

BURST.COM, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2002 AND 2001

	<u>Assets</u>	
	<u>2002</u>	<u>2001</u>
Current assets		
Cash and cash equivalents	\$ 644,201	\$ 6,112
Accounts receivable, net of allowance of \$0 and \$0	2,331	17,500
Loans to officers	-	-
Prepaid expenses and other current assets	-	12,258
Total current assets	646,532	35,870
Property and equipment, net of accumulated depreciation of \$84,979 and \$38,895 respectively	57,545	102,984
Other assets	2,700	2,700
Total assets	\$ 706,777	\$ 141,554
<u>Liabilities and Stockholders' Equity</u>		
Current liabilities		
Accounts payable	\$ 427,288	\$ 692,423
Accrued expenses	382,681	504,573
Accrued interest	258,426	93,079
Deferred revenue	161,200	322,400
Notes and obligations payable, current portion	-	1,053,239
Total current liabilities	1,229,595	2,665,714
Long Term Liabilities	\$ 1,923,409	\$ 274,970
Stockholders' Deficit		
Convertible preferred stock, \$.00001 par value, 20,000,000 shares authorized; none issued outstanding	-	-
Common stock, \$.00001 par value; 100,000,000 shares authorized; 22,681,771 and 18,734,958 shares issued and outstanding during 2002 and 2001 respectively	550,718	187
Additional paid-in-capital	58,534,464	57,823,883
Accumulated deficit (60,623,200)	(61,531,409)	
Total stockholders' deficiency	(2,446,227)	(2,799,130)
Total Liabilities and Stockholders' Deficiency	\$ 706,777	\$ 141,554

BURST.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

	<u>2002</u>	<u>2001</u>
Revenue	\$ 191,950	\$ 138,019
Cost of revenues	<u>-</u>	<u>-</u>
Gross profit	<u>191,950</u>	<u>138,019</u>
Costs and expenses:		
Research and development	-	188,223
Sales and marketing	-	120,710
Losses on abandonment, disposition and write-downs of property and equipment	-	384,959
General and administrative	<u>590,186</u>	<u>3,150,766</u>
Total costs and expenses	<u>590,186</u>	<u>3,844,658</u>
Loss from operations	<u>(398,236)</u>	<u>(3,706,639)</u>
Other income (expenses):		
Loss on sale of marketable securities	-	(324,430)
Gains on sale of assets	17,550	269,733
Interest income	1,931	7,951
Interest expense	<u>(524,036)</u>	<u>(467,935)</u>
Total other income (expenses)	<u>(504,555)</u>	<u>(514,681)</u>
Income tax benefit (expense)	(5,419)	244,719
Net loss before extraordinary item	(908,210)	(3,976,601)
Extraordinary gain, Net of income tax expense	<u>-</u>	<u>399,279</u>
Net loss	<u>\$ (908,210)</u>	<u>\$ (3,577,322)</u>
Net loss per share, basic and diluted, before extraordinary item	<u>\$ (0.03)</u>	<u>\$ (0.19)</u>
Net loss per share, basic and diluted	<u>\$ (0.03)</u>	<u>\$ (0.17)</u>
Weighted average number of common shares outstanding	<u>21,414,948</u>	<u>21,460,318</u>

BURST.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

	<u>Common Stock</u>	
	<u>Shares</u>	<u>Amount</u>
Balance, December 31, 2000	20,148,125	201
Year ended December 31, 2001:		
Stock issued in exchange for marketable securities	1,500,000	15
Negotiated settlement to prior offering costs	-	-
Warrants and options issued with debt	-	-
Revaluation of stock options	-	-
Shares returned	(2,913,167)	(29)
Net loss	<u>-</u>	<u>-</u>

Balance, December 31, 2001	18,734,958	187
Year ended December 31, 2002:		
Stock issued in exchange for marketable securities	-	-
Negotiated settlement to prior offering costs	-	-
Common Stock issued in settlement with prior officers	595,757	-
Common Stock issued in return for services	25,000	-
Common Stock issued to investors	2,537,535	-
Additional Common Stock issued during 2002	<u>788,521</u>	<u>-</u>
Balance, December 31, 2002	<u>22,681,771</u>	<u>227</u>

BURST.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001 (CONTINUED)

	Additional Paid-In Capital	Deficit
	<u>Total</u>	<u>Deficit</u>
Balance, December 31, 2000	55,852,947 (1,192,730)	(57,045,878)
Year ended December 31, 2001:		
Stock issued in exchange for marketable securities	843,735	-
	843,750	-
Negotiated settlement to prior offering costs	629,665	-
	629,665	-
Warrants and options issued with debt	649,960	-
	649,960	-
Revaluation of stock options	(152,453)	-
	(152,453)	-
Shares returned	29	-
	-	-
Net loss	<u>-</u>	<u>(3,577,322)</u>
	<u>(3,577,322)</u>	<u>(3,577,322)</u>
Balance, December 31, 2001	57,823,883 (2,799,130)	(60,623,200)
Year ended December 31, 2002:		
Compensation related to sale of common stock to investors	289,483	-
	289,483	-
Compensation related to issuance of common stock For services	3,500	-
	3,500	-
Stock issued in exchange for extension of notes	214,472	-
	214,472	-
Stock issued in exchange for settlement Of debt	17,268	-
	27,268	-
Warrants and options issued with debt	160,859	-
	160,859	-

Warrants exercised	24,999	-	
	24,999		
Net loss	-	(780,207)	
	<u>(780,207)</u>		
Balance, December 31, 2002	<u>\$ 58,534,464</u>	<u>\$(61,403,407)</u>	\$
	<u>(2,318,225)</u>		

BURST.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Net loss	\$ (908,210)	\$ (3,577,322)
Adjustments to reconcile net loss to net cash used by operations activities:		
Depreciation and amortization	46,084	82,757
Loss on asset impairments	-	384,959
Non-cash interest expense	-	369,434
Settlement of receivable	-	139,633
Loss on sale of marketable securities	-	324,430
Gain on sale of assets	-	(269,733)
Revaluation of stock options	-	(152,453)
Stock options issued for services	-	-
Compensation from stock and option Awards to employees	-	-
Purchased research and development	-	-
Conversion of legal fees to note payable	-	-
Issuance of penalty shares	-	-
Change in operating assets and liabilities:		
Accounts receivable	17,460	(8,930)
Prepaid and other current assets	9,967	29,826
Other assets	-	314,637

Accounts Payable	(280,135)	(649,415)
Accrued expenses	(106,892)	618,365
Accrued interest	165,347	91,887
Deferred revenue	<u>(161,200)</u>	<u>-</u>
Net cash used by operating activities	<u>(1,217,579)</u>	<u>(2,301,925)</u>
Cash flows from investing activities:		
Purchase of property and equipment	(644)	-
Sales of property and equipment	-	269,733
Proceeds from sale of marketable securities	<u>-</u>	<u>841,720</u>
Net cash used by investing activities	<u>(644)</u>	<u>1,111,453</u>
Cash flows from financing activities:		
Payments of receivable from Series B convertible		
Stock offering	-	-
Proceeds from sale of stock, net of costs	550,502	-
Exercise of warrants and stock options	-	-

BURST.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001 (CONTINUED)

	<u>2002</u>	<u>2001</u>
Cash flows from financing activities (continued):		
Payment of costs in connection with conversion of preferred stock to common	-	-
Proceeds from debt financing	595,199	1,000,000
Repayment of debt	<u>710,611</u>	<u>(100,000)</u>
Net cash provided by financing activities	1,856,312	900,000
Increase (Decrease) in cash and cash equivalents	638,090	(290,472)
Cash and cash equivalents, beginning of year	<u>6,112</u>	<u>296,584</u>
Cash and cash equivalents, end of year	<u>\$ 644,202</u>	<u>\$ 6,112</u>

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND CAPITALIZATION

Burst.com, Inc. and subsidiaries (“The Company”) was incorporated in the State of Delaware as Instant Video Technologies, Inc. On January 27, 2000, the Certificate of Incorporations was amended to change the Company’s name to Burst.com, Inc.

The Company’s authorized capital stock consists of 100,000,000 shares of common stock, \$0.00001 par value per share, and 20,000,000 shares of preferred stock, \$0.00001 per share.

The board of directors has the authority, without action by the Company’s stockholders, to provide for the issuance of preferred stock in one or more classes or series and to designate the rights, preferences and privileges of each class or series, which may be greater than the rights of the common stock. The Company had no preferred stock outstanding as of December 31, 2002 and 2001.

BUSINESS

The Company licenses burst transmission software and intellectual property for use within commercial, multimedia and interactive environments. The burst technology allows for time compression and burst transmission of video/audio programming that results in time-savings, network efficiency and superior quality products.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Burst.com, Inc and its wholly-owned subsidiaries, Explore Technology, Inc. and Timeshift-TV. All significant intercompany balances and transactions have been eliminated.

USE OF ESTIMATES

The accompanying consolidated financial statements have been prepared in conformity with U.S generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and operations for the period. Although these estimates are based on management’s knowledge of current events and actions it may undertake in the future, they may ultimately differ from actual results. The Company’s most significant estimates are those related to the valuation of stock, stock options, and warrants in

connection with equity and financing transactions.

Cash and cash equivalents consist of money market accounts and other short-term investments with an original or remaining term of three months or less.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash.

The Company maintains cash balances at several banks. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$100,000. From time to time, the Company had cash in financial institutions in excess of federally insured limits.

INVESTMENTS

In accordance with Statement of Financial Accounting Standards (SFAS No. 115) "Accounting for Certain Investments in Debt and Equity Securities", securities are classified into three categories: held-to maturity, available-for-sale and trading. The Company's investments consisted of equity securities classified as available-for-sale. Accordingly, they were carried at fair value in accordance with SFAS No. 115. Further, SFAS No. 115 requires that unrealized gains and losses for available-for-sales securities be excluded from earnings and reported, net of deferred income taxes, as other comprehensive income. As of December 31, 2002 and 2001, the Company had disposed of all of its available for sale securities.

COMPREHENSIVE INCOME

The Company had no component of comprehensive income other than its reported amounts of net loss applicable to holders of common stock.

LONG-LIVED ASSETS

The Company periodically evaluates whether events and circumstances have occurred that may warrant revision of the estimated life of intangible and other long-lived assets, or whether the remaining balance of intangible and other long-lived assets should be evaluated for possible impairment. If and when such factors, events or circumstances indicate that intangible or other long-lived assets should be evaluated for possible impairment, the Company would make an estimate of undiscounted cash flows over the remaining lives of the respective assets in measuring recoverability.

During the years ended December 31, 2001, the Company recognized approximately \$385,000 of impairment in leasehold improvements, computers and equipment assets; Further description in Note 4. There were no impairments recognized in the year ended December 31, 2002.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION

The Company recognizes revenue in accordance with Statement of Position (SOP) No. 97-2, "Software Revenue Recognition". Under the guidance of SOP No. 97.2, no revenue is recognized until evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection is probable. License fees and services are generally recognized as

revenue ratably over the license period.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets that range from three to five years. Replacements, maintenance and repairs, which do not extend the lives of the respective assets are charged to expense as incurred.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable, and debt. The carrying amounts of such financial instruments approximate their respective estimated fair value due to the short-term maturities and approximate market interest rates of these instruments.

NET LOSS PER COMMON SHARE AND DILUTIVE SECURITIES

Earnings (loss) per share is computed in accordance with SFAS No. 128, "Earnings per Share". Basic earnings per share is computed by dividing net income, after deducting preferred stock dividends accumulated during the period, by the weighted-average number of shares of common stock outstanding during each period. Diluted earnings per share is computed by dividing net income by the weighted-average number of shares of common stock, common stock equivalents and other potentially dilutive securities outstanding during the period.

The following is a summary of the securities that could potentially dilute basic loss per share in the future that were not included in the computation of diluted loss per share because to do so would be anti-dilutive.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

	2002	2001
Convertible Preferred Stock	-	-
Options	5,907,497	7,697,880
Warrants	<u>17,396,678</u>	<u>12,827,291</u>
Total	<u>23,304,175</u>	<u>20,525,171</u>

INCOME TAXES

The Company accounts for income taxes using SFAS No. 109, "Accounting for Income Taxes," which requires recognition of deferred tax liabilities and assets for expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is recorded for deferred tax assets if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

ADVERTISING COSTS

Advertising costs are expensed as incurred. The Company incurred no advertising costs in 2002 and \$86,619 in 2001.

RESEARCH AND DEVELOPMENT

Research and development costs are charged to operations as incurred until such time as both technological feasibility is established and future economic benefit is assured. To date, such conditions have not been satisfied, and, accordingly, all software engineering and development costs have been expensed as incurred. See Note 8 for certain in-process research and development purchased in 1999.

STOCK-BASED COMPENSATION

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations, in accounting for its employee stock options rather than the alternative fair value accounting followed by SFAS No. 123 "Accounting for Stock-Based Compensation." APB No. 25 provides that the compensation expense relative to the Company's employee stock options is measured based on the intrinsic value of the stock option. SFAS No. 123 requires companies that continue to

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

follow APB No. 25 to provide a pro-forma disclosure of the impact of applying the fair value method of SFAS No. 123.

Equity instruments issued to non-employees are accounted for at fair value. The fair value of the equity instrument is determined using either the fair value of the underlying stock or the Black-Scholes option pricing model.

RECLASSIFICATIONS

Certain items have been reclassified to conform to current year presentation.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 requires companies to recognize all derivative contracts as either assets or liabilities in the balance sheet and to measure them at fair value. If certain conditions are met, a derivative may be specifically designated as a hedge, the objective of which is to match the timing of the gain or loss recognition on the hedging derivative with the recognition of (i) the changes in the fair value of the hedge asset or liability that are attributable to the hedge risk or (ii) the earnings effect of the hedge forecasted transaction. For a derivative not designated as a hedging instrument, the gain or loss is recognized in income in the period of change. On June 30, 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133". SFAS No. 133 as amended by SFAS No. 137 is effective for all fiscal years beginning after June 15, 2000. In June 2000, the FASB issued SFAS No. 138, "Accounting for Certain Derivatives Instruments and Certain Hedging Activities". SFAS No. 133 as amended by SFAS No. 137 and 138 is effective for all fiscal quarters of fiscal years beginning after June 15, 2000.

The Company has not entered into derivatives contracts to hedge existing risks or for speculative purposes. Accordingly, SFAS 133, 137 and 138 do not affect the Company's financial statements.

In March 2000, the FASB issued Interpretation No. 44 (FIN 44), "Accounting for Certain Transactions Involving Stock Compensation", an interpretation of APB No. 25. FIN No. 44 clarifies the application of APB No. 25 for (a) the definition of an employee for purposes of applying APB No. 25, (b) the criteria for determining whether a plan qualifies as a non-compensatory plan, (c) the accounting consequences of various modifications to the terms of a previously fixed stock option or award, and (d) the accounting for an exchange of stock compensation awards in a business combination. FIN No. 44 became effective in July 2000, but certain conclusions cover specific events that occur after either December 15, 1998, or

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

January 12, 2000. FIN 44 did not have a material impact on the Company's financial position, results of operations, or cash flows.

In June 2001, the FASB issued Statement No. 142 "Goodwill and Other Intangible Assets". This Statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, Intangible Assets. It provides guidance on how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This Statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. FASB Statement No. 142 does not affect the Company's financial statements.

NOTE 2 - GOING CONCERN CONSIDERATIONS

The accompanying consolidated financial statements have been presented in accordance with accounting principles generally accepted in the United States of America, which assume the continuity of the Company to continue as a going concern. However, the Company has incurred substantial losses resulting in an accumulated deficit of \$61,531,409 as of December 31, 2002. The Company's current liabilities exceed current assets by \$583,062 at December 31, 2002. These conditions raise substantial doubt as the ability of the Company to continue as a going concern.

Management's plans with regards to these issues are as follows:

- Expanding revenues by focusing on existing customers that are growing and whose needs for Burstware are increasing.
- Expanding revenues by finding a limited number of new customers that can benefit by utilizing either Burstware in its current form, or by licensing a combination of the Company's intellectual property and/or Burstware source-code.
- Continue and expand the enforcement of our intellectual property rights.

Presently, the Company cannot ascertain the eventual success of management's plans with any degree of certainty. No assurances can be given that the Company will achieve profitability or positive cash flows. If the Company is unable to bring the Company to profitability or positive cash flows, there can be no assurance that the Company can continue as a going concern. The accompanying consolidated financial statements do not include any adjustments that might result from the eventual outcome of the risks and uncertainty described above.

NOTE 3 - INVESTMENTS

The Company had no securities as of December 31, 2002 or 2001.

NOTE 4 - PROPERTY AND EQUIPMENT

	December 31	
	2002	2001
Computer equipment	\$ 61,880	\$ 61,880
Furniture	15,000	15,000
Office equipment	5,000	5,000
Software	55,644	55,000
Trade show booth	<u>5,000</u>	<u>5,000</u>
	142,524	141,880
Less accumulated depreciation	<u>(84,979)</u>	<u>(38,896)</u>
	<u>\$ 57,545</u>	<u>\$ 102,984</u>

During 2001, management determined that certain computers and other equipment were not recoverable at their current book value, and certain leasehold improvements and other assets had been abandoned when sales offices were closed. Accordingly, the Company recognized losses and write-downs of approximately \$385,000 during the year ended December 31, 2001. No additional write-downs were recorded in 2002.

Depreciation expense was \$46,083 and \$82,757, for the years ended December 31, 2002 and 2001, respectively.

NOTE 5 - ACCRUED LIABILITIES

	December 31	
	2002	2001
Accrued severance costs	\$ 186,600	\$ 274,100
Accrued wages and vacation	192,626	180,223
Stock to be issued	-	31,796
Other	<u>3,454</u>	<u>18,454</u>
	<u>\$ 382,680</u>	<u>\$ 504,573</u>

NOTE 5 - ACCRUED LIABILITIES (CONTINUED)

During 2001, the Company closed and abandoned its sales offices. It also moved out of its San Francisco headquarters and moved to new smaller facilities in Santa Rosa, California.

During 2001, the Company commenced settlement negotiations to terminate the lease with the landlord of the former San Francisco headquarters. Based upon the results of the in-process negotiations, the Company reduced its prior estimate of leasehold costs on abandoned leases by approximately \$900,000, to approximately \$330,000. In December 2001, the Company reached a final settlement whereas the Company issued a note payable in the amount of \$50,000 due in 2005, and agreed to issue 300,000 shares of the Company's common stock valued at \$12,000.

Additionally, by December 31, 2001, the Company had terminated all but two of its remaining employees and had reached severance agreements with several former key officers and employees. The Company also entered into various settlement agreements with certain vendors, resulting in the issuance of notes payable.

NOTE 6 - DEFERRED REVENUE

During 2001, the Company entered into a licensing agreement with Eagle Wireless International, Inc. whereby Eagle Wireless issued 104,000 of its common stock valued at \$322,400 in exchange for a two-year license for certain technological rights. The license agreement is effective the earlier of January 2002 or the commercial deployment of any products incorporating the technology licensed from Burst. Accordingly, the entire \$322,400 was deferred as of December 31, 2001.

During 2002, the Company recognized revenue of \$161,200 in conjunction with this agreement, reducing deferred revenue to \$161,200 as of December 31, 2002.

NOTE 7 - NOTES AND OBLIGATIONS PAYABLE

		December 31
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	<u>2002</u>	<u>2001</u>
6% convertible note payable to Mercer Management, Inc., interest and principal due December 28, 2001	\$ -	\$ -
Notes payable to Gordon Rock (net of unamortized discount of \$184,248 and \$276,246, respectively)	\$ 1,305,752	\$ 993,754
Notes payable to investors, (net of unamortized discount of \$16,239 and \$4,280, respectively)	\$ 183,761	\$ 125,720
Notes and obligations payable issued in connection with debt settlements	<u>\$ 433,896</u>	<u>\$ 208,735</u>
	<u>\$1,923,409</u>	<u>\$ 1,328,209</u>

Notes Payable to Gordon Rock

In February and April 2001, the Company issued two notes payable to Gordon Rock in the aggregate principal amount of \$350,000 at 9% collateralized by a security interest in the assets of the Company. Mr. Rock was a member of the Board of Directors at that time, but has since resigned his seat on the Board. Mr. Rock is also one of the Company's major stockholders and is deemed a related party.

In August and September 2001, the Company issued a series of notes payable to Mr. Rock totaling an additional \$305,000. Each of these notes bear interest at 9% and is collateralized by a security interest in all assets of the Company.

NOTE 7 - NOTES AND OBLIGATIONS PAYABLE (CONTINUED)

In connection with the April, August and September notes, Mr. Rock received five-year warrants to acquire up to 183,333 shares of the Company's common stock at an exercise price of \$.30 per share, 1,000,000 shares at \$.20 per share, and 1,666,666 shares at \$.15 per share. Accordingly, the Company recorded a discount on the notes for the fair value of the warrants issued using the Black-Scholes model. The resulting discount of \$368,333 is being amortized over the term of the notes.

In October and December 2001, the Company issued three additional notes to Mr. Rock for loans totaling \$115,000, with interest ranging from prime plus 2% to 9%. The notes are collateralized by a security interest in all assets of the Company. In connection with these notes payable, Mr. Rock was issued 383,333 warrants to acquire common stock at \$.30 per share. Accordingly, the Company recorded a discount on the notes for the fair value of the warrants issued using the Black-Scholes model. The discount of \$23,900 is being amortized over the term of the notes.

In December 2001, all of Mr. Rock's notes, originally expiring in various amounts from

November 2001 through February 2002, were extended as follows: aggregate principal amount of \$1,210,000 plus accrued interest due and payable in November 2002; aggregate principal amount of \$30,000 plus accrued interest due in November 2004; and the remaining \$30,000 of principal and accrued interest due in December 2004. In connection with the extensions, Mr. Rock received 2,600,000 additional warrants to buy shares of the Company's common stock at \$.25 per share. In addition, the convertibility feature of the note payable to Mercer Management at December 31, 2000 was removed (see below). Accordingly, the Company recorded a discount on the notes for the fair value of the warrants issued using the Black-Scholes model. The discount of \$151,060 is being amortized over the term of the notes.

On September 30, 2002, the maturities of all of the above notes payable to Mr. Rock, aggregating \$1,270,000, were extended to January 15, 2005. In connection with the extensions, Mr. Rock received 1,000,000 additional warrants to buy shares of the Company's common stock at \$.75 per share. Accordingly, the Company recorded a discount on the notes for the fair value of the warrants issued using the Black-Scholes model. The discount of \$198,100 will be amortized over the term of the notes.

During February 2002, the Company issued two additional notes to Mr. Rock for loans totaling \$60,000, with interest at prime plus 2%. The notes are collateralized by a security interest in all assets of the Company. In connection with these notes, Mr. Rock was issued 200,000 warrants to acquire common stock at \$.30 per share. Accordingly, the Company recorded a discount on the notes for the fair value of the warrants issued using the Black-Scholes model. The discount of \$6,700 is being amortized over the respective terms of the notes.

NOTE 7 - NOTES AND OBLIGATIONS PAYABLE (CONTINUED)

During April 2002, the Company issued two additional notes to Mr. Rock for loans totaling \$160,000, with interest at prime plus 2%. The notes are collateralized by a security interest in all assets of the Company. In connection with these notes, Mr. Rock was issued 300,000 warrants to acquire common stock at \$.30 per share. Accordingly, the Company recorded a discount on the notes for the fair value of the warrants issued using the Black-Scholes model. The discount of \$16,620 is being amortized over the respective terms of the notes.

Notes Issued to Investors

During 2001, the Company issued 9% convertible notes payable to Draysec Finance Limited, one of the Company's major stockholders, in the aggregate principal amount of \$100,000, with interest and principal due in February and March 2002. The notes are convertible into a new series of preferred stock to be identified as Series A-2001 at a per share conversion price of \$5.00 at the option of the noteholder.

In November 2001, Draysec agreed to extend the due date of the loan to November 2002.

On September 30, 2002, the maturities of the Draysec notes were extended to January 15, 2005. In connection with the extensions, Draysec received 82,645 warrants to buy shares of the Company's common stock at \$.75 per share. Accordingly, the Company recorded a discount on the notes for the fair value of the warrants issued using the Black-Scholes model. The discount of \$16,372 will be amortized over the term of the notes.

In addition during 2001, the Company issued a promissory note to an investor, in the principal amount of \$30,000. The note is collateralized by a security interest in all assets of the Company. The note is due in March 2004 and bears interest at prime plus 2%. In connection with the note, the Company issued 100,000 warrants to the investor to acquire common stock at \$.30 per share. Accordingly, the Company recorded a discount on the note for the fair value of the warrants issued using the Black-Scholes model. The discount totaling \$4,280 is being amortized over the term of the note.

During February 2002, the Company issued promissory notes to two investors, in the aggregate principal amount of \$70,000. The notes are due in December 2004 and January 2005, respectively, and bear interest at prime plus 2%. In connection with the notes, the Company issued 233,333 warrants to the investors to acquire common stock at \$.30 per share. Accordingly, the Company recorded a discount on the notes for the fair value of the warrants issued using the Black-Scholes model. The discount totaling \$8,437 is being amortized over the respective terms of the notes.

NOTE 7 - NOTES AND OBLIGATIONS PAYABLE (CONTINUED)

During June 2002, the Company issued a promissory note to an investor, in the principal amount of \$60,000. The note is due in June 2005, and bears interest at prime plus 2%. In connection with the note, the Company issued 200,000 warrants to the investor to acquire common stock at \$.30 per share. Accordingly, the Company recorded a discount on the note for the fair value of the warrants issued using the Black-Scholes model. The discount totaling \$30,629 is being amortized over the term of the note.

Notes and Obligations Issued in Connection with Debt Settlements

During 2001, the Company entered into various settlement agreements with some of its vendors, employees and landlord. In connection therewith, the Company renegotiated its liabilities and reduced its overall obligations from approximately \$2,388,900 to \$208,735.

Some settlements resulted in the recognition of extraordinary income. In addition, the Company issued 80,000 warrants to acquire common stock at \$0.30 per share and 50,000 options to acquire common stock at \$0.30 per share. The warrants were valued at \$2,520 and the options were valued at \$2,140, using the Black-Scholes model. As part of these settlements, the Company was obligated to issue an aggregate amount of 794,946 shares of its common stock. Accordingly, the Company recorded a liability for stock to be issued in the amount of \$31,796. During the year ended December 31, 2002, all of those shares were issued.

During 2002, the Company entered into settlement agreements with two other employees. In connection therewith, the Company renegotiated its liabilities and reduced its obligations from \$152,816 to \$64,487. As part of these settlements, the Company issued an aggregate amount of 103,361 shares of its common stock valued at \$3,547. In addition, some of the settlement agreements entered into by the Company with some of its former employees during 2001 were amended to include additional payments of \$115,083. As a result of these settlements and revised settlement agreements, the Company recognized additional compensation expense of \$32,841 during the year ended December 31, 2002.

Maturities of long-term debt at December 30, 2002 are as follows:

2003	\$ -
2004	20,000
2005	1,903,409
2006	=
Total	1,923,409
Less: current portion	(-)
	<u>\$1,923,409</u>

NOTE 8 - EQUITY

Share Exchange Agreement

During 2001, the Company exchanged 1,500,000 shares of its common stock for 400,000 shares of Eagle Wireless International, Inc. common stock. This transaction was valued at \$843,735, the estimated fair value of the Company's common stock at the date of the transaction.

COMMON STOCK ISSUED FOR CONSULTING SERVICES

During 2002, the Company issued 138,750 shares of its common stock at fair market value to independent consultants for services performed during the year. In connection with these agreements, the Company recognized \$4,114 in consulting fees.

Sales of Common Stock

During January 2000, the Company issued a total of 3,474,625 shares of its common stock and warrants to purchase 3,474,625 shares of its common stock for total proceeds of \$13,898,500 in transactions with various investors, including some directors and employees of the Company. The price per share of common stock was \$4.00, which included the issuance of one warrant for each share of stock sold. The gross proceeds were reduced by approximately \$1,303,000 in transaction costs. Each warrant was exercisable for one share of common stock at an exercise price of \$5.00 per share and expires 5 years from the date of issue. Those warrants contained anti-dilution provisions that adjust the exercise price and the number of shares exercisable thereunder if shares of the Company's common stock were issued or deemed issued at prices below the warrant exercise price. The issuance of new warrants through December 31, 2002, as described in Note 7, resulted in a decrease in the exercise price of these warrants to \$3.60 per share and an increase of 1,877,685 warrant shares.

In connection with this offering, the Company also issued 98,870 five-year warrants to purchase common stock at \$8.4375 per share. Compensation expense of \$77,726 was recorded as a result of sales of stock to employees for the excess of fair value over the price paid.

NOTE 8 - EQUITY (CONTINUED)

During August 2000, the Company issued a total of 857,633 shares of its common stock and warrants to purchase 857,633 shares of its common stock for total proceeds of \$5,000,000 to SBC Venture Capital Corp. The price per share of common stock was \$5.83 per share, which included the issuance of one warrant for each share of stock sold. The gross proceeds were reduced by approximately \$460,214 in transaction costs. Each warrant is exercisable for one share of common stock at an exercise price of \$5.83 per share and expires 5 years from the date of issue. Those warrants contained anti-dilution provisions that adjust the exercise price and the number of shares exercisable there-under if shares of the Company's common stock were issued or deemed issued at prices below these warrant exercise price. The issuance of new warrants through December 31, 2002, as described in Note 7, resulted in a decrease in the exercise price of these warrants to \$4.19 per share and an increase of 328,850 warrant shares.

During 2002, the Company issued 233,333 shares of its common stock to two investors, for net proceeds of \$70,000.

During November 2002, the company raised \$845,000 by issuing to accredited investors 2,537,535 shares of common stock at \$.333/share. These investors also received 1,268,772 Warrants, exercisable at \$.75.

Shares Issued in Debt Settlements

In connection with the January 2000 sale of common stock, the Company converted approximately \$5,335,000 of notes payable to 1,333,750 shares of its common stock and issued warrants to purchase 1,333,750 of its common stock to the former debt holders.

Liability for Stock to be Issued

In connection with several settlement agreements, to Company agreed to issue 794,946 shares of its common stock valued at \$31,796. See Note 7.

Exercise of Stock Options and Warrants

During 2002, warrants to purchase 138,888 shares of the Company common stock were exercised for \$25,000.

Shares Returned

In December 2001, a significant shareholder returned 2,913,167 shares of common stock to the Company for personal tax purposes.

NOTE 8 - EQUITY (CONTINUED)

Settlement of Prior Offering Costs

During the year ended December 31, 2000, the Company had accrued approximately \$630,000 of costs in connection with various stock offerings. During 2000, disputes arose between the Company and the investment banking firm over the meaning and the interpretation of the respective parties' obligations. During the year ended December 31, 2001, the Company entered into a settlement agreement with the investment banking firm whereby both parties dismissed each other of any further obligations. As a result, the Company adjusted additional paid-in-capital and the related liability, to reverse previously recorded stock issuance costs.

SHARES ISSUED IN CONNECTION WITH SETTLEMENT AGREEMENTS

During 2001, the Company had agreed to issue 794,946 shares of its common stock valued at \$31,796 in connection with various settlement agreements. In addition, during the six months ended June 30, 2002, the Company agreed to issue an additional 103,361 shares of its common stock valued at \$3,547 in connection with new settlement agreements. All of these shares were issued during the year ended December 31, 2002.

WARRANTS ISSUED IN DEBT SETTLEMENT

During 2002, the Company issued 30,000 warrants to acquire common stock at \$0.75 to a vendor in connection with a debt settlement. See Note 9. The warrants expire in October 2005.

Share Exchange Agreement

During 2001, the Company exchanged 1,500,000 shares of its common stock for 400,000 shares of Eagle Wireless International, Inc. common stock. This transaction was valued at \$843,735, the estimated fair value of the Company's common stock at the date of the transaction. The Eagle Wireless stock was subsequently sold in 2001.

NOTE 9 - STOCK OPTIONS

On November 6, 1992 and April 29, 1998, the Board of Directors adopted the 1992 Stock Incentive Plan and 1998 Stock Incentive Plan, respectively. Under the plans, the Board may grant options to officers, key employees, directors and consultants. Incentive stock options may be granted at not less than 100% of the fair market value of the stock on the date the option is granted. The option price of stock not intended to qualify as incentive stock options may not be less than 85% of the fair market value on the date of grant.

NOTE 9 – STOCK OPTIONS (CONTINUED)

The maximum term of the options cannot exceed ten years. A total of 3,500,000 and 4,000,000 shares have been reserved for issuance under the plans, respectively. Certain options are still outstanding from prior to the 1992 and 1998 plans that carried similar terms.

On August 23, 1999, the Board of Directors adopted the 1999 Stock Incentive Plan. Under the plan, the Board may grant options to officers, key employees, directors and consultants. Incentive stock options may be granted at not less than 100% of the fair market value of the stock on the date the option is granted. The option price of stock not intended to qualify as incentive stock options may not be less than 85% of the fair market value on the date of grant. The maximum term of the options cannot exceed ten years. A total of 3,000,000 shares have been reserved for issuance under the plan.

During 1999, the Company issued stock options in lieu of cash for services performed, covering 120,621 shares of the Company's common stock at exercise prices ranging from \$2.19 to \$9.72 per share, expiring between February 2000 and December 2004. \$105,805 was recorded as a general and administrative expense, \$160,588 was recorded as a sales and marketing expense, and \$2,082 was recorded as a research and development expense based on the fair value of the stock options issued.

During 2000, the Company repriced all options held by the 20 remaining employees and Board members. The revised exercise price was \$0.2812 per share.

During 2000, the Company issued stock options in lieu of cash for services performed, covering 8,621,242 shares of the Company's common stock at exercise prices ranging from \$.2812 to \$4.50 per share, expiring by December 2005. \$332,563 was recorded as a general and administrative expenses based on the fair value of the stock options issued.

During 2001, the Company granted options to purchase 150,000 shares of common stock exercisable at \$0.2812 per share to an independent contractor. In addition, during 2001, existing options granted to employees under variable plan accounting and unvested options being earned by contractors were revalued, resulting in a net reduction in stock-based compensation of \$280,400. Furthermore, as a result of severance agreements with certain senior officials, the lives of their options were extended to one year after termination or the full contractual life instead of expiring within a shorter time. These extensions resulted in a stock-based compensation charge of approximately \$127,947. These two adjustments resulted in a net reduction in stock-based compensation of approximately \$152,453.

NOTE 9 – STOCK OPTIONS (CONTINUED)

During 2001, the Company granted options to purchase 250,000 shares of common stock at an exercise price of \$0.18 to John Micek III, a member of the Board of Directors. The Company also granted options to purchase 100,000 options of common stock to an employee at an exercise price of \$0.1875 per share. The Company also granted a former employee options to purchase 50,000 shares of common stock at an exercise price of \$0.30 per share in connection with a settlement agreement. See note 7.

During 2002, the Company granted a total of 955,000 options to purchase shares of common stock at an exercise price of \$.75 to the following individuals:

Richard Lang	500,000
Eric Walters	150,000
Ping Zhao	5,000
Barry Ritholtz	200,000
Brian Murphy	100,000

The Company applies APB opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for options issued to employees. Compensation cost for stock options is measured at the intrinsic value, which is the excess of the market price of the Company's common stock at the date of grant over the amount the recipient must pay to acquire the common stock.

Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock-Based Compensation", requires the Company to provide pro forma information regarding net income (loss) and earnings (loss) per share as if compensation cost for employee stock options has been determined in accordance with the fair value based method prescribed by SFAS 123.

The per share weighted average fair value of stock options granted during 2001 and 2000 was \$0.21 and \$1.43, respectively, on the date of grant using the Black-Scholes pricing model with the following weighted average assumptions: volatility of 217% and 251%, respectively; expected dividend yield of 0% for all years; risk free interest rate of approximately 4% and 6%, respectively; and an expected life of 2.5 years for 2001 and 2000.

The option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, valuation models require input of highly subjective assumptions, including the expected price volatility. Since the Company's stock options have characteristics significantly different from those of traded options, and since variations in the subjective input assumptions can materially affect the fair value estimate, the actual results can vary significantly from estimated results.

NOTE 9 – STOCK OPTIONS (CONTINUED)

Under the accounting provision of SFAS 123, the Company's net loss and loss per share in 2001 would have been increased to the pro forma amounts indicated below. There was no stock based compensation in 2002.

	<u>2002</u>	<u>2001</u>
Net loss:		
As reported	\$(908,210)	\$(3,577,322)
Pro forma	\$(908,210)	\$(3,665,937)
Net loss per share:		
As reported	\$ (0.03)	\$ (0.17)
Pro forma	\$ (0.03)	\$ (0.17)

Stock options activity for 2001 and 2002 is as follows:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance on December 31, 2000	<u>8,716,659</u>	<u>\$1.04</u>
Options granted	550,000	\$0.22
Options exercised	0	0
Options expired	(30,500)	\$6.96
Options forfeited	<u>(1,538,279)</u>	<u>\$2.43</u>
Balance on December 31, 2001	<u>7,697,880</u>	<u>0.84</u>
Options granted	1,272,198	\$0.63
Options exercised	(138,888)	\$0.18
Options cancelled	(2,923,693)	\$0.54
Options forfeited		
Balance on December 31, 2002	<u>5,907,497</u>	<u>\$0.91</u>

NOTE 9 – STOCK OPTIONS (CONTINUED)

Stock options outstanding and exercisable at December 31, 2002 are as follows:

	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>S h a r e s O u t s t a n d i n g</u>	<u>W e i g h t e d A v e r a g e E x e r c i s e P r i c e</u>	<u>W e i g h t e d A v e r a g e R e m a i n i n g L i f e</u>	<u>S h a r e s O u t s t a n d i n g</u>	<u>W e i g h t e d A v e r a g e E x e r c i s e P r i c e</u>
\$0.18-\$0.30	3,123,160	\$0.28	4.16	3,049,967	\$0.28
\$0.50-\$1.00	1,885,000	\$0.88	3.84	1,349,814	\$0.93
\$1.37-\$2.75	495,087	\$2.00	1.08	495,087	\$2.00
\$3.50-\$5.00	279,250	\$3.95	2.46	276,125	\$3.94
\$5.75-\$6.38	<u>125,000</u>	<u>\$6.15</u>	<u>2.10</u>	<u>112,500</u>	<u>\$6.17</u>
	<u>5,907,497</u>	<u>\$0.91</u>	<u>3.70</u>	<u>5,283,493</u>	<u>\$0.92</u>

	<u>Warrants Outstanding</u>			<u>Warrants Exercisable</u>	
	<u>S h a r e s</u> <u>Outstanding</u>	<u>W e i g h t e d</u> <u>A v e r a g e</u> <u>Exercise Price</u>	<u>W e i g h t e d</u> <u>A v e r a g e</u> <u>Remaining</u> <u>Life</u>	<u>S h a r e s</u> <u>Outstanding</u>	<u>W e i g h t e d</u> <u>A v e r a g e</u> <u>Exercise Price</u>
\$0.15-\$0.20	2,666,666	\$0.17	3.51	2,666,666	\$0.17
\$0.25-\$0.30	4,279,999	\$0.27	3.14	4,279,999	\$0.27
\$0.75-\$1.00	2,595,377	\$0.76	6.38	2,595,377	\$0.76
\$3.60	6,668,153	\$3.60	2.08	6,668,153	\$3.60
\$4.19	<u>1,186,483</u>	<u>\$4.19</u>	<u>2.62</u>	<u>1,186,483</u>	<u>\$4.19</u>
	<u>17,396,678</u>	<u>\$1.87</u>	<u>3.22</u>	<u>17,396,678</u>	<u>\$1.87</u>

NOTE 10 – LEASE COMMITMENTS

The Company leases its office space under a one year operating lease, which provides for one-year extensions. The lease was extended to April 30, 2003.

NOTE 10 – LEASE COMMITMENTS (CONTINUED)

Rent paid in the years ended December 31, 2002 and 2001 was \$12,150 and \$359,573 respectively.

Future minimum lease payments at December 31, 2002 is \$3,780 and will be paid in 2003.

NOTE 11 – INCOME TAXES

At December 31, 2002, the Company had net operating loss carry-forwards for federal income tax purposes of approximately \$44,740,200 which are subject to annual limitations, and are available to offset future taxable income, if any, through 2022 and net operating loss carry-forwards for state income tax purposes of approximately \$20,754,100, which are available to offset future state taxable income through 2012.

The temporary differences that give rise to deferred tax assets and liabilities at December 31, 2002 and 2001 are as follows:

	<u>2002</u>	<u>2001</u>
Deferred tax assets:		
Net operating losses	17,001,300	16,656,000
Compensation accruals	0	178,600
Research and experimentation credit	421,900	421,900
State income tax effect on federal	<u>(765,600)</u>	<u>(661,200)</u>
Total deferred tax assets	16,657,600	16,595,300
Less valuation allowance	<u>(16,657,600)</u>	<u>(16,595,300)</u>

Net deferred tax assets	\$ _____ -	\$ _____ -

In assessing the amount of deferred tax assets to be recognized, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. It is not possible at this time to determine that the deferred tax assets are more likely to be realized than not. Accordingly, a full valuation allowance has been established for all periods presented.

NOTE 11 – INCOME TAXES (CONTINUED)

The Tax Reform Act of 1986 imposed substantial restrictions on the utilization of net operating losses and tax credits in the event of an “ownership change”, as defined by the Internal Revenue Code. All federal and state net operating loss carryforwards are subject to limitations as a result of these restrictions. If there should be a subsequent ownership change, as defined, the Company’s ability to utilize its carryforwards could be reduced.

NOTE 12 – BUSINESS RISKS AND SEGMENT DISCLOSURES

The Company’s primary source of revenue is the licensing of Burst technology, and its success is largely dependent on this product. Changes in desirability of the product in the marketplace may significantly affect the Company’s future operating results.

The Company operates in one segment and accordingly has provided only the required enterprise wide disclosure. The Company recognized no foreign revenues in 2002 and 2001.

NOTE 13 – SETTLEMENTS AND EXTRAORDINARY GAINS

During the year 2001, the Company entered and executed various settlements with employees and its landlord. Accordingly, rent and salaries previously recognized during the year as a result of prior oral agreements and estimates were offset against the related expenses of rent and salaries for approximately \$1,116,000.

During the year 2001, the Company entered and executed various settlements with some vendors and creditors. As a result of these settlements, the Company recognized approximately \$643,000 of extraordinary gain.