



2003 ANNUAL REPORT

Phonetime™ Inc. is one of Canada's fastest growing telecommunications companies, with traffic volume of more than 100 million minutes per month. A TSX venture – listed company, graduated to tier 2 and now trading under the symbol “PHD”, Phonetime has built one of Canada's largest private networks in 24 urban areas with plans for further expansion.

Phonetime's retail and wholesale telecommunications services incorporate state-of-the-art VoIP (Voice over Internet Protocol) technology for commercial applications, high capacity switching platforms, and an international carrier network.

Phonetime also operates a multi-lingual customer-service call center and sells its own branded pre-paid long distance phone cards through more than 3,000 retail outlets, including Real Canadian Super Stores and Business Depot/Staples. Licensed as a Class A, International Carrier by the CRTC, Phonetime has offices in Toronto, Vancouver and Montreal.

Dear Shareholder:

We are pleased to present Phonetime's 2003 results. The year was challenging for a variety of reasons, but the company dealt effectively with the challenges presented to us and we are now moving into a new growth phase, with a new platform, more capacity, stronger cash flow and balance sheet and better ability to take advantage of new opportunities.

In general, Canada's telecom market continues to grow, despite fluctuating economic conditions. The industry is in a relatively healthy state compared to only a couple of years ago, and there are new developments that offer Phonetime some exciting opportunities. One of these developments is the fact that, voice over Internet protocol (VoIP) has moved into the mainstream, with many of the major players targeting it as a significant growth area. Phonetime has been using VoIP for quite a while in its pre-paid long-distance phone cards, which has resulted in a more cost efficient operation.

In Canada, the prepaid long-distance market was estimated last year to be worth about \$400 million annually. Discount long-distance is a growing market in Canada that we have targeted as an area in which to increase our efforts. We also offer a competitive, low cost, long-distance subscription service including travel cards (Dial 'n' Save, at www.dialnsave.ca). In addition, we are in the early stages of launching our Point of Sale Activation (POSA) program, which enables stores to provide virtual prepaid long-distance and cellular cards. POSA will both increase our competitive advantage and support our top-line sales in phone cards. We now offer customers the ability to subscribe to a personal toll free 800 service from anywhere in Canada and the U.S.A.

Phonetime has evolved a number of different and synergistic business lines, but for the past ten years the company has been best known for its line of prepaid long-distance calling cards as well as controlling one of Canada's largest private long-distance networks. Our strong branding is recognized in over 24 urban areas across the country in which our products are being offered. These products include Bravo, Call Value, Chit Chat, Eureka, Gold Bonus, Hot and Nuvo cards plus others. In addition, we operate our own multilingual call center in order to better service our customers' growing needs.

For Phonetime, 2003 represented a year of consolidation and regrouping. We pulled back from an investment in Carib-Tel while strengthening our Canadian network and upgrading our switch, platform, billing system and servers. These housekeeping activities coincided with a decline in both business and leisure travel in Canada as a result of the SARS outbreak and the war in Iraq which was followed by mad cow, West Nile, a stronger Canadian dollar, and the blackout. This resulted in Canada's tourism levels in 2003 being uncharacteristically low, as we all know. Historically, travelers have been significant users of the company's products and services, with the bulk of the added tourism-generated revenues being realized from May through September. As a result, Phonetime's sales were down slightly compared to the previous year, contrary to the company's expectations of another increase.

Balanced against lower sales in the first three quarters of the year were Phonetime's aggressive actions to tighten processes, improve services and software, and analyze trends and usage. The company has implemented a new switching software platform that makes it possible to better follow user and supplier patterns more closely, therefore minimizing the chance of over-billing or over-charging by suppliers. In addition, we created a new internal management group to oversee carrier services and thereby improve product costs and quality. These and other administrative changes are working to improve both cash flow and margins, which were negatively impacted at the beginning of the year, but saw growth by year-end.

LETTER TO SHAREHOLDERS

In our third quarter, Phonetime recorded a write-down of \$409,869 due to the decline in value of its investment in Carib-tel, a Jamaican telecommunications company. This contributed to a loss in that quarter – our first quarterly net loss in 30 months.

Overall, Phonetime's core business is getting stronger. Management has focused on strengthening margins, which is resulting in improving both cash flow and profitability. We continue to focus on cost efficiencies as a major element in our daily operations.

With technology shifting within the telecommunications sector, we continue to focus on acquiring better quality and lower cost routes as well as improving our platform's efficiency and increasing its capacity.

Our partnership with Radiant International Holdings BV has helped us in building our equity and working capital position. Phonetime has derived substantial benefit from its strategic relationship with Radiant, which provides Phonetime with low-cost U.S. termination minutes, over its VoIP network. Further, Radiant has proven a significant customer for Canadian termination of long-distance minutes over Phonetime's private network.

Phonetime has continued to be one of Canada's fastest-growing companies. The company was once again recognized by Profit Magazine in June of 2003, this time ranking sixth amongst the top 100 fastest growing companies in Canada after its third-place finish in the previous year.

In addition to the recognition by Profit Magazine, the TSX Venture Exchange approved our application for graduation to a Tier 2 listing, and we now trade under a newly assigned symbol, "PHD". The improved classification is a positive reflection of the direction the company has taken and should increase our profile and improve the liquidity of the company's shares.

The support of our employees, customers, suppliers and shareholders contribute significantly to Phonetime's success. We thank all of you for your interest in and support of Phonetime, and are particularly appreciative of the ongoing effort from the hard-working dealers and distributors who sell and promote our products across Canada.



Wayne Silver
President



Rodney Franklin
Chairman

MANAGEMENT'S DISCUSSION AND
ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto.

RESULTS OF OPERATIONS

For the Year Ended December 31, 2003 Compared to the Year Ended December 31, 2002.

Sales from operations for Phonetime Inc. were \$28.6 million for fiscal 2003 compared to \$30.5 million for the year ended December 31, 2002. this represent a decrease of \$1.9 million or 6.2% which was primarily the result of a reduction in business and leisure travel due to the SARS scare.

Gross margin was \$6.0 million or 21% for the year ended December 31,2003 as compared to \$6.4 million for the previous year. Margins for 2003 would have been approximately 24% if the supplier over-billing had not occurred.

Operating expenses for the year ended December 31, 2003 rose \$237,305 to \$5.5 million from \$5.2 million for the same period in the previous year

Interest expense for the year ended December 31, 2003 decreased to \$156,851 from \$170,165 in the previous year. Interest expense came down as a result of a period of stable borrowing and declining interest rates.

Amortization expense increased from \$760,213 in 2002 to \$944,913 for the year ended December 31, 2003. This increase was the result of the acquisition of additional equipment required to continue to build its private long-distance network and expand its platform.

For the year ended December 31, 2003, the Company earned \$87,061 compared to earnings of \$1,827,638 for the year ended December 31, 2002. The reduction in earnings for the 2003 year was due primarily to the net decrease in one time gains.

LIQUIDITY AND CAPITAL RESOURCES

The Company has funded operations primarily from cash generated from its operations, the issuance of equity and capital lease financings. The Company's activities provided net cash of \$666,930 in the year ended December 31, 2003.

The Company's operations will continue to require capital to fund the development of its network and services in Canada, and for other corporate purposes, including acquisitions, marketing and other working capital needs. The Company has undertaken strategic measures to reduce costs, achieve growth in wholesale operations and build sales to international carriers and renegotiate arrangements with suppliers. Although management has implemented strong marketing and business strategies,

MANAGEMENT'S DISCUSSION AND
ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

there can be no assurance that these initiatives will continue to sustain profitability and positive cash flow. This inability would have a material adverse effect on Phonetime's business, operating results and financial conditions.

RISK AND UNCERTAINTIES

Demand and pricing for certain of Phonetime's services are cyclical and seasonal in nature and are subject to general economic conditions that affect market demand.

Consistent with other business, the Company faces a certain degree of credit risk arising from the sales of products on credit terms to customers. As at December 31, 2003 concentration of credit risk exists as four customers comprised 32% of accounts receivable. The Company attempts to mitigate its credit risk through the establishment of credit limits and terms of sales with its customers. Credit limits are reviewed and monitored regularly.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of its results of operations and financial condition are based upon its consolidated financial statements that have been prepared in accordance with generally accepted accounting principals in Canada. The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Estimates and assumptions are evaluated on an ongoing basis and are based on historical and other factors believed to be reasonable under the circumstances. The results of these estimates may form the basis of the carrying value of certain assets and liabilities and may not be readily apparent from other sources. Actual results, under conditions and circumstances different from those assumed, may differ from estimates.

The Company believes the following accounting policies are critical to its business operations and the understanding of results of operations and affect the more significant judgements and estimates used in the preparation of its consolidated financial statements:

Allowance for Doubtful Accounts - The Company maintains accounts receivable allowances for estimated losses resulting from the inability of its customers to make payments. Additional allowances may be required if the financial condition of the Company's customers deteriorates.

Revenue recognition - Revenue from prepaid phone cards is recognized as phone time is used by the customer. As a result, revenue is deferred for the amount of unused time on the phone cards. Management has estimated unused phone time based on historical patterns of the phone card usage which includes estimates of the lead time for the first call and the residual talk time on the cards at the year end date.

MANAGEMENT'S DISCUSSION AND
ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

Future Income Taxes - The Company follows the asset and liability method of accounting for income taxes.

Under this method, future tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying value and tax basis of the assets and liabilities. Consistent with this policy, the Company recognizes future tax assets, net of a valuation allowance. Based on current projections of future taxable income over the periods in which the future income tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of the future tax assets, net of existing valuation allowance. However changes in future profitability of the Company may impact the realization of these future tax assets.

CHANGES IN ACCOUNTING POLICIES

Share-based compensation:

Commencing with the Company's 2004 fiscal year, the amended recommendations of the the Canadian Institute of Chartered Accountants ("CICA") for accounting for share-based compensation (CICA Handbook Section 3870) will apply to the Company. The amendments will result in the Company no longer being able to use the intrinsic method of accounting for share options granted to employees. The Company has selected the modified-prospective transition method (also referred to as the retroactive application without restatement method), which will be implemented effective January 1, 2004. The modified-prospective transition method will result in no share option expense being recognized in the consolidated statements of earnings in fiscal years prior to 2004. The share option expense that is recognized in fiscal years subsequent to 2003 will be in respect of share options granted after 2001 and vesting in fiscal periods subsequent to 2003.

Recently issued accounting standards:

In 2003, the Emerging Issues Committee of the CICA issued new guidance on revenue recognition. It is effective for the Company beginning January 1, 2004. The Company does not expect that this guidance will have a significant effect on its revenue recognition practices.

In 2003, CICA issued Handbook Section 1100, "Generally accepted accounting principles" together with Handbook section 1400, "General Standards of Financial Statements Presentation". HB 1100 establishes standards for financial reporting in accordance with Canadian GAAP as it clarifies the relative authority for various accounting pronouncements and other sources of guidance within GAAP. HB 1400 supersedes HB 1500 and clarifies what constitutes fair presentation in accordance with GAAP. The new standards are effective for the Company's 2004 fiscal year. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

P H O N E T I M E I N C .

CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR
ENDED DECEMBER 31, 2003

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CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR
ENDED DECEMBER 31, 2003

AUDITOR'S REPORT

To the shareholders of Phonetime Inc. :

We have audited the consolidated balance sheets of Phonetime Inc. as at December 31, 2003 and December 31, 2002 and the consolidated statements of earnings and deficit, and cash flows for the years ended December 31, 2003 and December 31, 2002. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting 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.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and December 31, 2002 and the results of its operations and its cash flows for the years ended December 31, 2003 and December 31, 2002 in accordance with Canadian generally accepted accounting principles.

Markham, Canada
March 24, 2004




"Klasner Solomon LLP" (signed)
Chartered Accountants

P H O N E T I M E I N C .

CONSOLIDATED
BALANCE SHEETS
AS AT DECEMBER 31,


	2003	2002
ASSETS		
Current assets		
Cash and cash equivalents	\$ 941,678	\$ 274,748
Short-term investment (note 3)	161,278	157,825
Accounts receivable	3,325,700	3,846,968
Inventories	326,330	519,821
Prepaid expenses and deposits	270,018	307,989
Deferred interest benefit	-	4,799
	5,025,004	5,112,150
Long-term investment (note 4)	-	274,365
Property and equipment (note 5)	1,961,041	2,277,417
	\$ 6,986,045	\$ 7,663,932
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$ 3,425,526	\$ 3,748,178
Other accounts payable	-	585,028
Dealer deposits	85,500	222,500
Current portion of long-term debt (note 6)	212,648	121,977
Current portion of capital lease obligations (note 7)	515,258	575,335
Deferred revenue	1,194,106	1,338,500
	5,433,038	6,591,518
Long-term debt (note 6)	34,804	9,800
Capital lease obligations (note 7)	212,070	312,831
Due to related parties (note 8)	111,628	143,421
	5,791,540	7,057,570
Shareholders' equity		
Share capital (note 9)	5,873,077	5,371,995
Deficit	(4,678,572)	(4,765,633)
	1,194,505	606,362
	\$ 6,986,045	\$ 7,663,932

Approved on behalf of the Board:



Director

"Wayne Silver" (signed)



Director

"Rodney Franklin" (signed)

See accompanying notes

P H O N E T I M E I N C .

CONSOLIDATED STATEMENTS
OF EARNINGS AND DEFICIT FOR THE
YEARS ENDED DECEMBER 31,

	2003	2002
Sales	\$ 28,612,052	\$ 30,450,621
Cost of sales	(22,646,859)	(24,043,576)
Gross profit	5,965,193	6,407,045
Operating expenses	(5,467,076)	(5,229,771)
Gain on foreign exchange	265,641	73,211
Amortization	(944,913)	(760,213)
Interest on long-term debt (notes 6 and 7)	(156,851)	(170,165)
	(6,303,199)	(6,086,938)
(Loss) earnings before under noted items	(338,006)	320,107
Adjustment of liabilities	-	313,136
Provision for loss in value on long-term investment (note 4)	(409,869)	-
Gain on settlement of litigation (note 11)	834,936	-
Gain on settlement of debt	-	1,194,395
	425,067	1,507,531
Earnings before income taxes	87,061	1,827,638
Provision for income taxes (note 12)		
Current	(370,025)	(360,560)
Reduction of income taxes on application of prior years' losses	370,025	360,560
	-	-
Net earnings for the year	87,061	1,827,638
Deficit, beginning of year	(4,765,633)	(6,553,926)
Write-off of goodwill	-	(39,345)
Deficit, end of year	\$ (4,678,572)	\$ (4,765,633)
Basic earnings per share (note 9c)	\$ 0.002	\$ 0.043
Diluted earnings per share (note 9c)	\$ 0.002	\$ 0.042

See accompanying notes

P H O N E T I M E I N C .

CONSOLIDATED STATEMENTS
OF CASH FLOWS FOR THE YEARS
ENDED DECEMBER 31,

	2003	2002
Operating activities:		
Net earnings for the year	\$ 87,061	\$ 1,827,638
Noncash items:		
Amortization	944,913	760,213
Write-off/amortization of deferred interest benefit	4,799	115,174
Issue of shares for services/compensation (notes 9b and 9e)	501,082	527,822
Forgiveness of loans	-	(1,650,000)
Write-down of property and equipment	-	350,029
Gain on disposal of property and equipment	-	(4,159)
Provision for loss in value on long-term investment (note 4)	409,869	-
	1,947,724	1,926,717
Net change in noncash working capital balances:		
Short-term investment	(3,453)	22,175
Accounts receivable	521,268	(1,281,444)
Inventories	193,491	(258,640)
Prepaid expenses and deposits	37,971	201,615
Dealer deposits	(137,000)	(50,050)
Accounts payable and accrued liabilities	(322,652)	273,045
Other accounts payable	(585,028)	-
Deferred revenue	(144,394)	203,500
	(439,797)	(889,799)
Cash flows from operating activities	1,507,927	1,036,918
Investing activities:		
Additions to equipment	(912,538)	(294,079)
Proceed from sale of equipment	284,001	12,675
Long-term investment	(135,504)	(176,000)
Cash flows from investing activities	(764,041)	(457,404)
Financing activities:		
Decrease in bank indebtedness	-	(8,000)
Increase (decrease) in long-term debt, net	115,675	(198,524)
Decrease in capital lease obligations, net	(160,838)	(652,350)
Decrease in due to related parties	(31,793)	(34,398)
Cash flows from financing activities	(76,956)	(893,272)
Net increase (decrease) in cash and cash equivalents during the year	666,930	(313,758)
Cash and cash equivalents, beginning of year	274,748	588,506
Cash and cash equivalents, end of year	\$ 941,678	\$ 274,748

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2002

1. GENERAL:

Phonetime Inc. and its subsidiary companies (the "Company") sell and market prepaid long-distance telephone calling cards and provide long-distance telephone services to other carriers.

2. SIGNIFICANT ACCOUNTING POLICIES

Management has prepared these consolidated financial statements in accordance with Canadian generally accepted accounting principles and are expressed in Canadian dollars. The significant accounting policies are as follows:

a) Basis of consolidation:

The consolidated financial statements include the accounts of Phonetime Inc. and all of its wholly owned subsidiaries. All intercompany transactions have been eliminated.

b) Use of estimates:

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

Examples of significant estimates include: the amount of receipts recognized as revenue; the allowance for doubtful accounts; the allowance for inventory obsolescence; the estimated useful lives of assets; the recoverability of long-term investments; the composition of future income tax assets and liabilities; the accruals for payroll and other employee-related liabilities.

c) Inventories:

Inventories consist of long-distance telephone calling cards. Inventories are valued at the lower of cost and net realizable value, with cost determined on a first-in, first-out basis.

d) Cash and cash equivalents:

Cash and cash equivalents, consist of cash on hand, balances with banks and investments in money market instruments with terms to maturity of less than 90 days.

e) Property and equipment:

Property and equipment are stated at cost. Amortization is calculated principally as follows:

Furniture and fixtures	4 years straight-line
Computer equipment	4 years straight-line
Computer software	3 years straight-line
Leasehold improvements	5 years straight-line

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2002

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f) Future income taxes:

The Company uses the asset and liability method to provide for income taxes on all transactions recorded in the consolidated financial statements. The asset and liability method requires that income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets or liabilities and their tax bases. Future income tax assets and liabilities are determined for each temporary difference based on the tax rates which are expected to be in effect when the underlying items of income and expense are expected to be realized. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized.

g) Revenue recognition:

Revenue from prepaid phone cards is recognized as phone time is used by the customer. As a result, revenue is deferred for the amount of unused time on the phone cards. Management has estimated unused phone time based on historical patterns of the phone card usage which includes estimates of the lead time for the first call and the residual talk time on the cards at the yearend date.

h) Foreign currency translation:

Trade transactions completed in foreign currencies are translated into Canadian dollars at the rates prevailing at the time of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange, in effect at the date of the consolidated balance sheets with any resulting gains or losses being included in the consolidated statements of earnings for the year.

i) Share-based compensation:

Commencing with the Company's 2004 fiscal year, the amended recommendations of the the Canadian Institute of Chartered Accountants ("CICA") for accounting for share-based compensation (CICA Handbook Section 3870) will apply to the Company. The amendments will result in the Company no longer being able to use the intrinsic method of accounting for share options granted to employees. The Company has selected the modified prospective transition method (also referred to as the retroactive application without restatement method), which will be implemented effective January 1, 2004. The modified prospective transition method will result in no share option expense being recognized in the consolidated statements of earnings in fiscal years prior to 2004. The share option expense that is recognized in fiscal years subsequent to 2003 will be in respect of share options granted after 2001 and vesting in fiscal periods subsequent to 2003.

j) Long-term investment :

Management evaluates the carrying value of the long-term investment for possible permanent impairment on an annual basis. Where there has been a loss in value of a long-term investment which is other than temporary decline, adequate provision for such loss is recorded as a charge against consolidated income.

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2002

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

k) Recently issued accounting standards :

In 2003, the Emerging Issues Committee of the CICA issued new guidance on revenue recognition. It is effective for the Company beginning January 1, 2004. The Company does not expect that this guidance will have a significant effect on its revenue recognition practices.

In 2003, CICA issued Handbook Section 1100, "Generally accepted accounting principles" together with Handbook section 1400, "General Standards of Financial Statements Presentation". HB 1100 establishes standards for financial reporting in accordance with Canadian GAAP as it clarifies the relative authority for various accounting pronouncements and other sources of guidance within GAAP. HB 1400 supersedes HB 1500 and clarifies what constitutes fair presentation in accordance with GAAP. The new standards are effective for the Company's 2004 fiscal year. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

3. SHORT-TERM INVESTMENTS

Short-term investment is comprised of a GIC maturing in November 2004. It has been pledged as collateral for the Company's operating lines of credit.

4. LONG-TERM INVESTMENT

The company holds a 20% interest in a privately held telecommunications company in Jamaica. Prior to the year end, the licences granted to the private telecommunication company in Jamaica was revoked. As a result, this investment has been written down.

	2003	2002
Transfer of equipment and software at carrying value	\$ 105,869	\$ 98,365
Cash contribution	304,000	176,000
 Total investment	 409,869	 274,365
Provision for loss in value on long-term investment	(409,869)	-
Net	\$ -	\$ 274,365

5. PROPERTY AND EQUIPMENT

			2003	2002
	Cost	Accumulated Amortization	Net	Net
Furniture and fixtures	\$ 177,019	\$ 158,488	\$ 18,531	\$ 26,682
Computer equipment	1,396,124	811,686	584,438	1,057,249
Equipment under capital leases	2,639,640	1,589,178	1,050,462	1,126,692
Computer software	569,883	294,904	274,979	18,511
Leasehold improvements	102,731	70,100	32,631	48,283
	\$ 4,885,397	\$ 2,924,356	\$ 1,961,041	\$ 2,277,417

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2002

6. LONG-TERM DEBT

	2003	2002
Corporate term loan in US dollars is payable monthly, to maturity in April 2003.	\$ -	\$ 94,545
Bank term loan bearing interest at institution's prime rate plus 2.25% per annum and principal repayments of \$1,334 plus interest monthly to maturity in August 2003.	-	10,632
Corporate term loan in US dollars bearing interest at 5% per annum and principal and interest repayments of \$17,510 (US \$12,076) monthly to maturity in February 2005.	237,652	-
Bank term loan bearing interest at institution's prime rate plus 1% per annum and principal repayments of \$1,400 plus interest monthly to maturity in July 2004.	9,800	26,600
	247,452	131,777
Less: current portion	(212,648)	(121,977)
	\$ 34,804	\$ 9,800

The loans are secured by general security agreements, guarantee by subsidiaries companies, certain property and equipment, with carrying value of \$317,614 and by personal guarantees of certain directors of the Company.

Principal repayments are as follows:

2004	\$ 212,648
2005	34,804
	\$ 247,452

Included in interest on long-term debt are interest charges on the above loans of \$5,826 (December 31, 2002 \$24,138) and amortization of deferred interest benefit of \$4,799 (December 31, 2002 \$9,598).

7. CAPITAL LEASE OBLIGATIONS

Future minimum lease payments under capital leases are as follows:

2004	\$ 587,868
2005	214,309
2006	34,496
2007	7,282
	843,955
Less: interest portion at average rate of 14 %	116,627
	727,328
Less: current portion	(515,258)
	\$ 212,070

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2002

7. CAPITAL LEASE OBLIGATIONS (CONTINUED)

Interest expense on capital lease obligations of \$146,226 (December 31, 2002 \$136,429) has been included in interest on long-term debt.

8. DUE TO RELATED PARTIES

Amounts due to related parties and amounts owing to directors are noninterest bearing and have no fixed terms of repayment.

During the year, the Company paid management fees of \$370,200 (December 31, 2002 \$291,400) and rent on premises to certain directors and Companies controlled by them of \$135,600 (December 31, 2002 \$135,000). These transactions have been recorded in the selling, general and administrative expenses, were conducted in the normal course of operations and on terms similar to those with arm's length parties. They have been measured at exchange rates being the amount of consideration established and agreed to by the related parties.

9. SHARE CAPITAL

a) Authorized:

The authorized share capital of the Company consists of 500,000 redeemable, voting, Series A special shares, and an unlimited number of common shares and special shares.

b) Common shares issued:

Changes in the issued and outstanding common shares are as follows:

	Number of Shares	Dollar Amount
Balance as at December 31, 2002	48,423,290	\$ 5,371,995
Exchange of shares for debt (note 9e)	2,386,107	501,082
Balance as at December 31, 2003	50,809,397	\$ 5,873,077

c) Earnings per share:

Earnings per share is calculated using the weighted-average number of common shares outstanding throughout the year.

The weighted average number of common shares outstanding for calculation of earnings per share are as follows:

	Basic	Diluted
Balance, December 31, 2003	49,430,042	51,718,708
Balance, December 31, 2002	42,149,519	43,850,769

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2002

9. SHARE CAPITAL (CONTINUED)

c) Earnings per share (CONTINUED)

The average market price in 2003 was \$0.09 (December 31, 2002 \$0.16) which was below the average option price of \$0.15.

As at December 31, 2003, the Company had 4,000,000 warrants issued to an equipment supplier at an exercise price of \$0.10, which expired in March 2004..

d) Fixed stock option plan

The Company has a fixed stock option plan under which, the maximum aggregate number of shares which may be purchased shall not exceed 8,000,000, subject to adjustment or increase of such number pursuant to changes in the capital stock of the Company.

A summary of the status of the stock option plan as of December 31, 2003 and 2002, and changes during the years ended on those dates is presented below:

	2003		2002	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding beginning of year	3,220,000	\$ 0.15	2,196,000	\$ 0.15
Granted	-	\$ -	1,604,000	\$ 0.15
Forfeited	(487,000)	\$ 0.15	(580,000)	\$ 0.15
Outstanding end of year	2,733,000	\$ 0.15	3,220,000	\$ 0.15
Options exercisable yearend	2,733,000	\$ 0.15	3,220,000	\$ 0.15

Included in the options were 1,050,000 options issued to the directors of the Company at an exercise price of \$0.15.

The following table summarizes information about fixed stock options outstanding at December 31, 2003:

Range of Exercise Prices	Options Outstanding and Exercisable		
	Number Outstanding December 31, 2003	WeightedAverage Remaining Contractual Life	WeightedAverage Exercise Price
\$.15 - \$.23	2,733,000	3 years	\$0.15

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
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9. SHARE CAPITAL (CONTINUED)

d) Fixed stock option plan (CONTINUED)

The Company has chosen to apply the intrinsic value method of accounting for share based compensation issued prior to fiscal 2003. Management believes the application of fair value based method would not have any significant impact on earnings, hence pro forma information has not been disclosed.

e) Share for debt settlement:

During the year 2002, the Company entered into an agreement with Radiant Americas, (Radiant) a company registered in the Netherlands and operating telecommunication services in the USA and internationally, to exchange up to 10 million common shares at an agreed price of \$0.21 for equipment and services. The following summarises the transactions to date under this agreement.

	2003	2002
Purchase of equipment	\$ -	\$ 796,811
Services	501,082	524,300
	\$ 501,082	\$ 1,321,111

Shares issued as at December 31,

	2003	2002
Balance beginning of the year	\$ 6,291,007	\$ -
Shares issued	2,386,107	6,291,007
	\$ 8,677,114	\$ 6,291,007

10. LEASE COMMITMENTS

The Company's leased premises are owned by certain directors. The future minimum annual lease payments under operating leases, with varying terms, are approximately as follows:

2004	\$ 135,600
2005	135,600
2006	143,600
2007	145,200
2008 and subsequent years	459,800
	\$ 1,019,800

11. GAIN ON SETTLEMENT OF LITIGATION CASES

a) In fiscal 2002, legal proceedings were commenced by the Company against a group of Telecom suppliers for breach of contract, breach of warranty and misrepresentation and breach of fiduciary duty in the sum of \$20,000,000 together with exemplary and punitive damages in the sum of \$1,000,000, prejudgment interest thereon and legal costs. During the year this action was settled and the parties obtained an Order of the Court dismissing the action on a without cost basis. In final settlement, the Company received cash compensation of \$399,908.

NOTES TO CONSOLIDATED FINANCIAL
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DECEMBER 31, 2002

11. GAIN ON SETTLEMENT OF LITIGATION CASES (CONTINUED)

b) In fiscal 2002, the Company disputed billings from a Carrier company in the amount of \$585,028 for telecom services and leased equipment. These amounts were recorded and disclosed as other accounts payable in the fiscal 2002 financial statements. During the year a settlement of this dispute was reached resulting in a payment of \$150,000 by the Company in full satisfaction of the disputed amounts.

Summary of gains on settlement of litigation cases :

Gain on settlement of telecom group proceedings (see a) above	\$ 399,908
Gain on settlement of trade debt with carrier (see b) above	435,028
	<u>\$ 834,936</u>

12. INCOME TAXES

Income tax expense differs from the amounts which would be obtained by applying the combined Canadian basic Federal and Provincial income tax rate to earnings before income taxes. These differences result from the following items:

Year ended December 31,	2003	2002
Earnings before income taxes	\$ 87,061	\$ 1,827,638
Combined applicable Canadian basic Federal and Provincial income tax rate	36.60 %	38.60 %
Income taxes based on combined income tax rate	31,864	705,468
Decrease in income taxes resulting from : adjustment of gain on forgiveness of loan against past losses	-	(503,197)
Increase in income taxes resulting from : provision for loss in value on long-term investment for which income tax benefit has not been recognized	150,012	-
Increase in taxes due to timing differences in amortization of assets	34,828	122,597
Increase in taxes due to non deductible expenses	9,650	9,004
Increase in income taxes resulting from : losses of subsidiary companies for which an income tax benefit has not been recognized	143,671	26,688
Income tax expense	<u>\$ 370,025</u>	<u>\$ 360,560</u>

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2002

12. INCOME TAXES (CONTINUED)

The Company has noncapital losses of approximately \$3,951,116 for income tax purposes which may be used to reduce taxable income in future years, expiring between 2005 and 2009. No future tax asset has been recognized in respect to these amounts.

Significant components of the Company's future income tax assets, are as follows:

Year ended December 31,	2003	2002
Potential tax benefit related to:		
Operating losses carried forward	\$ 1,426,352	\$ 1,498,357
Accelerated tax depreciation on property and equipment	-	(7,066)
Total future tax assets	1,426,352	1,491,291
Valuation allowance	(1,426,352)	(1,491,291)
Net future income tax assets	\$ -	\$ -

13. FINANCIAL INSTRUMENTS

Credit risk management:

The Company's exposure to credit risk arises from the possibility that its customers may fail to meet their obligations. The Company has credit evaluation, approval and monitoring processes, intended to mitigate potential credit risk.

The Company evaluates the collectibility of accounts receivable and records an allowance for doubtful accounts, which reduces the receivables to the amount management reasonably believes will be collected. A specific allowance is recorded against customer receivables that are considered to be impaired on the Company's knowledge of the financial condition of its customers. As at December 31, 2003 concentration of credit risk exists as four customers comprised 32% of accounts receivable.

Currency risk:

Approximately 80% of its purchases are in foreign currency. Consequently, those related liabilities and expenses are exposed to foreign exchange fluctuations. As at December 31, 2003, accounts payable from US suppliers are \$1,507,111 (2002, \$1,181,520). The Company does not use forward exchange contracts to reduce its exposure to foreign exchange risk.

Fair value:

The Company's financial instruments include cash, short-term investments, accounts receivable, accounts payable and accrued liabilities, long-term debt, capital lease obligations and amounts due to related parties. Due to the short-term maturity of cash, short-term investments, accounts receivable and accounts payable and accrued liabilities, the carrying values of these financial instruments are reasonable estimates of their fair value.

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2002

13. FINANCIAL INSTRUMENTS (CONTINUED)

The fair value of amounts due to related parties are not determinable due to the unavailability of similar borrowing arrangements on an arm's length basis.

The fair value of the components of long-term debt and capital lease obligations are estimated by reference to current market prices for other debt securities with similar terms and characteristics. The carrying amount and fair value of these liabilities are as follows:

	2003		2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term liabilities (including current portion)	\$ 247,451	\$ 238,615	\$ 131,777	\$ 121,486
Obligations under capital leases	\$ 727,328	\$ 708,185	\$ 888,166	\$ 872,509

14. SEGMENTED INFORMATION

The Company generates approximately 99% of its sales from the telecommunication. Accordingly, no segmented information was presented.

15. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Noncash operating, investing and financing activities are as follows:

Acquisitions of equipment through lease obligations	\$ 521,612
Common shares and options issued for services/compensation (9e)	\$ 501,082

16. COMPARATIVE FIGURES

Certain 2002 comparative figures have been reclassified to conform with the presentation adopted for 2003.

OFFICERS

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Rodney Franklin
Chairman

Jeffrey D. Chelin
Chief Financial Officer

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Rodney Franklin

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LISTING

TSX Venture Exchange Symbol: PHD

SHARE INFORMATION

Shares Outstanding: 50,809,397
as at March 24

ANNUAL GENERAL &
SPECIAL MEETING OF
SHAREHOLDERS

Wednesday June 23, 2004
4pm
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Delta Toronto Airport West Hotel
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Mississauga, Ontario



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