters of the agreement that will be recognized as revenue in the fiscal quarter in which it is invoiced. License fees beyond the quarterly minimum will be recognized as revenue in the quarter in which they are invoiced, due and payable.

STRATEX NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Included in the agreement are certain additional support services that the Company may provide to Alcatel. In accordance with Emerging Issues Task Force (EITF) 00-21, Revenue Arrangements with Multiple Deliverables , the Company determined that revenue related to these services should be recognized separately from the license fee and accordingly will be recognized when the services are performed.

NET INCOME (LOSS) PER SHARE

Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share are computed by dividing net income by the weighted average number of shares of common stock and potentially dilutive securities outstanding during the period. Net income (loss) per share is computed using only the weighted average number of shares of common stock outstanding during the period, as the inclusion of potentially dilutive securities would be anti-dilutive.

The following is a reconciliation of the weighted-average common shares used to calculate basic net income per share to the weighted-average common shares used to calculate diluted net income per share (in thousands):

	Six Months Ended September 30,	
	2006	2005
Weighted-average common shares for basic net income per share	97,405	95,059
Weighted-average dilutive stock options outstanding under the treasury stock method	3,132	
Total	100,537	95,059

STOCK-BASED COMPENSATION

Prior to April 1, 2006, our stock-based employee and director compensation plans were accounted for under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees and related interpretations, and we provided the pro forma disclosures as required by Statement of Financial Accounting Standard, SFAS No. 123 (SFAS 123), Accounting for Stock-based Compensation , as amended by SFAS 148, Accounting for Stock-Based Compensation Transition and Disclosure . Effective April 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123 (Revised 2004), Share-Based Payment , (SFAS No. 123(R)), requiring us to recognize expense related to the fair value of our stock-based compensation awards. We elected to use the modified prospective transition method as permitted by SFAS No. 123(R) and therefore have not restated our financial results for prior periods. Under this transition method, stock-based compensation expense for the six months ended September 30, 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of March 31, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, as adjusted for estimated forfeitures. Stock-based compensation expense for all stock-based compensation awards granted subsequent to March 31, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Under SFAS No. 123(R), the Employee Stock Purchase Plan (ESPP) is considered a compensatory plan and we are required to recognize compensation expense for discounts related to purchases of common stock made under the ESPP.

STRATEX NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

We recognize compensation costs for all stock-based awards over the period during which the employee or director is required to provide service in exchange for the award (the vesting period).

For a further detailed discussion of stock based compensation expense recorded in the financials due to adoption of SFAS 123(R), please see Note 4.

COMPREHENSIVE INCOME

The following table reconciles net income (loss) to comprehensive income (loss) (in thousands):

	Six Months Ended September 30,	
	2006	2005
Net income (loss)	$ 3,375	$ (6,427)
Other comprehensive income (loss):		
Unrealized currency translation gain/ (loss)	155	29
Unrealized holding gain (loss) on investments	21	19
Comprehensive income (loss)	$ 3,551	$ (6,379)

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans a amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS 158). SFAS 158 requires employers to (i) recognize in its statement of financial position the funded status of a benefit plan measured as the difference between the fair value of plan assets and the benefit obligation, (ii) recognize net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to SFAS No. 87, Employers Accounting for Pensions or SFAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions, (iii) measure defined benefit plan assets and obligations as of the date of the employer s statement of financial position and (iv) disclose additional information in the notes to the financial statements about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. For companies with publicly traded securities, the requirements of SFAS 158 are effective for fiscal years ending after December 15, 2006 and are to be applied prospectively upon adoption. For companies without publicly traded equity securities, the requirements to recognize the funded status of a defined benefit postretirement plan and provide related disclosures are effective for fiscal years ending after June 15, 2007, while the requirement to measure plan assets and benefit obligations as of the date of the employer s statement of financial position is effective for fiscal years ending after December 15, 2008, with earlier application encouraged. The Company is currently in the process of assessing the impact the adoption of SFAS 158 will have on its financial position, results of operations and liquidity.

In September 2006, FASB issued SFAS 157, Fair Value Measurements (SFAS 157), which clarifies that fair value is the amount that would be exchanged to sell an asset or transfer a liability in an orderly transaction between market participants. Further, the standard establishes a framework for measuring fair value in generally accepted accounting principles and expands certain disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS 157 to have a material impact on its consolidated financial position, results of operations or cash flows.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB 108 is effective for fiscal years ending on or after November 15, 2006 and addresses how financial statement errors should be considered from a materiality perspective and corrected. The

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literature provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. Historically there have been two common approaches used to quantify such errors: (i) the rollover approach, which quantifies the error as the amount by which the current year income statement is misstated, and (ii) the iron curtain approach, which quantifies the error as the cumulative amount by which the current year balance sheet is misstated. The SEC Staff believes that companies should quantify errors using both approaches and evaluate whether either of these approaches results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The Company is currently assessing the impact of adopting SAB 108 but does not expect that it will have a material effect on our consolidated financial position or results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements, tax positions taken or expected to be taken on a tax return, including a decision whether to file or not to file in a particular jurisdiction. FIN 48 provides that the tax effects from an uncertain tax position can be recognized in an entity s financial statements, only if the position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently assessing the impact of FIN 48 on its consolidated financial position and results of operations.

In February 2006, FASB issued SFAS No.155, Accounting for Certain Hybrid Financial Instruments (SFAS 155), an amendment to SFAS 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS 155 provides the framework for fair value remeasurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation as well as establishes a requirement to evaluate interests in securitized financial assets to identify interests. SFAS 155 further amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The SFAS 155 guidance also clarifies which interest-only strips and principal-only strips are not subject to the requirement of SFAS 133 and concentrations of credit risk in the form of subordination are not embedded derivatives. This statement is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The Company does not expect the adoption of SFAS 155 to have a material impact on the Company s consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections (SFAS No. 154). SFAS No.154 replaces APB Opinion No. 20, Accounting Changes , and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements , and changes the requirements of the accounting for and reporting of a change in accounting principle. SFAS No. 154 also provides guidance on the accounting for and reporting of error corrections. The provisions of this statement are applicable for accounting changes and error corrections made in fiscal years beginning after December 15, 2005. The adoption of this standard did not have a material impact on the Company s results of operations or financial condition.

NOTE 2. PROPOSED BUSINESS COMBINATION

On September 5, 2006, the Company and Harris Corporation (Harris) entered into a Formation, Contribution and Merger Agreement (the Contribution Agreement) which provides for the formation of a Delaware corporation named Harris Stratex Networks, Inc. (Newco). Under the Contribution Agreement, upon receipt of the approval of the Company s stockholders a newly-organized Delaware corporation which is a wholly-owned subsidiary of Newco will merge with and into the Company with the Company surviving as a wholly-owned subsidiary of Newco (the Merger). Under the terms of the Contribution Agreement, Harris Corporation will contribute its

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(MCD) and $25 million of cash and Newco will assume those liabilities primarily resulting from or primarily arising out of MCD, other than certain specified liabilities (the Contribution). The Contribution and the Merger are collectively referred to as the Combination. In consideration of its contribution, Harris will receive approximately 56% of the outstanding stock of Newco. and stockholders of the Company will receive approximately 44% of the outstanding stock of Newco.

At the effective time of and as a result of the Combination, (i) Newco will issue to the stockholders of the Company one-fourth share of Newco Class A common stock for each share of Company common stock held immediately prior to the Combination, (ii) Newco will assume the Company s obligations under all outstanding options, equity awards and warrants exercisable for Company common stock, substituting one-fourth share of Newco Class A common stock for each share of Company common stock subject thereto and with an exercise price per share of Newco Class A common stock equal to four times the exercise price stated therein for each share of Company common stock, and (iii) Newco will issue to Harris or one of Harris domestic subsidiaries the number of shares of Newco Class B common stock which will equal 56/44ths of the sum of (x) the number of shares of Newco Class A common stock issued in the Merger and (y) the number of additional shares of Newco Class A Common Stock which would be deemed outstanding immediately after the effective time of the Merger by applying the treasury stock method to the Newco options and warrants outstanding by virtue of Newco s assumption of corresponding options and warrants for Company common stock, on the assumption that the fair market value of each share of Newco Class A common stock was $20.80. This value is an element of the negotiated transaction and does not represent or purport to indicate the actual fair market value of Newco Class A common stock or the Company s common stock.

Pending the receipt of stockholder approval, as well as satisfaction of other customary closing conditions, the Combination is expected to close in the third or fourth quarter of fiscal 2007.

NOTE 3. LONG-TERM DEBT

On May 27, 2004 the Company borrowed $25 million on a long-term basis against its $35 million credit facility with a commercial bank. This $25 million loan is payable in equal monthly installments of principal plus interest over a period of four years. This loan bears interest at a fixed interest rate of 6.38% per annum. As of September 30, 2006 the Company had repaid $14.6 million of the loan.

In February 2006, the Company increased the amount of its credit facility with the bank from $35 million to $50 million and extended the facility for an additional one year term to April 30, 2008. On March 1, 2006, the Company borrowed an additional $20 million on a long-term basis under the facility. This loan is payable in equal monthly installments of principal plus interest over a period of four years. The loan is at a fixed interest rate of 7.25%. As of September 30, 2006, the Company had repaid $2.5 million under the new term loan.

The credit facility agreement contains a tangible net worth covenant and a liquidity ratio covenant. As of September 30, 2006 the Company was in compliance with these financial covenants.

At September 30, 2006, the Company s future long-term debt payment obligations were as follows:

	Years ending March 31, (in thousands)	
2007	$	5,625
2008		11,250
2009		6,042
2010		5,000
Total	$	27,917

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At the end of September 2006, the Company had $15.9 million of credit available against the $50 million revolving credit facility with a commercial bank as mentioned above. Per the amended agreement, the total amount of revolving credit available was expanded to $50 million less the outstanding balance of the term debt portion and any usage under the revolving credit portion. As of September 30, 2006, the balance of the long-term debt portion of our credit facility was $27.9 million and there were $6.1 million in outstanding standby letters of credit as of that date which are defined as usage under the revolving credit portion of the facility.

NOTE 4. STOCK BASED COMPENSATION

The Company has stock options plans, a restricted stock plan and an employee stock purchase plan under which it grants stock to employees as incentives.

Stock Option Plans. The Company has granted options to employees under several stock option plans. The Company s 1984 Stock Option Plan (the 1984 Plan) provided for the grant of both incentive and nonqualified stock options to its key employees and certain independent contractors. Upon the adoption of its 1994 Stock Incentive Plan (the 1994 Plan), the Company stopped granting options under the 1984 Plan. The 1994 Stock Incentive Plan terminated in July 2004. As of September 30, 2006, there are 2.3 million options outstanding under this plan.

In April 1996, the Company adopted the 1996 Non-Officer Employee Stock Option Plan (the 1996 Plan) which had 1,000,000 shares of Common Stock to be reserved for issuance to non-officer key employees as an incentive to continue to serve with the Company. The 1996 Plan terminated in April 2006. No future grants will be made under this plan. As of September 30, 2006, there are 0.3 million of options and awards outstanding under this plan.

In November 1997, the Company adopted the 1998 Non-Officer Employee Stock Option Plan (the 1998 Plan), which became effective on January 2, 1998. The 1998 Plan reserved 500,000 shares of Common Stock for issuance to non-officer key employees as an incentive to continue to serve with the Company. The 1998 Plan will terminate on the date on which all shares available have been issued. As of September 30, 2006, there are 0.2 million of options and awards outstanding under this plan.

The 1999 Stock Incentive Plan (the 1999 Incentive Plan), which was approved by the Company s stockholders in August 1999, provides for the issuance of stock options covering up to 2,500,000 shares of its Common Stock. In August 2001, the stockholders approved the reservation for issuance of 4,000,000 additional shares of Common Stock under this plan for granting options as needed to retain and attract talented employees. Options granted under the 1999 Incentive Plan generally vest over four years and expire after seven years. The 1999 Plan terminated in June 2006 and no future grants will be made under this plan. As of September 30, 2006, there are 5.0 million of options and awards outstanding under this plan.

In August 2002, the shareholders approved the 2002 Stock Incentive Plan, which reserved up to 10,000,000 shares of common stock for issuance of stock options and awards of the Company s common stock to the Company s directors, officers, consultants and other employees. Awards may be granted under the 2002 Stock Incentive Plan subject to vesting schedules and restrictions on transfer. The 2002 Stock Incentive Plan also contains two separate equity incentive programs related to Director grants, (i) a non-employee director option program under which option grants will be made at specified intervals to non-employee directors of the Company s board of directors and (ii) a non-employee director stock program under which non-employee directors of the Company s board may elect to apply all or a portion of their annual retainer and meeting fees to the purchase of shares of the Company s common stock. The 2002 Stock Incentive Plan will terminate in August 2009, unless terminated earlier by the Company s board of directors. As of September 30, 2006, there are 6.0 million of options and awards outstanding under this plan.

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In August 2006, the shareholders approved the 2006 Stock Equity Plan which reserves up to 8,000,000 shares of its common stock for issuance of stock options and awards of common stock to the Company s directors, officers, consultants and other employees. The 2006 Plan is administered by the Compensation Committee of the Board of Directors. The Committee has the discretion to determine the employee, consultant or director to receive an award, the form of award, the terms and provisions of the respective award agreements and any acceleration or extension of an award. The Plan will terminate in August 2013, unless terminated earlier by the Company s board of directors or in connection with the Combination. As of September 30, 2006, there are no options and awards outstanding under this plan.

At September 30, 2006, 10,377,616 shares remained available for grant under all of the Company s stock option plans.

The Company did not modify any of its stock option plans during the three months ended September 30, 2006.

The following represents the activity in our stock option plans:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average remaining contractual term in years	Aggregate Intrinsic Value (in thousands)
Outstanding at March 31, 2006	11,358	$ 5.74		
Granted	3,145	4.31		
Exercised	(339)	3.17		
Forfeitures and cancellations	(79)	3.33		
Expired	(239)	9.50		
Outstanding at September 30, 2006	13,846	$ 5.43	4.42	$ 12,186
Vested and expected to vest at September 30, 2006	13,434	$ 5.47	4.35	$ 12,186
Exercisable at September 30, 2006	9,426	$ 6.00	3.57	$ 10,389

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the options that were in-the-money at September 30, 2006. The aggregate intrinsic value of options exercised during the three and six months ended September 30, 2006 was $0.1 million and was $0.8 million, respectively, determined as of the date of option exercise.

Employee Stock Purchase Plan. In addition to our stock option plans, we also have an Employee Stock Purchase Plan which generally allows employees to purchase Company stock at a 15% discount to market prices with a three month look-back period. Based on the 15% discount and the fair value of the option feature of this plan, this plan is considered compensatory under SFAS 123(R). Compensation expense is calculated using the fair value of the employees purchase rights under the Black-Scholes model. The Company recognized compensation expense of $152,955 in the first half of fiscal 2007. The Company did not recognize expense during the first half of fiscal 2006 as it was not required prior to the adoption of SFAS No. 123(R).

Restricted Stock Plan. The Company grants restricted stock under its 2002 stock incentive plan. On June 15, 2005, the Company granted 906,575 of shares of Common Stock to its employees under its 2002 Stock Incentive Plan. Per the plan the shares will vest at the rate of a minimum of one third annually for the next three fiscal years. In addition, the vesting schedule is subject to acceleration when performance goals defined in the Restricted Stock Award Agreement (the agreement) are achieved. In fiscal 2006, all the shares (net of forfeitures) granted under this plan vested due to achievement of certain performance goals. On March 31, 2006, the Company granted an additional 637,544 shares of common stock to its employees

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under the 2002 Stock Incentive Plan. A minimum of 50% of shares will vest by March 31, 2008. In addition, the vesting schedule is subject to certain acceleration if any or all of the performance goals defined in the Restricted Stock Award Agreement (the agreement) are achieved during the period beginning April 1, 2006 and ending March 31, 2007. If more than 50% of the shares vest based upon achievement of the performance goals during this period, any shares that do not vest at that time shall automatically be forfeited and no additional shares will vest on March 31, 2008. Under this same plan, the Company granted an additional 44,826 shares on April 3, 2006 and 85,096 on May 18, 2006.

The following table summarizes the Company s restricted stock award activity for the three months and six months ended September 30, 2006 (in thousands, except per share amounts):

	Number of Shares		Weighted Average Grant Date Fair Value Per Share
Nonvested stock at April 1, 2006	637	$	6.15
Granted	130		6.08
Vested	(307)		6.14
Nonvested stock at June 30, 2006	460	$	6.14
Granted			
Vested	(269)		6.02
Nonvested stock at September 30, 2006	191	$	6.31

The Company settles employee stock option exercises, employee stock purchases under the Employee Stock Purchase Plan and restricted stock awards vested with newly issued shares of common stock.

Determining Fair Value of Stock-based Compensation Awards

Valuation method The Company estimates the fair value of stock options granted using the Black-Scholes-Merton multiple option valuation model.

Amortization method For options granted prior to March 31, 2006, the fair value is amortized on a graded vesting method, and for stock awards granted after March 31, 2006 on a straight-line basis, over the requisite service period of the awards.

Expected Term The expected term represents the period that the stock-based awards are expected to be outstanding and was determined based on the simplified method per Staff Accounting Bulletin (SAB) No. 107, giving consideration to the contractual terms of the stock- based awards and the vesting schedules. In developing its estimate, the Company concluded that the expected term determined using the historical exercise data was not indicative of future exercise behavior primarily due to past structural changes of its business and differences in vest terms of post equity-based share option grants.

Expected Volatility The Company s computation of expected volatility for the three and six months ended September 30, 2006 is based on historical volatility.

Risk-Free Interest Rate The risk-free interest rate used in the Black-Scholes-Merton option valuation method is based on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equal to the expected term of the option.

Expected Dividend The dividend yield reflects that the Company has not paid any dividends and have no intention to pay dividends in the foreseeable future.

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Estimated Pre-vesting Forfeitures When estimating forfeitures, the Company considers voluntary termination behavior as well as future workforce reduction programs. Estimated forfeiture rates are trued-up to actual forfeiture results as the stock-based awards vest.

In connection with the adoption of SFAS No. 123(R), the Company reassessed its valuation technique and related assumptions. The Company estimates the fair value of stock options using the Black-Scholes-Merton option valuation model, consistent with the provisions of SFAS No. 123(R), SEC SAB No. 107 and its prior period pro forma disclosures of net earnings, including stock-based compensation (determined under a fair value method as prescribed by SFAS No. 123). The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model and the graded-vesting method with the following weighted-average assumptions:

Employee Stock Options

	Six Months Ended September 30,	
	2006	2005
Expected dividend yield	0.0%	0.0%
Expected stock volatility	94.0%	96.9%
Risk-free interest rate	5.0%	3.9%
Expected life in years(*)	2.2	1.5

(*) From vest date.

The weighted average fair value of stock options granted during the six months ended September 30, 2006 and September 30, 2005, was $2.90 and $1.00, respectively.

Employee Stock Purchase Plan

	Six Months Ended September 30,	
	2006	2005
Expected dividend yield	0.0%	0.0%
Expected stock volatility	71.9%	50.7%
Risk-free interest rate	5.0%	2.9%
Expected life in years	0.3	0.2

Total stock compensation expense recorded in the condensed consolidated statement of operations for the six months ended September 30, 2006 was $5.6 million which included $2.1 million of expense for stock options due to the adoption of SFAS 123(R) effective April 1, 2006 and $3.5 million of stock expense for restricted stock awards that vested during the period.

The effect of adopting FAS123R for the six month periods ended September 30, 2006 was as follows (in thousands except per share amounts):

	Six Months Ended September 30, 2006
Total stock-based compensation expense on adoption of FAS123R	$ 2,103
Tax effect on stock-based compensation expense	

Net effect on stock compensation expense	$	2,103
Effect on loss per share:		
Basic	$	0.02
Diluted	$	0.02

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The following table shows total stock-based compensation expense included in the Condensed Consolidated Statements of Operations for the six months ended September 30, 2006 (in thousands):

		Six Months Ended September 30, 2006
Cost of sales	$	463
Research and development		1,359
Selling, general and administrative		3,750
	$	5,572

During the six months ended September 30, 2006 the Company capitalized as part of inventory approximately $0.5 million of stock-based compensation.

At September 30, 2006, the total compensation cost related to unvested stock-based awards granted to employees under the stock option plans but not yet recognized was approximately $8.6 million, after estimated forfeitures. This cost will be recognized over an estimated weighted-average period of approximately 2.4 years and will be adjusted if necessary in subsequent periods if actual forfeitures differ from those estimates. At September 30, 2006, the total compensation cost related to unvested stock-based awards granted to employees under the restricted stock plan but not yet recognized was approximately $1.1 million, after estimated forfeitures. This cost will most likely be recognized in the second half of fiscal 2007 and will be adjusted if necessary in subsequent periods if actual forfeitures differ from those estimates.

At September 30, 2006, the total compensation cost related to options to purchase common shares under the ESPP but not yet recognized was insignificant.

Pro Forma Disclosures. Pro forma information required under SFAS 123 for the six months ended September 30, 2005 as if the Company had applied the fair value recognition provisions of SFAS 123, to options under the Company s stock-based compensation plans, was as follows (in thousands, except for per share amounts):

		Six months ended September 30, 2005
Net loss as reported	$	(6,427)
Add: Stock-based compensation expense determined under fair value method for all awards, net of related tax effects		(2,522)
Net loss pro forma	$	(8,949)
Basic and diluted loss per share as reported	$	(0.07)
Basic and diluted loss per share pro forma	$	(0.09)

NOTE 5. COMMITMENTS AND CONTINGENCIES

The Company is subject to legal proceedings and claims that arise in the normal course of its business. In the opinion of management, these proceedings should not have a material adverse effect on the business, financial position, and results of operations of the Company.

Warranty

At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with its sales, recorded as a component of cost of sales. The Company s standard warranty is

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generally for a period of 27 months from the date of sale if the customer uses the Company s or their approved installers to install the products, otherwise it is 15 months from the date of sale. Under certain circumstances warranty is extended beyond the standard warranty terms of 27 months. The Company s warranty accrual represents the best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. Warranty accrual is made based on forecasted returns and average cost of repair. Forecasted returns are based on trend of historical returns. While the Company believes that its warranty accrual is adequate and that the judgment applied is appropriate, the amounts estimated to be due and payable could differ materially from what will actually transpire in the future.

The changes in the warranty reserve balances during the periods indicated are as follows (in thousands):

	Six Months Ended September 30, 2006	Six Months Ended September 30 2005
Balance at the beginning of period	$ 4,539	$ 5,340
Additions related to current period sales	1,218	2,947
Warranty costs incurred in the current period	(2,173)	(2,701)
Adjustments to accruals related to prior period sales	126	(546)
Balance at the end	$ 3,710	$ 5,040

NOTE 6. RESTRUCTURING CHARGES

The Company did not record any restructuring during six months ended September 30, 2006 and 2005.

During fiscal 2002 to fiscal 2005, the Company announced several restructuring programs. These restructuring programs included the consolidation of excess facilities and reduction of workforce. Due to these actions, the Company recorded restructuring charges of $19.0 million in fiscal 2003 and $8.6 million in fiscal 2002 for vacated building lease obligations. In fiscal 2004 and fiscal 2005, we recorded $4.6 and $2.3 million of restructuring charges, respectively, for the building lease obligations, related to facilities which were vacated in fiscal 2002 and fiscal 2003, due to changes in estimated sub-lease income.

The following table summarizes the activities of the restructuring accrual during the fiscal year ended March 31, 2006 and the six months ended September 30, 2006 (in millions):

	Severance and Benefits	Facilities and Other	Total
Balance as of March 31, 2005	$ 1.1	$ 21.9	$ 23.0
Cash payments	(1.2)	(3.6)	(4.8)
Reclassification	0.3	(0.6)	(0.3)
Balance as of March 31, 2006	$ 0.2	$ 17.7	$ 17.9
Cash payments		(0.8)	(0.8)
Balance as of June 30, 2006	$ 0.2	$ 16.9	$ 17.1
Provision			
Cash payments		(0.7)	(0.7)

Balance as of September 30, 2006	$	0.2	$	16.2	$	16.4
Current portion	$	0.2	$	3.5	$	3.7
Long-term portion	$		$	12.7	$	12.7

The remaining accrual balance of $16.4 million as of September 30, 2006 is expected to be paid out in cash ($0.2 million in severance and benefits, $0.3 million in legal and $15.9 million in vacated building lease obligations). Of the vacated building lease obligations, $3.2 million is expected to be paid out in the next twelve months and $12.7 million to be paid out during fiscal 2008 through fiscal 2012.

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NOTE 7. OPERATING SEGMENT AND GEOGRAPHIC INFORMATION

SFAS No. 131 Disclosures about Segments of an Enterprise and Related Information (SFAS 131) establishes annual and interim reporting standards for an enterprise s operating segments and related disclosures about products, geographic information, and major customers. Operating segment information for the second quarter of fiscal 2007 and 2006 and first half of fiscal 2007 and 2006 is presented in accordance with SFAS 131.

The Company is organized into two operating segments: Products and Services. The Chief Executive Officer (CEO) has been identified as the Chief Operating Decision-Maker as defined by SFAS 131. Resources are allocated to each of these groups using information on their revenues and operating profits before interest and taxes.

The Products operating segment includes the Eclipse , XP4 , Altium®, DXR® and Velox digital microwave systems for digital transmission markets. The Company began commercial shipments of a new wireless platform consisting of an Intelligent Node Unit and a radio element, which combined are called Eclipse (Eclipse), in January 2004. The Company designs and develops the above products in Wellington, New Zealand and San Jose, California. Prior to June 30, 2002, the Company manufactured the XP4 and Altium family of digital microwave radio products in San Jose, California. In June 2002, the Company entered into an agreement with Microelectronics Technology Inc. (MTI), a Taiwanese company, for outsourcing of the Company s XP4 and Altium products manufacturing operations. In fiscal 2005, the Company outsourced its DXR manufacturing operations in New Zealand to GPC in Australia and Velox manufacturing operations in Cape Town, South Africa to Benchmark Electronics in Thailand. The Eclipse family of products is also manufactured by these contract manufacturers.

Operating segments generally do not sell products to each other, and accordingly, there are no significant inter-segment revenues to be reported. The Company does not allocate interest,, other expense and income taxes to operating segments. The accounting policies for each reporting segment are the same.

The following table sets forth net revenues and operating income (loss) by operating segments (in thousands):

	Six Months Ended September 30,	
	2006	2005
Products:		
Revenues	$116,918	$ 95,629
Operating income (loss)	1,292	(6,153)
Services:		
Revenues	16,598	15,797
Operating income	2,864	2,342
Total:		
Revenues	$133,516	$111,426
Operating income (loss)	4,156	(3,811)

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The following table sets forth net revenues from unaffiliated customers by product (in thousands):

	Six Months Ended September 30,	
	2006	2005
Eclipse	$ 100,121	$ 55,547
Velox	3,404	3,145
DXR	3,207	11,253
XP4	4,992	12,705
Other Products	5,194	12,979
Total Products	116,918	95,629
Total Services	16,598	15,797
Total Revenues	$ 133,516	$ 111,426

The following table sets forth revenues from unaffiliated customers by geographic region (in thousands):

	Six Months Ended September 30			
	2006	% of Total	2005	% of Total
United States	$ 4,159	3%	$ 6,194	6%
Other Americas	9,228	7%	13,564	12%
Poland	5,677	4%	11,800	10%
Other Europe	33,613	25%	25,089	22%
Middle East	10,018	8%	8,589	8%
Thailand	4,770	4%	11,724	11%
Bangladesh	2,896	2%	13,258	12%
Other Asia/Pacific	19,238	14%	9,178	8%
Ghana	17,335	13%	2,994	3%
Tanzania	9,976	8%	65	0%
Other Africa	16,606	12%	8,971	8%
Total Revenues	$133,516	100%	$111,426	100%

Long-lived assets by country consisting of net property and equipment was as follows (in thousands):

	September 30, 2006	March 31, 2006
United States	$ 4,232	$ 3,698
United Kingdom	13,634	14,193
New Zealand	3,122	3,648
Other foreign countries	2,491	2,510
Total property and equipment, net	$ 23,479	$ 24,049