SOCKET MOBILE, INC.
Form 10-Q
August 09, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

**FORM 10-Q**

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

**For the quarterly period ended June 30, 2010**

**OR**

**[ ] TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period ____________ to ____________

**Commission file number 1-13810**

# SOCKET MOBILE, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **94-3155066** |
| (State of incorporation) | (IRS Employer Identification No.) |

**39700 Eureka Drive, Newark, CA 94560**
(Address of principal executive offices including zip code)

**(510) 933-3000**
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES [ ] NO [ ]

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES [ ] NO [X]

The number of shares of Common Stock ($0.001 par value) outstanding as of July 30, 2010 was 3,800,339 shares.

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**Item 1. Financial Statements**

**SOCKET MOBILE, INC.**
**CONDENSED BALANCE SHEETS**

| | | June 30, 2010 (unaudited) | | | December 31, 2009* | |
|---|---|---|---|---|---|---|
| | | |   | | |   |
| **ASSETS** | | | | | | |
| Current assets: | | | | | | |
| Cash and cash equivalents | $ | 1,992,071 | | $ | 1,940,295 | |
| Accounts receivable, net | | 1,866,084 | | | 1,659,383 | |
| Inventories | | 1,596,565 | | | 2,044,119 | |
| Prepaid expenses and other current assets | ** ** | 468,596 |   | ** ** | 415,102 |   |

| | | | | |
|---|---|---|---|---|
| Total current assets |   | 5,923,316  |   | 6,058,899  |
|   | | | | |
| Property and equipment: | | | | |
| Machinery and office equipment | | 2,175,652 | | 2,165,775 |
| Computer equipment | ** ** | 1,288,619  | ** ** | 1,253,511  |
|   | | 3,464,271 | | 3,419,286 |
| Accumulated depreciation | ** ** | (2,810,928)  | ** ** | (2,631,822)  |
| Property and equipment, net |   | 653,343  |   | 787,464  |
|   | | | | |
| Intangible assets, net | | 240,000 | | 270,000 |
| Goodwill | | 4,427,000 | | 4,427,000 |
| Other assets | ** ** | 185,500  | ** ** | 199,834  |
| Total assets | $ | 11,429,159 | $ | 11,743,197 |
|   | | | | |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | |
| Current liabilities: | | | | |
| Accounts payable | $ | 3,811,342 | $ | 2,902,294 |
| Accrued payroll and related expenses | | 684,532 | | 806,750 |
| Bank line of credit | | 1,145,053 | | 1,002,088 |
| Deferred income on shipments to distributors | | 964,518 | | 917,756 |
| Short term portion of deferred service revenue | | 340,890 | | 304,193 |
| Short term portion of capital leases and deferred rent | ** ** | 49,102  | ** ** | 42,491  |
| Total current liabilities |   | 6,995,437  |   | 5,975,572  |
|   | | | | |
| Long term portion of deferred service revenue | | 260,062 | | 282,840 |
| Long term portion of capital leases and deferred rent | ** ** | 70,060  | ** ** | 96,785  |
| Total liabilities |   | 7,325,559  |   | 6,355,197  |
|   | | | | |
| Commitments and contingencies | | | | |
| | | | | |
| Stockholders' equity: | | | | |
| Common stock, $0.001 par value: Authorized shares 10,000,000, | | | | |
| Issued and outstanding shares 3,793,879 at June 30, 2010 and 3,788,767 at December 31, 2009 | | 3,794 | | 3,789 |
| Additional paid-in capital | | 56,520,270 | | 56,190,112 |
| Accumulated deficit | ** ** | (52,420,464)  | ** ** | (50,805,901)  |
| Total stockholders equity | ** ** | 4,103,600  | ** ** | 5,388,000  |
| Total liabilities and stockholders equity | $ | 11,429,159 | $ | 11,743,197 |

* Derived from audited financial statements.

See accompanying notes.

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**SOCKET MOBILE, INC.**
**CONDENSED STATEMENTS OF OPERATIONS**
(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010  | 2009 | 2010  | 2009  |
| Revenues | $ 3,654,107 | $ 4,143,156 | $ 7,461,256 | $ 8,915,046 |
| Cost of revenues |   2,148,775  |   2,428,273  |   4,350,464  |   4,974,710  |
| Gross profit |   1,505,332 |   1,714,883 |   3,110,792 |   3,940,336 |
|   | | | | |
| Operating expenses: | | | | |
| Research and development | 558,537 | 726,608 | 1,240,057 | 1,503,082 |
| Sales and marketing | 960,374 | 1,309,322 | 2,199,741 | 2,723,164 |
| General and administrative | 492,493 | 548,725 | 1,153,118 | 1,190,724 |
| Amortization of intangible assets |   15,000 |   15,000 |   30,000 |   46,787 |
|   Total operating expenses | 2,026,404 | 2,599,655 | 4,622,916 | 5,463,757 |
| | | | | |
| Operating loss |   (521,072) |   (884,772) |   (1,512,124) |   (1,523,421) |
|   | | | | |
| Interest income and other | 26 | 19 | 60 | 369 |
| Interest expense |   (54,716) |   (51,845) |   (102,499) |   (117,276) |
| | | | | |
| Net loss before deferred taxes | (575,762) | (936,598) | (1,614,563) | (1,640,328) |
| Deferred tax expense |   --- |   (7,985) |   --- |   (15,970) |
| Net loss | $ (575,762) | $ (944,583) | $ (1,614,563) | $ (1,656,298) |
| |   |   |   |   |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net loss per share: | | | | | | | | |
| Basic | $ | (0.15) | $ | (0.27) | $ | (0.43) | $ | (0.50) |
| Diluted | $ | (0.15) | $ | (0.27) | $ | (0.43) | $ | (0.50) |
|   | | | | | | | | |
| Weighted average shares outstanding: | | | | | | | | |
| Basic and Diluted | | 3,793,768 | | 3,444,065 | | 3,791,379 | | 3,336,991 |

See accompanying notes.



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**SOCKET MOBILE, INC.**
**CONDENSED STATEMENTS OF CASH FLOWS**
(Unaudited)

| | Six Months Ended June 30, | | | | |
|---|---|---|---|---|---|
| | | 2010 |   | | 2009 |   |
| **Operating activities** | | | | | |
| Net loss | $ | (1,614,563) | $ | (1,656,298) | |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | | | | |
| Stock-based compensation | | 320,143 | | 319,096 | |
| Depreciation and amortization | | 240,804 | | 248,506 | |
| Amortization of intangible assets | | 30,000 | | 46,787 | |
| Net foreign currency transaction losses | | 7,170 | | 2,389 | |
| Deferred tax expense | | --- | | 15,970 | |
| Change in deferred rent | | (14,049) | | (7,886) | |
| ** ** | | | | | |
| Changes in operating assets and liabilities: | | | | | |
| Accounts receivable | | (213,995) | | 1,292,362 | |
| Inventories | | 447,554 | | 1,403,315 | |
| Prepaid expenses and other current assets | | (53,494) | | 151,264 | |

| | | | | |
|---|---|---|---|---|
| Other assets | | 14,334 | | 22,500 |
| Accounts payable | | 909,172 | | (1,272,334) |
| Accrued payroll and related expenses | | (122,218) | | (23,056) |
| Deferred income on shipments to distributors | | 46,762 | | (733,622) |
| Deferred service revenue | ** ** | 13,918  |   | 196,808  |
| Net cash provided by operating activities | ** ** | 11,538 |   | 5,801 |
|   | | | | |
| **Investing activities** | | | | |
| Purchases of equipment | ** ** | (106,683)  |   | (154,065)  |
| Net cash used in investing activities | ** ** | (106,683) |   | (154,065) |
| ** ** | | | | |
| **Financing activities** | | | | |
| Payments on capital leases | | (6,064) | | (5,519) |
| Proceeds from borrowings under bank line of credit agreement | | 3,606,823 | | 5,353,548 |
| Repayments of borrowings under bank line of credit agreement | | (3,463,858) | | (5,157,994) |
| Proceeds from the issuance of common stock and warrants | | --- | | 884,728 |
| Stock options exercised | ** ** | 10,020  |   | ---  |
| Net cash provided by financing activities | ** ** | 146,921 |   | 1,074,763 |
| ** ** | | | | |
| Net increase in cash and cash equivalents | | 51,776 | | 926,499 |
| | | | | |
| Cash and cash equivalents at beginning of period | ** ** | 1,940,295  | ** ** | 757,342  |
| Cash and cash equivalents at end of period | $ | 1,992,071 | $ | 1,683,841 |
| | | | | |
| **Supplemental cash flow information** | | | | |
| Cash paid for interest | $ | 101,903 | $ | 117,478 |

See accompanying notes.



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**SOCKET MOBILE, INC.**
**NOTES TO CONDENSED FINANCIAL STATEMENTS**
(Unaudited)

**NOTE 1 - Basis of Presentation**

The accompanying unaudited condensed financial statements of Socket Mobile, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring accruals considered necessary for fair presentation have been included. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. These condensed financial statements should be read in conjunction with the audited financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The financial statements in the Company's annual report on Form 10-K were prepared on a going concern basis. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. These financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from uncertainty related to the Company's ability to continue as a going concern.

*Liquidity and Going Concern*
The Company's cash balances at June 30, 2010 were $2.0 million, including cash of $1.1 million drawn against its bank lines of credit. The Company's cash balances at June 30, 2010, reflect a net increase of $143,000 in amounts drawn on its bank lines of credit and net cash provided of $12,000 from operating activities in the first half of 2010. On March 3, 2010, the Company agreed with its bank to extend the term of the existing credit facility to March 23, 2011, to amend the terms of the credit facility with a minimum cash deposit requirement of $1.0 million and minimum quarterly revenue requirements for fiscal 2010, to extend the period of forbearance related to the Company's fourth quarter 2009 covenant default, and to provide that the bank would waive that event of default if the Company met the requisite financial covenants for the first quarter of 2010. The Company failed to meet the minimum revenue covenant for the quarter ended March 31, 2010, however, on May 12, 2010 the bank agreed to waive the events of default and to replace the quarterly minimum revenue requirements with quarterly net income targets for the remaining quarters of fiscal 2010. The Company failed to meet the minimum quarterly net income target for the quarter ended June 30, 2010. On August 5, 2010 the bank agreed to waive the event of default and to revise the minimum quarterly net income targets for the third and fourth quarters of 2010. The other financial covenants remain in effect (see "Note 4 - Bank Financing Arrangements" for more information). The Company's balance sheet at June 30, 2010 has a current ratio (current assets divided by current liabilities) of 0.85 to 1.0, and no material long term debt. The Company has taken actions to reduce expenses to align its cost structure with current economic conditions. The Company has the ability to reduce expenses further if necessary. If the Company can return to revenue growth and attain profitability, the Company anticipates requirements for cash will include funding of higher receivable and inventory balances, and increased expenses, including an increase of costs relating to new employees to support its growth and increases in salaries, benefits, and related support costs for existing employees. If the Company cannot attain profitability, the Company will not be able to support its operations from positive cash flows, and the Company will use its existing cash to support operating losses. The Company may also find it necessary to raise additional capital to fund its operations, however, there can be no assurance that additional capital will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. If the Company is unable to secure the necessary capital for its business, the Company may need to suspend some or all of its current operations.

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**SOCKET MOBILE, INC.**
**NOTES TO CONDENSED FINANCIAL STATEMENTS**
(Unaudited)

The Company's continuing operating losses, declines in its working capital balances and the Company's failure to achieve the revenue levels required to maintain compliance with its bank line covenants are conditions that raise doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is dependent upon its ability to establish profitable operations and to increase its capital. Management has been taking steps intended to reduce operating losses and achieve profitability including the introduction of new products, continued close support of the Company's distributors and its application partners as they establish their mobile applications in key vertical markets, and management of its costs. Management believes that it will be able to improve the Company's liquidity and secure additional sources of financing by managing its working capital balances, returning to compliance with the bank line covenants as operating results improve, and raising additional capital as needed including development funding from development partners and the issuance of additional equity securities. There can be no assurance that management will be successful in achieving these steps, and there can be no assurance that additional financing will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. The Company's inability to secure and maintain the necessary liquidity would have a material adverse effect on the Company's financial condition and results of operations.

**NOTE 2 - Summary of Significant Accounting Policies**

*Use of Estimates*
The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates, and such differences may be material to the financial statements.

*Recent Accounting Standards*
In January 2009, the Securities and Exchange Commission ("SEC") issued Release No. 33-9002, "Interactive Data to Improve Financial Reporting." The final rule requires companies to provide their financial statements and financial statement schedules to the SEC and on their corporate websites in interactive data format using the eXtensible Business Reporting Language ("XBRL"). The rule was adopted by the SEC to improve the ability of financial statement users to access and analyze financial data. The SEC adopted a phase-in schedule indicating when registrants must furnish interactive data. Under this schedule, the Company will be required to submit filings with financial statement information using XBRL commencing with its June 30, 2011 quarterly report on Form 10-Q. The Company is currently evaluating the impact of XBRL reporting on its financial reporting process.

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**SOCKET MOBILE, INC.**
**NOTES TO CONDENSED FINANCIAL STATEMENTS**
(Unaudited)

In October 2009, the FASB amended revenue recognition guidance for arrangements with multiple deliverables. The guidance eliminates the residual method of revenue recognition and allows the use of management's best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence ("VSOE"), vendor objective evidence ("VOE") or third-party evidence ("TPE") is unavailable. This guidance should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. Full retrospective application of the guidance is optional. The Company is currently evaluating the impact of adopting this guidance on its financial statements.

In October 2009, the FASB issued guidance which amends the scope of existing software revenue recognition accounting. Tangible products containing software components and non-software components that function together to deliver the product's essential functionality would be scoped out of the accounting guidance on software and accounted for based on other appropriate revenue recognition guidance. This guidance should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. Full retrospective application of the new guidance is optional. This guidance must be adopted in the same period that the Company adopts the amended accounting for arrangements with multiple deliverables described in the preceding paragraph. The Company is currently evaluating the impact of adopting this guidance on its financial statements.

In January 2010, the FASB issued guidance which clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements. The Company implemented these new requirements in the first quarter of fiscal 2010. Certain additional disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measures are not effective until fiscal years beginning after December 15, 2010. Other than requiring additional disclosures, implementation of this new guidance will not have a material impact on the Company's financial statements.

*Cash Equivalents and Fair Value of Financial Instruments*
The Company considers all highly liquid investments purchased with an original maturity date of 90 days or less at date of purchase to be cash equivalents. At June 30, 2010 and December 31, 2009, all of the Company's cash and cash equivalents consisted of amounts held in demand and money market deposits in banks. The carrying value of the Company's cash and cash equivalents, accounts receivable, accounts payable, debt and foreign exchange contracts approximate fair value due to the relatively short period of time to maturity.

*Derivative Financial Instruments*
The Company regularly enters into forward foreign currency contracts to reduce exposures related to rate changes in certain foreign currencies. The Company's forward foreign currency contracts are recorded at fair value and are included within current liabilities at June 30, 2010. At June 30, 2010, these derivative instruments were not designated as hedges, and accordingly, changes in the fair value of the forward foreign currency contracts were recorded in net income. At June 30, 2010, contracts with a notional amount of $305,275 to hedge Euros were recorded as a liability with a fair value of $600 based on quotations from financial institutions, and had maturity dates in July 2010. At December 31, 2009, contracts with a notional amount of $721,500 to hedge Euros were recorded as an asset with a fair value of $5,175 based on quotations from financial institutions, and had maturity dates in January 2010.

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**SOCKET MOBILE, INC.**
**NOTES TO CONDENSED FINANCIAL STATEMENTS**
(Unaudited)

*Goodwill and Other Intangible Assets Review*
Goodwill is tested for impairment annually or more frequently when events or circumstances indicate that the carrying value of the Company's single reporting unit more likely than not exceeds its fair value. Based on indicators in the fourth quarter of 2009 the Company performed additional goodwill impairment testing with the assistance of a third party valuation specialist. The Company used the two step test as required to assess goodwill for impairment. The first step of the goodwill impairment test consisted of comparing the carrying value of the reporting unit to its fair value. Management estimated the fair value of the Company using various methods and compared the fair value to the carrying amount (net book value) to ascertain if potential goodwill impairment existed. The Company utilized methods that focused on its ability to produce income ("Income Approach") and the estimated consideration it would receive if there were a sale of the Company ("Market Approach"). Key assumptions utilized in the determination of fair value in step one of the test included the following: the Company's market capitalization; market multiples of comparable companies within its industry; revenue and expense forecasts used in the evaluation were based on trends of historical performance and management's estimate of future performance; cash flows utilized in the discounted cash flow analysis were estimated using a weighted average cost of capital determined to be appropriate for the Company.

Based on the fair value estimated in step one, the Company determined a step one failure occurred which indicated a goodwill impairment may exist. The Company performed a step two analysis which included estimating the fair value of its assets and liabilities, including previously unrecognized intangible assets. The Income Approach was utilized to value the Company's identified intangible assets, including developed technology, trade name, patents, and internally developed software. As a result of a preliminary step two test as of December 31, 2009, the estimated fair value of the Company's goodwill was $4,427,000, which exceeded the carrying value by $5,370,946. As a result, the Company recorded an estimated $5,370,946 goodwill impairment as of December 31, 2009. In the quarter ended March 31, 2010, the Company finalized the identification and valuation of the intangible assets with the assistance of a third party specialist and there was no adjustment to the estimated impairment recorded at December 31, 2009 based on the completion of the step two analysis. As of June 30, 2010, no events had occurred or circumstances had changed that would more likely than not reduce the fair value of the Company below its carrying amount.



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**SOCKET MOBILE, INC.**
**NOTES TO CONDENSED FINANCIAL STATEMENTS**
(Unaudited)

**NOTE 3 - Inventories**

Inventories are stated at the lower of cost (first-in, first-out) or market, and consist of the following:

| | | June 30, 2010 | | December 31, 2009 |
|---|---|---|---|---|
| Raw materials and sub-assemblies | $ | 1,520,527 | $ | 1,939,416 |
| Finished goods |    | 76,038 |   | 104,703 |
| | $ | 1,596,565 | $ | 2,044,119 |

**NOTE 4 - Bank Financing Arrangements**

The Company has a credit facility with Silicon Valley Bank which allows the Company to borrow up to $2,500,000 based on the level of qualified domestic and international receivables, up to a maximum of $1,500,000 and $1,000,000, respectively. Borrowings under the lines bear an annual interest rate equal to the greater of (i) the Lender's prime rate plus 2%, or (ii) 6%. The annual interest rate in effect at June 30, 2010 and December 31, 2009 was 6%. The borrowings under the credit facility are secured by a first priority security interest in the assets of the Company. The advance rate for receivables is 50% from distributors and 70% for all other receivables. The agreement also specifies a collateral handling fee of 0.62% per month. The applicable interest and fees are calculated based on the full amount of the accounts receivable provided as collateral, rather than on the actual amounts borrowed. The outstanding amounts borrowed under the domestic and international lines at December 31, 2009 were $649,905 and $352,183, respectively, and the full amounts of accounts receivable provided as collateral were $1,124,770, and $678,794, respectively. The Company was out of compliance with the minimum revenue covenant for the quarter ended December 31, 2009. Silicon Valley Bank agreed to forbear any actions relating to the event of default through March 24, 2010.

On March 3, 2010, the Company agreed with Silicon Valley Bank to extend the term of the existing credit facility to March 23, 2011 and to amend its other terms. Under the terms of the amendment the Company is required to maintain at all times a minimum cash deposit balance at Silicon Valley Bank of no less than $1,000,000; and to achieve minimum quarterly revenue requirements for fiscal 2010. The amendment also extended the period that Silicon Valley Bank agreed to forbear from enforcing its rights and remedies under the credit facility through April 30, 2010, and provided that Silicon Valley Bank would waive the existing event of default under the credit facility if the Company met the requisite financial covenants for the quarter ending March 31, 2010. The Company failed to meet the minimum revenue covenant for the quarter ended March 31, 2010, however, on May 12, 2010 the bank agreed to waive the events of default and to replace the quarterly minimum revenue requirements with quarterly net income targets for the remaining quarters of fiscal 2010. The Company failed to meet the minimum quarterly income target for the quarter ended June 30, 2010. On August 5, 2010 the bank agreed to waive the event of default and to revise the minimum quarterly net income targets for the third and fourth quarters of 2010. For the quarter ending September 30, 2010 the Company's net loss is not to exceed $500,000; for the quarter ending December 31, 2010 the net loss is not to exceed $350,000. The minimum cash deposit covenant remains in effect. The outstanding amounts borrowed under the domestic and international lines at June 30, 2010 were $785,569 and $359,484, respectively, and the full amounts of accounts receivable provided as collateral were $1,358,493, and $653,345, respectively. Should the Company fail to meet any of the financial covenants specified in the credit facility agreement, such failure would constitute an event of default under the terms of the credit agreement, and Silicon Valley Bank may, among its remedies, declare all obligations under the credit facility immediately due and payable.



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**SOCKET MOBILE, INC.**
**NOTES TO CONDENSED FINANCIAL STATEMENTS**
(Unaudited)

**NOTE 5 - Intangible Assets**

Intangible assets consist of a patent purchased in 2004 for $600,000 covering the design and functioning of plug-in bar code scanners, bar code imagers, and radio frequency identification products, which is being amortized on a straight line basis over its estimated life of ten years. Intangible assets of $570,750 remaining from a prior acquisition in 2000 consisting of developed software and technology with estimated lives at the time of acquisition of 8.5 years was fully amortized in the quarter ended June 30, 2009.

Amortization of all intangible assets for the three and six months ended June 30, 2010 was $15,000 and $30,000, respectively, compared to $15,000 and $46,787, respectively, for the same periods in 2009. Intangible assets as of June 30, 2010 consisted of the following:

| | Gross Assets | Accumulated Amortization | Net |
|---|---|---|---|
| Patent | $ 600,000 | $ 360,000 | $ 240,000 |
| Project management tools |   570,750  |   570,750  |   ---  |
| Total intangible assets | $ 1,170,750 | $ 930,750 | $ 240,000 |

Based on definite lived intangible assets recorded at June 30, 2010, and assuming no subsequent impairment of the underlying assets, the annual amortization expense is expected to be as follows:

| Year | Amount |
|---|---|
| 2010 (six months remaining) | $ 30,000 |
| 2011 | 60,000 |
| 2012 | 60,000 |
| 2013 | 60,000 |
| 2014 |   30,000  |
| | $240,000  |

Intangible assets as of December 31, 2009 consisted of the following:

| | Gross Assets | Accumulated Amortization | Net |
|---|---|---|---|
| Patent | $ 600,000 | $ 330,000 | $ 270,000 |
| Project management tools |   570,750  |   570,750  |   ---  |
| Total intangible assets | $ 1,170,750 | $ 900,750 | $ 270,000 |

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**SOCKET MOBILE, INC.**
**NOTES TO CONDENSED FINANCIAL STATEMENTS**
(Unaudited)

**NOTE 6 - Segment Information and Concentrations**

*Segment Information*
The Company operates in one segment-mobile systems solutions for businesses. Mobile systems solutions typically consist of a handheld computer, data collection and connectivity peripherals, and third-party vertical applications software. The Company markets its products in the United States and foreign countries through its sales personnel, distributors, and vertical industry partners. Revenues for the geographic areas for the three and six months ended June 30, 2010 and 2009 were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| Revenues: | 2010 | 2009 | 2010 | 2009 |
| United States | $ 2,877,579 | $ 2,302,505 | $ 5,680,508 | $ 5,055,851 |
| Europe | 718,403 | 1,209,163 | 1,543,573 | 2,746,120 |
| Asia and rest of world |   58,125  |   631,488  |   237,175  |   1,113,075  |
| Total revenues | $ 3,654,107 | $ 4,143,156 | $ 7,461,256 | $ 8,915,046 |

Export revenues are attributable to countries based on the location of the Company's customers. The Company does not hold long-lived assets in foreign locations.

Major customers who accounted for at least 10% of the Company's total revenues were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Tech Data Corporation | 16% | 20% | 14% | 18% |
| Ingram Micro Inc. | 13% | 21% | 15% | 22% |
| Epocal Inc. | 16% | * | * | * |
| BlueStar | * | * | 14% | * |

* Customer accounted for less than 10% of total revenues for the period

*Concentration of Credit Risk*
Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. The Company invests its cash in demand and money market deposit accounts in banks. To the extent of the amounts recorded on the balance sheet, cash is concentrated at the Company's bank to the extent needed to comply with the minimum cash balance covenant of the bank line agreement. This exposure from an event of default by the bank is offset in part by amounts drawn against the bank

line. To date, the Company has not experienced losses on these investments. The Company's trade accounts receivables are primarily with distributors and OEMs. The Company performs ongoing credit evaluations of its customers' financial conditions but the Company generally requires no collateral. Reserves are maintained for potential credit losses, and such losses have been within management's expectations. At June 30, 2010 there were three customers with material amounts outstanding totaling 44% of the Company's accounts receivable balances. At December 31, 2009, there were two customers with material amounts outstanding totaling 35% of the Company's accounts receivable balances.



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**SOCKET MOBILE, INC.**
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(Unaudited)

*Concentration of Suppliers*
Several of the Company's component parts are produced by a sole or limited number of suppliers. Shortages could occur in these essential materials due to an interruption of supply or increased demand in the industry. If the Company were unable to procure certain of such materials, it would be required to reduce its operations, which could have a material adverse effect upon its results. At June 30, 2010 and December 31, 2009, 41% and 33%, respectively, of the Company's accounts payable balances were concentrated in a single supplier. For the three and six months ended June 30, 2010, two suppliers accounted for 70% and 69%, respectively, of the inventory purchases.

**NOTE 7 - Stock-Based Compensation**

The Company recognizes stock-based compensation in the financial statements for all share-based awards to employees, including grants of employee stock options, based on their fair values. The Company uses a binomial lattice valuation model to estimate the fair value of stock option grants. The binomial lattice model incorporates calculations for expected volatility, risk-free interest rates, employee exercise patterns and post-vesting employment termination behavior, and these factors affect the estimate of the fair value of the Company's stock option grants.

Total stock-based compensation expense recognized in the Company's statements of operations for the three and six months ended June 30, 2010 and 2009 is shown below:

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| Income Statement Classification | | 2010 | | 2009 | | 2010 | | 2009 |
|  &nbspCost of revenues | $ | 13,638 | $ | 15,447 | $ | 28,045 | $ | 26,796 |
|  &nbspResearch and development | | 35,760 | | 36,078 | | 75,586 | | 67,775 |
|  &nbspSales and marketing | | 50,181 | | 62,838 | | 101,186 | | 119,811 |
|  &nbspGeneral and administrative |   | 55,324  |   | 52,213  |   | 115,326  |   | 104,714  |
|  &nbspTotal | $ | 154,903 | $ | 166,576 | $ | 320,143 | $ | 319,096 |

In the three and six months ended June 30, 2010, 139,000 and 144,000 stock options were granted, respectively, at weighted average per share fair values estimated at $1.96 and $1.97, respectively. In the three and six months ended June 30, 2009, 186,381 and 469,781 stock options were granted, respectively, at weighted average per share fair values estimated at $2.04 and $1.62, respectively. At June 30, 2010, options issued to employees for 1,323,151 shares were outstanding, of which options for 901,829 shares were exercisable.



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Weighted average assumptions for stock options granted during the three and six months ended June 30 2010 and 2009 are shown below:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Risk-free interest rate (%) | 3.41% | 3.43% | 3.42% | 3.04% |
| Dividend yield | --- | --- | --- | --- |
| Volatility factor | 0.93 | 1.09 | 0.94 | 0.99 |
| Expected option life (years) | 4.3 | 3.4 | 4.3 | 4.0 |

In June 2010 the Company offered to exchange certain outstanding stock options granted under the Company's equity incentive plans for new stock options to purchase shares of the Company's common stock under modified vesting terms. On July 1, 2010, the Company completed the exchange offer and cancelled 703,550 stock options and reissued an equal number of new stock options to purchase the Company's common stock at a per share price of $3.04, at a weighted average per share fair value estimated at $1.92, with a weighted average vesting period of 2.1 years. At June 30, 2010, prior to the completion of the exchange offer, total remaining unrecognized compensation costs related to unvested stock options was approximately $0.86 million to be amortized over the weighted average remaining requisite period of 2.4 years. At July 1, 2010, after the completion of the exchange offer, total remaining unrecognized compensation costs related to all unvested stock options was approximately $1.6 million, which will be amortized over the weighted average remaining requisite period of 2.4 years.

**NOTE 8 - Net Loss Per Share Applicable to Common Stockholders**

The following table sets forth the computation of basic and diluted net loss per share:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Numerator: | | | | |

| | | | | |
|---|---|---|---|---|
| Net loss | $ (575,762) | $ (944,583) | $ (1,614,563) | $ (1,656,298) |
| Denominator: | | | | |
| Weighted average common shares outstanding used in computing net loss per share: | | | | |
| Basic | 3,793,768 | 3,444,065 | 3,791,379 | 3,336,991 |
| Diluted | 3,793,768 | 3,444,065 | 3,791,379 | 3,336,991 |
|   | | | | |
| Net loss per share: | | | | |
| Basic and Diluted | $ (0.15) | $ (0.27) | $ (0.43) | $ (0.50) |



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For the quarters ended June 30, 2010 and 2009, the diluted net loss per share is equal to the basic net loss per share because the Company experienced losses in these periods. Thus no potential common shares underlying stock options and warrants have been included in the net loss per share calculation, as their effect is anti-dilutive. Options and warrants to purchase 1,400,793 shares of common stock at June 30, 2010, and options and warrants to purchase 1,364,586 shares of common stock at June 30, 2009, have been omitted from the net loss per share calculation.

**NOTE 9 - Taxes**

Deferred tax expense in the three and six months ended June 30, 2009 was related entirely to the deferred tax liability on the portion of the Company's goodwill amortized for tax purposes. Due to the indefinite characteristic of this deferred tax liability, it could not be offset against deferred tax assets, and therefore resulted in a deferred tax expense of $7,985 and $15,970 in the three and six months ended June 30, 2010, respectively. Goodwill impairment charges recorded as of December 31, 2009 on that portion of our goodwill being amortized for tax purposes, resulted in the reversal of accumulated deferred tax expense and the related deferred tax liability, temporarily eliminating the difference between financial and tax reporting. As a result no deferred tax expense was incurred in the three and six months ended June 30, 2010.

At December 31, 2009, the Company has an unrecognized tax benefit of approximately $599,000, which did not change significantly during the three and six months ended June 30, 2010. Future changes in the unrecognized tax benefit will have no impact on the effective tax rate due to the existence of the valuation allowance. It is the Company's policy to include interest and penalties related to tax positions as a component of income tax expense. No interest was accrued for the three and six months ended June 30, 2010.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include statements forecasting our future financial condition and results, our future operating activities, market acceptance of our products, expectations for general market growth of handheld computers and other mobile computing devices, growth in demand for our products, expansion of the markets that we serve, expansion of the distribution channels for our products, adoption of our embedded products by third-party manufacturers of electronic devices, and the timing of the introduction and availability of new products, as well as other forecasts discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations." Words such as "may," "will," "predicts," "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," variations of such words, and similar expressions are intended to identify such forward-looking statements. Such forward-looking statements are based on current expectations, estimates, and projections about our industry, management's beliefs, and assumptions made by management. These forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties, and assumptions that are difficult to predict; therefore, actual results and outcomes may differ materially from what is expressed or forecasted in any such forward looking statements. Factors that could cause actual results and outcomes to differ materially include, but are not limited to: continued weakness in the U.S. and world economy generally and in the markets we serve in particular; the risk of delays in the availability of our products due to technological, market or financial factors including the availability of necessary working capital; our ability to successfully develop, introduce and market future products; our ability to effectively manage and contain our operating costs; the availability of announced third-party handheld computer hardware and software that our products are intended to work with; product delays associated with new model introductions and product changeovers by the makers of products that our products are intended to work with; continued growth in demand for handheld computers; market acceptance of emerging standards such as Bluetooth and wireless LAN and of our related connection, data collection and mobile handheld computer products; the ability of our strategic relationships to benefit our business as expected; our ability to enter into additional distribution relationships; or other factors described in this Form 10-Q including "Part II, Item 1A. Risk Factors" and recent Form 8-K and Form 10-K reports filed with the Securities and Exchange Commission. We assume no obligation to update such forward-looking statements or to update the reasons why actual results could differ materially from those anticipated in such forward-looking statements.*

*You should read the following discussion in conjunction with the interim condensed financial statements and notes included elsewhere in this report, the Company's annual financial statements in the Form 10-K, and other information contained in other reports and documents filed from time to time with the Securities and Exchange Commission.*



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**Revenues**

We are a producer of mobile computing hardware systems serving business mobility markets with an emphasis on healthcare and hospitality. We offer a family of handheld computer products and a wide range of data collection products. We also offer embedded Bluetooth and wireless LAN products. Our data collection peripheral products also work with many third-party mobile handheld devices including smartphones, handheld computers, tablet computers, ultra-mobile personal computers (UMPCs), and notebooks, adding data collection and connectivity capabilities to these devices. Our products are designed to run or enhance mobile applications that enable the accessing, collection and processing of data by employees while mobile. Our mobile computing products utilize popular Bluetooth and wireless LAN connection technologies. Our plug-in and cordless data collection products offer a variety of data collection technologies including one dimensional (1D) laser scanning and two dimensional (2D) barcode scanning, plus we offer RFID (radio frequency identification) and magnetic stripe readers.

More than 200 software integration companies are offering or developing vertical software applications for use with our handheld computers and data collection products. Healthcare and hospitality are two of the primary areas of focus for our software integration partners and more than half of our handheld computer sales now come from organizations within the healthcare and hospitality industries. Other vertical markets benefiting from our mobile solutions include retail merchandising, automotive, government and education. These mobile solutions are designed to improve the productivity of business enterprises and service providers by automating manual tasks, improving the quality of information collected, and enhancing mobile productivity by processing and transferring information from remote locations and mobile devices to the business or medical enterprise, and then if required, back to the remote locations and mobile devices.

We believe growth in the mobile workforce along with technical advances and cost reductions in mobile devices and networking technologies and the pervasive use of the Internet are driving broader adoption of mobile computing. Our products are designed to address the growing need for mobile computing by today's mobile workforce by enabling them to run or enhance mobile applications that allow access to business data files, or collect and process data while mobile, thereby enhancing their productivity and allowing them to exploit time sensitive opportunities and improve customer satisfaction. Overall, our hardware products enable mobile third-party software applications to become complete mobile data collection and connectivity solutions.

We also make available to Original Equipment Manufacturers ("OEMs") our component Bluetooth and wireless LAN technologies. We develop these components for our own products and leverage that investment through the sale of modules and plug-in cards to OEM manufacturers to embed into their products, including driver and device management software that is designed to simplify the ability of mobile employees to get and stay connected with Wi-Fi as well as with Bluetooth.

Our handheld computers and peripheral products are sold through a worldwide network of distributors and resellers, vertical industry partners, and value added resellers (VARs). Our OEM products are sold directly to the original equipment manufacturers. The geographic regions we serve include the Americas, Europe, the Middle East, Africa and Asia Pacific. Total revenues for the three and six months ended June 30, 2010 were $3.7 million and $7.5 million, which represented decreases of 12% and 16%, respectively, from revenues of $4.1 million and $8.9 million in the corresponding periods one year ago.

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Our revenues in the comparable three and six month periods are classified into three broad product families:

- Mobile handheld computer products;
- Mobile peripheral products for data collection and connectivity; and
- OEM embedded products.

Our ***mobile handheld computer products*** are designed to be durable, lightweight and dependable devices which meet the requirements of the healthcare and hospitality markets we serve. Our initial model, the SoMo® 650 (SoMo is derived from Socket Mobile), was introduced in June 2007 with initial volume shipments in September 2007, and features the Microsoft Windows Mobile Classic operating system, Versions 5.0 and 6. Windows Mobile is the industry standard OS for mobile applications thereby ensuring that the SoMo is compatible with a large number of business applications and giving workers a familiar computing environment. Our mobile handheld computers are easy to customize for a particular application with peripherals and accessories. The SoMo products have an expected product life cycle of three to five years which meets the needs of our customers who are deploying mobile solutions. In order to extend the life of the current product family, we expect to upgrade components used in our SoMo products from time to time in response to decisions by component manufacturers to improve or replace their components. The SoMo's features include wireless LAN and Bluetooth, a fast processor, a large, bright screen display enabling its use outdoors, large amounts of SDRAM and flash memory, an extended battery, programmable action buttons to activate peripheral devices, reinforced CompactFlash and SDIO card slots, and a durable case. The SoMo is available with multiple language support. The SoMo 650 was specifically designed without an integrated mobile phone to serve the market for business mobility applications that are not mobile phone centric such as medication dispensing in the healthcare market or serving tables in the hospitality market, many of which use Bluetooth or wireless LAN connections for data communications. In late 2008, we introduced the SoMo 650 Rx model made with antimicrobial materials added to the case plastics to provide an extra layer of protection to the device to aid against the multiplication and spread of potentially harmful bacteria and microbes found in healthcare environments. We also introduced a SoMo 650 Dx model without Bluetooth or wireless LAN for high security environments. We have also developed accessory products such as our backpack to enable direct connections to mobile phone networks using network phone cards and a durable case to provide additional protection in the event the computer is dropped. In addition, we work with third-party accessory providers, who have qualified to make a number of accessory products that work with the SoMo family of products, including headsets, battery chargers, keyboards, mobile printers, and smartcard readers. Mobile handheld computer products, accessories and related service revenues represented approximately 53% and 47% of our revenues for the three and six months ended June 30, 2010, respectively, compared to 39% and 35%, respectively, of our revenues in the same periods one year ago.

Our ***mobile peripheral products*** consist of data collection products and the related service revenues, connectivity products, and through September 30, 2009, serial interface products, which together represented approximately 35% and 40% of our revenues for the three and six months ended June 30, 2010, compared to 45% and 47% of our revenues in the same periods one year ago.



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Our *data collection products* enable the electronic collection of data from barcodes, radio frequency identification (RFID) tags, or magnetic stripes and consist of:

- barcode scanning products that plug into or connect wirelessly to handheld computers, tablet computers, ultra-mobile personal computers, notebook computers and smartphones that use Windows Mobile, Windows CE, Windows 7/Vista/XP/Embedded, RIM Blackberry, Apple iOS4, Android, or Nokia Symbian for E Series operating systems, and turn these devices into portable barcode scanners and RFID readers that can be used in various retail and industrial workplaces; our cordless hand scanner and cordless ring scanner may also be connected wirelessly to a desktop computer, enabling mobile barcode scanning around a fixed workstation;
- RFID plug-in products that read radio frequency identification tags;
- a combination plug-in barcode scanner and RFID reader; and
- a plug-in magnetic stripe reader.

Our plug-in and Bluetooth cordless data collection products offer a variety of data collection price/performance levels. Our plug-in barcode scanners are available in both CompactFlash and SDIO form factors and we offer standalone cordless hand scanners that use Bluetooth as the connection interface. We also offer a ring scanner worn on the index finger which connects via Bluetooth to computing systems. During 2009 we realigned our data collection barcode scanning products to introduce an entry level laser barcode scanner, upgraded the durability of our ring scanner, and introduced both a CompactFlash and a Bluetooth cordless 2D barcode scanner. 2D scanning enables larger amounts of data to be scanned compared to linear 1D barcodes, and the use of 2D scanning is becoming more widespread. In 2010 we introduced a line of low-cost barcode scanners for the Apple iPad, iPhone and iPod touch.

We have developed extensive barcode scanning and RFID reading software called SocketScan that supports our data collection products, and offer software developer kits that assist third-party developers in integrating our SocketScan software and our hardware products into their applications and solutions.

Our *connectivity products* are connection devices that can be plugged into standard CompactFlash or Secure Digital SDIO expansion slots in handheld computers, tablet computers, ultra mobile personal computers, and notebook computers that use Windows Mobile, Windows XP/Vista, or Windows Tablet operating systems. These products allow users to connect their devices over a cable via Ethernet or telephone to communicate with other networks and devices such as desktop computers, other handheld computers, tablet computers, ultra-mobile personal computers, and notebook computers, smartphones and printers. Our connectivity products include:

- a modem for telephone connections that connects over a cable; and
- an Ethernet card for local area network connections that connects over a cable.

Most users of mobile computing devices now connect to networks wirelessly, and we expect to phase out our connectivity products during 2010.



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Our *serial interface products* enabled the connection of a mobile computer to electronic devices either by way of a plug-in card (one, two or four ports) connecting over cables, or wirelessly over a Bluetooth network. These products were legacy products first introduced in 1993, and we were selling them over the past several years under a SocketSerial brand name and logo. Serial technology has gradually been replaced by alternative technologies such as USB (Universal Serial Bus) and serial product revenue in 2009 had become less than 5 percent of our total quarterly revenues. On September 30, 2009, we sold our serial product technology and business to Quatech, Inc., who continues to offer the line under the SocketSerial brand, and we discontinued distributing the product line in our distribution channels. As a result of this sale there are no revenues related to these products beyond fiscal 2009.

Our ***OEM embedded products*** consist of Bluetooth and wireless LAN modules and plug-in cards used primarily by Original Equipment Manufacturers (OEMs) of industrial grade handheld computers and other devices to build wireless connection functions into their products using the Bluetooth and wireless LAN standards for wireless connectivity. Our plug-in cards and modules using the Bluetooth standard for short-range wireless connectivity include extensive communications software enabling the use of these products. Our Bluetooth products use the Bluetooth 2.1 + EDR standard, reflecting our continued commitment to keep our Bluetooth products current with evolving Bluetooth technology standards. Our plug-in cards for connecting wirelessly to local area networks have been upgraded to use the wireless LAN 802.11 a/b/g Wi-Fi standard, an upgrade from the previous wireless LAN 802.11b/g standard. Our wireless LAN products include extensive communications software with Cisco Compatible Extensions (CCX) designed to make these products easy to use. Our OEM product sales are primarily based on the acceptance of our designs by OEM customers (referred to as design-wins), and the above transitions in our product offerings have resulted in last-time buys by existing customers and reductions in ongoing revenue as we pursue new OEM customers for new design-wins. OEM embedded products represented approximately 12% and 13% of our revenues for the three and six months ended June 30, 2010, compared to 16% and 18% of our revenues for the same periods one year ago.

Our ***SocketCare services*** provide extended warranty and accidental breakage coverage for selected products including our handheld computers and our ring and cordless hand scanners. Premium service purchased at the time of product purchase provides coverage for three years. Service revenues were approximately 5 percent of our revenues in the three and six months ended June 30, 2010. Service revenues were insignificant for the same periods a year ago. Service revenues are included within the related handheld computer and data collection revenues in the table that follows.

Our revenues by product family for the three and six months ended June 30, 2010 and 2009, and the corresponding increase or decrease in revenues for the comparable periods are shown in the following table:

| *(revenues in thousands)* | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| Product family: | 2010 | 2009 | Increase (Decrease) | 2010 | 2009 | Increase (Decrease) |
| Mobile handheld computer products | $ 1,919 | $ 1,616 | 19% | $ 3,532 | $ 3,157 | 12% |
| Mobile peripheral products: | | | | | | |
| Data collection | 1,152 | 1,375 | (16%) | 2,665 | 3,089 | (14%) |
| Connectivity | 132 | 255 | (48%) | 284 | 491 | (42%) |
| Serial interface products | --- | 228 | (100%) | --- | 590 | (100%) |
| OEM embedded products | 451 | 669 | (33%) | 980 | 1,588 | (38%) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total | $ 3,654 | $ 4,143 | (12%) | $ 7,461 | $ 8,915 | (16%) |



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Our mobile handheld computer product revenues in the three and six months ended June 30, 2010 were $1.9 million and $3.5 million, an increase of 16% and 12% compared to revenues of 1.6 million and $3.2 million in the corresponding periods one year ago. The increase in the comparable three and six month periods was due to an increase in mobile handheld computer sales combined with an increase in service revenues due to an increased percentage of customers opting to purchase our SocketCare extended warranty and accidental breakage coverage in conjunction with their deployments.

Our data collection product revenues in the three and six months ended June 30, 2010 were $1.2 million and $2.7 million, a decrease of 16% and 14% compared to revenues of $1.4 million and $3.1 million in the corresponding periods one year ago. Revenue decreases of $0.2 million and $0.4 million in the comparable three and six month periods were due to reduced sales of our SDIO In-Hand Scan card. Declines in sales of our Cordless Ring Scanner in the comparable three months were offset by increases in sales of our primary scanning product, the CompactFlash In-Hand Scan card. Declines in sales of our CompactFlash In-Hand Scan card in the comparable six months were offset by increases in sales of our Cordless Ring Scanner. Sales of our Cordless Hand Scanner were flat in the comparable three and six month periods. Our data collection product revenues continue to be affected by the worldwide economic slowdown as customers defer their deployment decisions.

Our connectivity product revenues in the three and six months ended June 30, 2010 were $132,000 and $284,000, a decrease of 48% and 42% compared to revenues of $255,000 and $491,000 in the corresponding periods one year go. The decline resulted from reduced sales volumes of our modem plug-in products and Ethernet plug-in products due to reduced corporate deployments of these wired connection solutions.

As a result of the sale of our serial product technology and business on September 30, 2009, there are no revenues from serial interface products recognized beyond fiscal 2009. Our serial interface product revenues in the three and six months ended June 30, 2009 were $0.2 million and $0.6 million. The majority of our serial product sales in the three and six month periods in 2009 were from our standard serial PC card products which were primarily sold to connect peripheral devices or other electronic equipment to notebook computers. Remaining serial revenues in the three and six months of 2009 were from sales of our CompactFlash card product and cordless Bluetooth serial adapter.

Our OEM embedded product revenues in the three and six months ended June 30, 2010 were $0.5 million and $1.0 million, a decrease of 33% and 38% compared to revenues of $0.7 million and $1.6 million in the corresponding periods one year ago. The majority of the revenue decreases in the three and six month comparable periods were from reduced sales of our Bluetooth modules to our OEM customers as a result of phasing out older Bluetooth technology and a last-buy purchase program in 2008 through 2009. The majority of these last-buy shipments were concluded by the end of the first quarter of 2009. Additional declines in the comparable three and six month periods in 2010 were from reductions in sales of our wireless LAN plug-in cards.

**Gross Margins**

Our gross margins in the three and six months ended June 30, 2010 were 41% and 42%, compared to margins of 41% and 44% in the corresponding periods one year ago. We generally price our products as a markup from our cost, and we offer discount pricing for higher volume purchases. Sales of our mobile handheld computer comprised a greater portion of our overall revenues in the comparable three and six month periods of 2010 combined with improved margins on this product in the comparable periods. Offsetting these margin improvements in the comparable three months and to a greater amount in the comparable six months were declines in sales of above average margin products and fixed overhead costs which comprised a greater portion of the overall cost of goods sold due to lower revenues in the three and six months of 2010 compared to the same periods one year ago.



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**Research and Development Expense**

Research and development expense for the three months ended June 30, 2010 was $0.6 million, a decrease of 23% compared to research and development expense of $0.7 million in the corresponding period one year ago. Research and development expense for the six months ended June 30, 2010 was $1.2 million, a decline of 17% compared to research and development expense of $1.5 million in the corresponding period one year ago. Approximately 30% and 40% of the reduction in research and development expense in the three and six months ended June 30, 2010 was due to lower personnel costs primarily from salary reductions. Additional reductions in research and development expense in the comparable three and six month periods were from reduced development costs due to a reduction in product development activities, and reduced equipment costs related to the reductions in product development activities. Research and development expense in the third quarter of 2010 is expected to continue at a level similar to the second quarter.

**Sales and Marketing Expense**

Sales and marketing expense for the three months ended June 30, 2010 was $1.0 million, a decrease of 27% compared to $1.3 million in the corresponding period one year ago. Sales and marketing expense for the six month period ended June 30, 2010 was $2.2 million, a decrease of 19% compared to sales and marketing expense of $2.7 million in the corresponding period one year ago. Over half of the reduction in sales and marketing expense in the comparable three and six month periods was due to reduced advertising and promotion expense and travel costs. Additional declines in the comparable periods were primarily from reduced personnel costs. Sales and marketing expense in the third quarter of 2010 is expected to continue at a level similar to the second quarter.

**General and Administrative Expense**

General and administrative expense for the three months ended June 30, 2010 was $492,000, a decrease of 10% compared to general and administrative expense of $549,000 in the corresponding period one year ago. General and administrative expense for the six month period ended June 30, 2010 was $1,153,000, a decrease of 3% compared to general and administrative expense of $1,190,000 in the corresponding period one year ago. Reductions in general and administrative expense in the comparable periods are primarily from salary reductions. General and administrative expense in the third quarter of 2010 is expected to continue at a level similar to the second quarter.

**Amortization of Intangibles**

In July 2004 we acquired a patent which covers the design and functioning of plug-in bar code scanners, bar code imagers, and radio frequency identification products. The patent was purchased for $600,000 and capitalized as an intangible asset. The patent is being amortized on a straight line basis over a ten-year period. Intangible assets of $571,000 remaining from a prior acquisition in 2000 consisted of developed software and technology with estimated lives at the time of acquisition of 8.5 years. Such amount was fully amortized in the first quarter of 2009. Amortization charges for all acquired intangibles for the three and six months ended June 30, 2010 were $15,000 and $30,000, respectively, compared to $15,000 and $47,000, respectively, in the comparable periods one year ago. Future intangible amortization charges are solely related to the patent acquired in 2004, and will be $15,000 per quarter going forward until fully amortized.



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**Interest Income and Expense**

Interest income reflects interest earned on cash balances. Interest income in the three and six months of 2010 and 2009 was immaterial in each of the periods, reflecting low average rates of return on cash balances. Interest expense of $55,000 and $102,000 in the three and six months ended June 30, 2010 compares to interest expense of $52,000 and $117,000 in the comparable periods one year ago. Interest expense is related to interest on amounts drawn on our bank lines of credit and interest on equipment lease financing obligations. Increased interest expense in the second quarter 2010 reflects higher average balances outstanding compared to the same period a year ago. Lower interest expense in the first six months of 2010 is due to lower average balances outstanding on our bank lines of credit compared to the same period one year ago. Interest expense in the third quarter of 2010 is expected to continue at levels similar to the second quarter.

**Taxes**

There were no provisions for federal or state income taxes for the three and six months ended June 30, 2010. We have not generated taxable income in any periods in any jurisdiction, foreign or domestic. The Company has maintained a full valuation allowance for all deferred tax assets. Deferred tax assets and liabilities are determined based on differences between the financial reporting and the tax bases of assets and liabilities, and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. We record a valuation allowance against deferred tax assets when it is more likely than not that such assets will not be realized. There can be no assurance that the deferred tax assets subject to the valuation allowance will be realized.

Deferred tax expense in the three and six months of 2009 was related entirely to the deferred tax liability on the portion of our goodwill amortized for tax purposes. Due to the indefinite characteristic of this deferred tax liability, it could not be offset against deferred tax assets, and therefore resulted in a deferred tax expense of $8,000 and $16,000 in the three and six months of 2009. Goodwill impairment charges recorded as of December 31, 2009 on that portion of our goodwill being amortized for tax purposes, resulted in the reversal of accumulated deferred tax expense and the related deferred tax liability, temporarily eliminating the difference between financial and tax reporting. As a result no deferred tax expense was incurred in the three and six months of 2010.

**Liquidity and Capital Resources**

We were unprofitable in the first half of 2010. We were profitable in the third quarter of 2009 due in part to the gain on the sale of our serial product line assets. We were unprofitable in each of the other three quarters of 2009, and unprofitable for fiscal year 2009. We have a history of operating losses and we may continue to be unprofitable in the foreseeable future. Historically we have financed our operations through the sale of equity securities, equipment financing, and revolving bank lines of credit. Since our inception we have raised approximately $41 million in equity capital to fund our operations.

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As reflected in our Statements of Cash Flows, net cash provided by operating activities was $12,000 in the first half of 2010 compared to cash provided by operating activities of $6,000 in the first half of 2009. We calculate net cash used in or provided by operating activities by reducing our net loss ($1.61 million and $1.66 million in the first half of 2010 and 2009, respectively) by those expenses that did not require the use of cash, and reversing gains or losses that did not generate or use cash. These items consist of stock based compensation expense, depreciation and amortization, amortization of intangible assets, net foreign currency transaction gains, deferred tax expense and change in deferred rent. These amounts totaled $584,000 in the first half of 2010 and $625,000 in the first half of 2009. In addition, we report increases in assets and reductions in liabilities as uses of cash and decreases in assets and increases in liabilities as sources of cash, together referred to as changes in operating assets and liabilities. In the first half of 2010 changes in operating assets and liabilities resulted in a net source of cash of $1,042,000 and were primarily from increases in accounts payable due to timing of payments and reductions in inventory levels as a result of planned reductions from year end levels, partially offset by increases in accounts receivable due to increases in overall shipments in the second quarter 2010 and the timing of those shipments later in the quarter compared to the fourth quarter 2009, and increases in prepaid expenses. In the first half of 2009 changes in operating assets and liabilities resulted in a net source of cash of $1,037,000, and were primarily from reductions in inventory, due primarily to reduced stocking levels of our mobile handheld computer as a result of actively managing overall inventory levels downward from year end levels, and reductions in accounts receivable due to lower shipments in the second quarter of 2009 compared to the fourth quarter of 2008, partially offset by reductions in accounts payable due to reductions in overall expenses and inventory purchases in the second quarter that create those payables, and reductions in deferred income on shipments to distributors due to lower stocking levels of our products in the distribution channel.

Cash used in investing activities was $107,000 in the first half of 2010 compared to $154,000 in the first half of 2009. Reductions in investing activities in the first half of 2010 reflects reductions in equipment and tooling purchases due to fewer projects requiring these expenditures.

Cash provided by financing activities was $147,000 in the first half of 2010 compared to $1,074,000 in the first half of 2009. Financing activities in the first half of 2010 consisted of a net increase in the amounts drawn on our bank lines of credit and proceeds from the exercise of stock options, partially offset by payments on capital leases. Financing activities in the first half of 2009 consisted primarily of net proceeds from the issuance of common stock and warrants, and a net increase in the amounts drawn on our bank lines of credit at the end of the second quarter 2009.

Our cash balances at June 30, 2010 were $2.0 million, including cash of $1.1 million drawn against our bank line of credit. Our cash balances at June 30, 2010, reflect a net increase of $143,000 in amounts drawn on our bank lines of credit and net cash provided of $12,000 from operating activities in the first half of 2010. On March 3, 2010, we agreed with our bank to extend the term of the existing credit facility to March 23, 2011, to amend the terms of the credit facility with a minimum cash deposit requirement of $1.0 million and minimum quarterly revenue requirements for fiscal 2010. We failed to meet the minimum revenue covenant for the quarter ended March 31, 2010, however, on May 12, 2010 the bank agreed to waive the events of default and to replace the quarterly minimum revenue requirements with quarterly net income requirements for the remaining quarters of fiscal 2010. We failed to meet the quarterly net income requirement for the second quarter of 2010, however, on August 5, 2010 the bank agreed to waive the event of default and to revise the minimum quarterly income targets for the third and fourth quarters of 2010 (see "Note 4 - Bank Financing Arrangements" for more information). Our balance sheet at June 30, 2010 has a current ratio (current assets divided by current liabilities) of 0.85 to 1.0, and no material long term debt. We have taken actions to reduce our expenses to align our cost structure with current economic conditions. We have the ability to reduce expenses further if necessary.

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Our continued operating losses, declines in our working capital balances and our failure to achieve the revenue levels required to maintain compliance with our bank line covenants are conditions that raise doubt about the Company's ability to continue as a going concern. Our ability to continue as a going concern is dependent upon our ability to establish profitable operations and to increase our capital. We have been taking steps intended to reduce operating losses and achieve profitability including the introduction of new products, continued close support of our distributors and of our application partners as they establish their mobile applications in key vertical markets, and management of our costs. We believe that we will be able to improve liquidity and secure additional sources of financing by managing our working capital balances, improving our operating results to cash positive levels, and raising additional capital as needed, including development funding from development partners and through the issuance of additional equity securities. There can be no assurance that we will be successful in achieving any of these steps, and there can be no assurance that additional financing will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. Our inability to secure and maintain the necessary liquidity would have a material adverse effect on our financial condition and results of operations. If we are unable to secure the necessary capital for our business, we may need to suspend some or all of our current operations. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of assets and liabilities that may result from the outcome of this uncertainty. If we can return to revenue growth and attain profitability, we anticipate requirements for cash will include funding of higher receivable and inventory balances, and increased expenses, including more employees to support our growth and increases in salaries, benefits, and related support costs for employees.

Our contractual cash obligations at June 30, 2010 are outlined in the table below:

| | | Payments Due by Period | | | |
|---|---|---|---|---|---|
| Contractual Obligations ** ** | Total | Less than 1 year | 1 to 3 years | 4 to 5 years | More than 5 years |
| Capital leases | $ 38,000 | $ 13,000 | $ 25,000 | $ --- | $ --- |
| Operating leases | 784,000 | 388,000 | 396,000 | --- | --- |
| Bank line of credit | 1,145,000 | $ 1,145,000 | --- | --- | --- |
| Unconditional purchase obligations with contract manufacturers | ** ** 2,743,000 | ** ** 2,743,000 | ** ** --- | ** ** --- | ** ** --- |
| Total contractual cash | $ 4,710,000 | $ 4,289,000 | $ 421,000 | $ --- | $ --- |

obligations

**Off-Balance Sheet Arrangements**
We have no off-balance sheet arrangements as defined in Item 303 of Regulation S-K.



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**Recent Accounting Pronouncements**
See Note 2 of "Notes to Condensed Financial Statements" of this Quarterly Report for additional information regarding the status of recent accounting pronouncements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to invested cash and our bank credit line facilities. Our cash is invested in short-term money market investments backed by U.S. Treasury notes and other investments that mature within one year and whose principal is not subject to market rate fluctuations. Accordingly, interest rate declines would adversely affect our interest income but would not affect the carrying value of our cash investments. Based on a sensitivity analysis of our cash investments during the quarter ended June 30, 2010, a decline of 1% in interest rates would not have had a material effect on our quarterly interest income.

Our bank credit line facilities of up to $2.5 million have variable interest rates based upon the greater of either 6% or the lender's prime rate plus 2%, for both the domestic line (up to $1.5 million) and the international line (up to $1.0 million). Accordingly, interest rate increases could increase our interest expense on our outstanding credit line balances. Based on a sensitivity analysis, an increase of 1% in the interest rate would increase our borrowing costs by $15,700 for each $1 million of borrowings against our credit facility, if outstanding for the entire year, or a maximum of $39,300 if we utilized our entire credit line (in cases where the applicable interest rate is greater than 6%). The credit line agreement also specifies a fixed collateral handling fee of 0.62% per month on the full amount of the accounts receivable provided as collateral for the outstanding balances advanced under the credit line. Prior to the third quarter of 2009 the fixed collateral handling fee was 0.7% per month.

**Foreign Currency Risk**

A substantial majority of our revenue, expense and purchasing activities are transacted in U.S. dollars. However, we require our European distributors to purchase our products in Euros, we pay the expenses of our European employees in Euros and British pounds, and we may enter into selected future purchase commitments with foreign suppliers that may be paid in the local currency of the supplier. We hedge a significant portion of our European receivables balance denominated in Euros to reduce the foreign currency risk associated with these assets, and we have not been subject to significant losses from material foreign currency fluctuations. Based on a sensitivity analysis of our net foreign currency denominated assets and expenses at the beginning, during and at the end of the quarter ended June 30, 2010, an adverse change of 10% in exchange rates would have resulted in an increase in our net loss for the second quarter 2010 of approximately $39,400, if left unprotected. For the second quarter of 2010 the total net adjustment for the effects of changes in foreign currency on cash balances, collections, payables, and derivatives was a net loss of $7,100. We will continue to monitor, assess, and mitigate through hedging activities, the risk associated with these exposures.



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**Item 4T. Controls and Procedures**

*Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures*

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control Over Financial Reporting*

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



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**PART II. OTHER INFORMATION**

**Item 1A. Risk Factors**

*The risks described in this Quarterly Report on Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and operating results.*

**Our ability to continue as a going concern is dependent upon our ability to establish profitable operations and to raise additional capital.**

The financial statements in our Annual Report on Form 10-K were prepared on a going concern basis. Our continued operating losses, declines in our working capital balances and our failure to achieve the revenue levels required to maintain compliance with our bank line covenants are conditions that raise doubt about the Company's ability to continue as a going concern. Our ability to continue as a going concern is dependent upon our ability to establish profitable operations and to raise additional financing. We have been taking steps intended to reduce operating losses and achieve profitability including the introduction of new products, continued close support of our distributors and of our application partners as they establish their mobile applications in key vertical markets, and management of our costs. We believe that we will be able to improve our liquidity and secure additional sources of financing by managing our working capital balances, returning to compliance with the bank line covenants as operating results improve, and raising additional capital as needed, including development funding from development partners and the issuance of additional equity securities. Nonetheless, there can be no assurance that we will be successful in achieving any of these steps, and there can be no assurance that additional financing will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. Our inability to secure and maintain the necessary liquidity would have a material adverse effect on our financial condition and results of operations. Our financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of assets and liabilities that may result from the outcome of this uncertainty.

**The global economic financial crisis may continue to have an impact on our business and financial condition in ways that we currently cannot predict, and may further limit our ability to raise additional funds.**

The continued credit crisis and related turmoil in the global financial system may continue to have an impact on our business and our financial condition. We may face significant challenges if economic conditions and conditions in the financial markets do not improve or continue to worsen. In particular, should these conditions cause our revenues to be materially less than forecast, we may find it necessary to initiate further reductions in our expenses and defer additional product development programs. In addition, our ability to access the capital markets and raise funds required for our operations may be severely restricted at a time when we would like, or need, to do so, which could have an adverse effect on our ability to meet our current and future funding requirements and on our flexibility to react to changing economic and business conditions.



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**If we do not maintain compliance with the financial covenants in our bank line, which we are dependent upon as a source of cash for our operations, we may lose our ability to draw upon it and the bank may accelerate our obligation to repay the amounts due.**

We are dependent upon our bank line under loan agreements with Silicon Valley Bank as a source of cash to fund our operations. The availability of the bank line is conditioned upon our complying with the terms of the loan agreements, including meeting certain financial covenants. We have failed to meet certain of these financial covenants since April 2009, and most recently we failed to meet the minimum quarterly net income target for the quarter ended June 30,

2010. Each time the Company has failed to meet its financial covenants under the bank line, Silicon Valley Bank has agreed to forbear from declaring an event of default on the bank line and has agreed to amend the financial covenants. On May 12, 2010, the bank agreed to waive the events of default and agreed to replace the quarterly minimum revenue requirements with quarterly net income requirements for the remaining quarters of fiscal 2010. The Company was not in compliance with the second quarter net income requirement, however, on August 5, 2010 the bank agreed to waive the event of default and to revise the minimum quarterly net income targets for the remaining quarters in 2010. The Company also continues to be required to maintain a cash balance of $1 million in accounts at Silicon Valley Bank. Should we continue to fail to meet any of the financial covenants specified in the credit facility agreement as amended, such failure would constitute an event of default under the terms of the credit agreement, and Silicon Valley Bank may among its remedies, declare all obligations under the credit facility immediately due and payable. Should the bank line become unavailable, we may not be able to find alternative sources of financing, and we may not be able to pay our liabilities and expenses when due, which could require us to suspend some or all of our current operations. It could also adversely affect the willingness of our vendors and employees to continue to work with us. As of June 30, 2010, we had $1,145,053 outstanding under the loan agreements, and we had $1,992,071 of unrestricted cash and cash equivalents at the bank. Our ability to meet the minimum revenue targets and maintain a cash balance at the required minimum level for compliance with the financial covenants is dependent on a number of factors, including our ability to (i) achieve sufficient revenues, (ii) manage our expenses, (iii) manage payment terms with our customers and suppliers, and (iv) manage our inventory levels. We can provide no assurance that we will be able to meet the requirements under any of the financial covenants under the loan agreements.

**We have a history of operating losses and may not achieve ongoing profitability.**

We were unprofitable in the first half of 2010. We were profitable in the third quarter of 2009 due to the one time gain on the sale of our serial product line assets. We were unprofitable in each of other three quarters of 2009, unprofitable for fiscal year 2009 as a whole, and unprofitable in each of the quarters in fiscal years 2008, 2007, and 2006. We were profitable in two quarters in 2005, but unprofitable for fiscal year 2005 as a whole. Fiscal year 2004 was the only profitable year in our history, and only to the extent of $288,000. Prior to 2004, we incurred significant operating losses in each financial period since our inception. To achieve ongoing profitability, we must accomplish numerous objectives, including growth in our business and the development of successful new products. We cannot foresee with any certainty whether we will be able to achieve these objectives in the future. Accordingly, we may not generate sufficient net revenue or manage our expenses sufficiently to achieve ongoing profitability. If we cannot achieve ongoing profitability, we will not be able to support our operations from positive cash flows, and we would use our existing cash and bank line of credit to support operating losses. If we are unable to secure the necessary capital to replace that cash, we may need to suspend some or all of our current operations.



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**We may require additional capital in the future, but that capital may not be available, if at all, on reasonable terms or on terms that would not cause substantial dilution to your stock holdings.**

We may incur operating losses in future quarters and would need to raise capital to fund such losses. Our forecasts are highly dependent on factors beyond our control, including market acceptance of our products and deployments by businesses of applications that use our handheld computers and our data collection products. If capital requirements vary materially from those currently planned, we may require additional capital sooner than expected. There can be no assurance that such capital will be available in sufficient amounts or on terms acceptable to us, if at all.

**Our quarterly operating results may fluctuate in future periods, which could cause our stock price to decline.**

We expect to experience quarterly fluctuations in operating results in the future. We generally ship orders as received, and as a result we may have little backlog. Quarterly revenues and operating results therefore depend on the volume and timing of orders received during the quarter, which are difficult to forecast. Historically, we have often recognized a substantial portion of our revenue in the last month of the quarter. This subjects us to the risk that even modest delays in orders may adversely affect our quarterly operating results. Our operating results may also fluctuate due to factors such as:

- the demand for our products;
- the size and timing of customer orders;
- unanticipated delays or problems in our introduction of new products and product enhancements;
- the introduction of new products and product enhancements by our competitors;
- the timing of the introduction and deployments of new applications that work with our products;
- changes in the revenues attributable to royalties and engineering development services;
- product mix;
- timing of software enhancements;
- changes in the level of operating expenses;
- competitive conditions in the industry including competitive pressures resulting in lower average selling prices;
- timing of distributors' shipments to their customers; and
- general economic conditions and conditions specific to our customers' industries

Because we base our staffing and other operating expenses on anticipated revenues, unanticipated declines or delays in the receipt of orders can cause significant variations in operating results from quarter to quarter. As a result of any of the foregoing factors, or a combination, our results of operations in any given quarter may be below the expectations of public market analysts or investors, in which case the market price of our Common Stock would be adversely affected.



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**If third-parties do not produce and sell innovative products with which our products are compatible, or if our own line of mobile handheld computers is not successful, we may not achieve our sales projections.**

Our success has been dependent upon the ability of third-parties in the mobile computer industry to successfully develop products that include or are compatible with our technology and then to sell these products into the marketplace. Even if we are successful in marketing and selling our new line of mobile handheld computers, our ability to generate increased revenue depends significantly on the commercial success of other parties' Windows mobile products, particularly vertical market software applications for use with our handheld computer and peripheral products, and standard Pocket PC handhelds, phone-integrated devices, tablet computers, and other phone-integrated devices, including those from Palm, Nokia, Blackberry, and Apple, with which our plug-in and wireless peripherals can be used, and the adoption of these mobile computer devices for business use. A number of manufacturers of handheld computers have reduced the number of handheld products they offer, or curtailed development of future handheld computer products. If manufacturers are unable or choose not to ship new products such as Pocket PC and other Windows mobile devices, or experience difficulties with new product transitions that cause delays in the market as we have experienced in the past three years, or if these products fail to achieve or maintain market acceptance, the number of our potential new customers could be reduced and we may not be able to meet our sales expectations.

**If we fail to develop and introduce new products rapidly and successfully, we will not be able to compete effectively, and our ability to generate sufficient revenues will be negatively affected.**

The market for our products is prone to rapidly changing technology, evolving industry standards and short product life cycles. If we are unsuccessful at developing and introducing new products and services on a timely basis that include the latest technologies conforming to the newest standards and that are appealing to end users, we will not be able to compete effectively, and our ability to generate significant revenues will be seriously harmed.

The development of new products and services can be very difficult and requires high levels of innovation. The development process is also lengthy and costly. Short product life cycles expose our products to the risk of obsolescence and require frequent new product introductions. We will be unable to introduce new products and services into the market on a timely basis and compete successfully, if we fail to:

- invest significant resources in research and development, sales and marketing, and customer support;
- identify emerging trends, demands and standards in the field of mobile computing products;
- enhance our products by adding additional features;
- maintain superior or competitive performance in our products; and
- anticipate our end users' needs and technological trends accurately.

We cannot be sure that we will have sufficient resources to make adequate investments in research and development or that we will be able to identify trends or make the technological advances necessary to be competitive.



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**A significant portion of our revenue currently comes from two distributors, and any decrease in revenue from these distributors could harm our business.**

A significant portion of our revenue comes from two distributors, Tech Data Corporation and Ingram Micro Inc., which together represented approximately 29% and 35% of our worldwide revenues in the first six months of 2010 and fiscal year 2009, respectively. We expect that a significant portion of our revenue will continue to depend on sales to Tech Data Corporation and Ingram Micro Inc. Additionally, 16% of our revenue in the second quarter 2010 came from Epocal Inc., an OEM customer. We do not have long-term commitments from Tech Data Corporation or Ingram Micro Inc. to carry our products. Each could choose to stop selling some or all of our products at any time, and each of these companies also carries our competitors' products. If we lose our relationship with Tech Data Corporation or Ingram Micro Inc., we would experience disruption and delays in marketing our products.

**If the market for mobile computers experiences delays, or fails to grow, we may not achieve our sales projections.**

Substantially all of our peripheral products are designed for use with mobile computers, including handhelds, notebooks, tablets, and handhelds with integrated phones. If the mobile computer industry does not grow, if its growth slows, or if product or operating system changeovers by mobile computer manufacturers and partners cause delays in the market, or if the markets for our mobile handheld computers do not grow, or if the impact of the global economic financial crisis continues, we may not achieve our sales projections.

**Our sales will be hurt if the new technologies used in our products do not become widely adopted, or are adopted slower than expected.**

Many of our products use new technologies, such as two dimensional bar code scanning and radio frequency identification, which are not yet widely adopted in the market. If these technologies fail to become widespread, or are adopted slower than expected, our sales will suffer.

**We could face increased competition in the future, which would adversely affect our financial performance.**

The market for mobile handheld computers in which we operate is very competitive. Our future financial performance is contingent on a number of unpredictable factors, including that:

- some of our competitors have greater financial, marketing, and technical resources than we do;
- we periodically face intense price competition, particularly when our competitors have excess inventories and discount their prices to clear their inventories; and
- certain OEMs of personal computers, mobile phones and handheld computers offer products with built-in functions, such as Bluetooth wireless technology, Wi-Fi, or bar code scanning, that compete with our products.

Increased competition could result in price reductions, fewer customer orders, reduced margins, and loss of market share. Our failure to compete successfully against current or future competitors could harm our business, operating results and financial condition.



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**If we do not correctly anticipate demand for our products, our operating results will suffer.**

The demand for our products depends on many factors and is difficult to forecast. We expect that it will become more difficult to forecast demand given current economic conditions, as we introduce and support more products, and as competition in the market for our products intensifies. If demand is lower than forecasted levels, we could have excess production resulting in higher inventories of finished products and components, which could lead to write-downs or write-offs of some or all of the excess inventories, and reductions in our cash balances. Lower than forecasted demand could also result in excess manufacturing capacity at our third-party manufacturers and in our failure to meet minimum purchase commitments, each of which may lower our operating results.

If demand increases beyond forecasted levels, we would have to rapidly increase production at our third-party manufacturers. We depend on suppliers to provide additional volumes of components, and suppliers might not be able to increase production rapidly enough to meet unexpected demand. Even if we were able to procure enough components, our third-party manufacturers might not be able to produce enough of our devices to meet our customer demand. In addition, rapid increases in production levels to meet unanticipated demand could result in higher costs for manufacturing and supply of components and other expenses. These higher costs could lower our profit margins. Further, if production is increased rapidly, manufacturing yields could decline, which may also lower operating results.

**We rely primarily on distributors, resellers, vertical industry partners, and OEMs to sell our products, and our sales would suffer if any of these third-parties stops selling our products effectively.**

Because we sell our products primarily through distributors, resellers, vertical industry partners, and OEMs, we are subject to risks associated with channel distribution, such as risks related to their inventory levels and support for our products. Our distribution channels may build up inventories in anticipation of growth in their sales. If such growth in their sales does not occur as anticipated, the inventory build up could contribute to higher levels of product returns. The lack of sales by any one significant participant in our distribution channels could result in excess inventories and adversely affect our operating results and working capital liquidity.

Our agreements with distributors, resellers, vertical industry partners, and OEMs are generally nonexclusive and may be terminated on short notice by them without cause. Our distributors, resellers, vertical industry partners, and OEMs are not within our control, are not obligated to purchase products from us, and may offer competitive lines of products simultaneously. Sales growth is contingent in part on our ability to enter into additional distribution relationships and expand our sales channels. We cannot predict whether we will be successful in establishing new distribution relationships, expanding our sales channels or maintaining our existing relationships. A failure to enter into new distribution relationships or to expand our sales channels could adversely impact our ability to grow our sales.

We allow our distribution channels to return a portion of their inventory to us for full credit against other purchases. In addition, in the event we reduce our prices, we credit our distributors for the difference between the purchase price of products remaining in their inventory and our reduced price for such products. Actual returns and price protection may adversely affect future operating results and working capital liquidity by reducing our accounts receivable and increasing our inventory balances, particularly since we seek to continually introduce new and enhanced products and are likely to face increasing price competition.



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**We depend on alliances and other business relationships with a small number of third-parties, and a disruption in any one of these relationships would hinder our ability to develop and sell our products.**

We depend on strategic alliances and business relationships with leading participants in various segments of the communications and mobile handheld computer markets to help us develop and market our products. Our strategic partners may revoke their commitment to our products or services at any time in the future or may develop their own competitive products or services. Accordingly, our strategic relationships may not result in sustained business alliances, successful product or service offerings, or the generation of significant revenues. Failure of one or more of such alliances could result in delay or termination of product development projects, failure to win new customers, or loss of confidence by current or potential customers.

We have devoted significant research and development resources to design activities for Windows Mobile, Windows CE, Windows 7/Vista/XP, RIM Blackberry, and Nokia Symbian for E Series operating systems, and more recently, to develop our own family of mobile handheld computers. Such design activities have diverted financial and personnel resources from other development projects. These design activities are not undertaken pursuant to any agreement under which Microsoft, Research In Motion, or Symbian is obligated to continue the collaboration or to support the products produced from the collaboration. Consequently, these organizations may terminate their collaborations with us for a variety of reasons, including our failure to meet agreed-upon standards or for reasons beyond our control, such as changing market conditions, increased competition, discontinued product lines, and product obsolescence.

**Our intellectual property and proprietary rights may be insufficient to protect our competitive position.**

Our business depends on our ability to protect our intellectual property. We rely primarily on patent, copyright, trademark, trade secret laws, and other restrictions on disclosure to protect our proprietary technologies. We cannot be sure that these measures will provide meaningful protection for our proprietary technologies and processes. We cannot be sure that any patent issued to us will be sufficient to protect our technology. The failure of any patents to provide protection to our technology would make it easier for our competitors to offer similar products. In connection with our participation in the development of various industry standards, we may be required to license certain of our patents to other parties, including our competitors, that develop products based upon the adopted standards.

We also generally enter into confidentiality agreements with our employees, distributors, and strategic partners, and generally control access to our documentation and other proprietary information. Despite these precautions, it may be possible for a third-party to copy or otherwise obtain and use our products, services, or technology without authorization, develop similar technology independently, or design around our patents.



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Effective copyright, trademark, and trade secret protection may be unavailable or limited in certain foreign countries. Furthermore, certain of our customers have entered into agreements with us which provide that the customers have the right to use our proprietary technology in the event we default in our contractual obligations, including product supply obligations, and fail to cure the default within a specified period of time.

**We may become subject to claims of intellectual property rights infringement, which could result in substantial liability.**

In the course of operating our business, we may receive claims of intellectual property infringement or otherwise become aware of potentially relevant patents or other intellectual property rights held by other parties. Many of our competitors have large intellectual property portfolios, including patents that may cover technologies that are relevant to our business. In addition, many smaller companies, universities, and individuals have obtained or applied for patents in areas of technology that may relate to our business. The industry is moving towards aggressive assertion, licensing, and litigation of patents and other intellectual property rights. In June 2007, we received a letter from Wi-LAN, Inc., claiming that certain of our wireless LAN products infringe on two U.S. and one Canadian patent held by Wi-LAN, Inc. In October 2007, Wi-LAN, Inc. filed patent infringement lawsuits against a number of companies alleging that those companies infringe the two U.S. patents by manufacturing, using, or offering for sale products with wireless capability compliant with the IEEE 802.11 standards. Wi-LAN, Inc. is asking for money damages and a court order barring the sale of products that use the patented technology. We have not been named in the lawsuit, and we do not plan to make any changes to our current business at this time. Nonetheless, we may be added to the lawsuit in the future, and even if we are not, the outcome of this lawsuit may result in future changes to our business, including potential increased costs for those of our products that make use of the related technology.

If we are unable to obtain and maintain licenses on favorable terms for intellectual property rights required for the manufacture, sale, and use of our products, particularly those products which must comply with industry standard protocols and specifications to be commercially viable, our results of operations or financial condition could be adversely impacted.

In addition to disputes relating to the validity or alleged infringement of other parties' rights, we may become involved in disputes relating to our assertion of our own intellectual property rights. Whether we are defending the assertion of intellectual property rights against us or asserting our intellectual property rights against others, intellectual property litigation can be complex, costly, protracted, and highly disruptive to business operations by diverting the attention and energies of management and key technical personnel. Plaintiffs in intellectual property cases often seek injunctive relief, and the measures of damages in intellectual property litigation are complex and often subjective or uncertain. Thus, any adverse determinations in this type of litigation could subject us to significant liabilities and costs.



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**New industry standards may require us to redesign our products, which could substantially increase our operating expenses.**

Standards for the form and functionality of our products are established by standards committees. These independent committees establish standards, which evolve and change over time, for different categories of our products. We must continue to identify and ensure compliance with evolving industry standards so that our products are interoperable and we remain competitive. Unanticipated changes in industry standards could render our products incompatible with products developed by major hardware manufacturers and software developers. Should any major changes, even if anticipated, occur, we would be required to invest significant time and resources to redesign our products to ensure compliance with relevant standards. If our products are not in compliance with prevailing industry standards for a significant period of time, we would miss opportunities to sell our products for use with new hardware components from mobile computer manufacturers and OEMs, thus affecting our business.

**Undetected flaws and defects in our products may disrupt product sales and result in expensive and time-consuming remedial action.**

Our hardware and software products may contain undetected flaws, which may not be discovered until customers have used the products. From time to time, we may temporarily suspend or delay shipments or divert development resources from other projects to correct a particular product deficiency. Efforts to identify and correct errors and make design changes may be expensive and time consuming. Failure to discover product deficiencies in the future could delay product introductions or shipments, require us to recall previously shipped products to make design modifications, or cause unfavorable publicity, any of which could adversely affect our business and operating results.

**The loss of one or more of our senior personnel could harm our existing business.**

A number of our officers and senior managers have been employed for fifteen to eighteen years by us, including our President, Executive Vice President, Chief Financial Officer, and Chief Technical Officer. Our future success will depend upon the continued service of key officers and senior managers. Competition for officers and senior managers is intense, and there can be no assurance that we will be able to retain our existing senior personnel. The loss of one or more of our officers or key senior managers could adversely affect our ability to compete.

**The expensing of options will continue to reduce our operating results and may continue to cause us to incur net losses such that we may find it necessary to change our business practices to attract and retain employees.**

Historically, we have used stock options as a key component of our employee compensation packages. We believe that stock options provide an incentive to our employees to maximize long-term stockholder value and, through the use of vesting, encourage valued employees to remain with us. The expensing of employee stock options adversely affected our net income and earnings per share in the first half of 2010 and in each of the quarters in fiscal 2009, will continue to adversely affect future quarters, and will make profitability harder to achieve. In addition, we may decide in response to the effects of expensing stock options on our operating results to reduce the number of stock options granted to employees or to grant options to fewer employees. This could adversely affect our ability to retain existing employees and attract qualified candidates, and also could increase the cash compensation we would have to pay to them. Additionally, on July 1, 2010, we completed an exchange offer for certain of our outstanding options. As a result, the total remaining unrecognized compensation costs related to unvested stock options increased by $0.74 million, which will be amortized over the weighted average remaining requisite period of 2.4 years.



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**If we are unable to attract and retain highly skilled sales and marketing and product development personnel, our ability to develop and market new products and product enhancements will be adversely affected.**

We believe our ability to achieve increased revenues and to develop successful new products and product enhancements will depend in part upon our ability to attract and retain highly skilled sales and marketing and product development personnel. Our products involve a number of new and evolving technologies, and we frequently need to apply these technologies to the unique requirements of mobile products. Our personnel must be familiar with both the technologies we support and the unique requirements of the products to which our products connect. Competition for such personnel is intense, and we may not be able to attract and retain such key personnel. In addition, our ability to hire and retain such key personnel will depend upon our ability to raise capital or achieve increased revenue levels to fund the costs associated with such key personnel. Failure to attract and retain such key personnel will adversely affect our ability to develop and market new products and product enhancements.

**We may not be able to collect revenues from customers who experience financial difficulties.**

Our accounts receivable are derived primarily from distributors and OEMs. We perform ongoing credit evaluations of our customers' financial conditions but generally require no collateral from our customers. Reserves are maintained for potential credit losses, and such losses have historically been within such reserves. However, many of our customers may be thinly capitalized and may be prone to failure in adverse market conditions. Although our collection history has been good, from time to time a customer may not pay us because of financial difficulty, bankruptcy or liquidation. The current global financial crisis may have an impact on our customers' ability to pay us in a timely manner, and consequently, we may experience increased difficulty in collecting our accounts receivable, and we may have to increase our reserves in anticipation of increased uncollectible accounts.

**We may be unable to manufacture our products, because we are dependent on a limited number of qualified suppliers for our components.**

Several of our component parts, including our serial interface chip, our Ethernet chip, our bar code scanning modules, and our new line of mobile handheld computers, are produced by one or a limited number of suppliers. Shortages could occur in these essential components due to an interruption of supply or increased demand in the industry. If we are unable to procure certain component parts, we could be required to reduce our operations while we seek alternative sources for these components, which could have a material adverse effect on our financial results. To the extent that we acquire extra inventory stocks to protect against possible shortages, we would be exposed to additional risks associated with holding inventory, such as obsolescence, excess quantities, or loss.



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**Our operating results could be harmed by economic, political, regulatory and other risks associated with export sales.**

Export sales (sales to customers outside the United States) accounted for approximately 24% and 42% of our revenue in the first half of 2010 and fiscal 2009, respectively. Accordingly, our operating results are subject to the risks inherent in export sales, including:

- longer payment cycles;
- unexpected changes in regulatory requirements, import and export restrictions and tariffs;
- difficulties in managing foreign operations;
- the burdens of complying with a variety of foreign laws;
- greater difficulty or delay in accounts receivable collection;
- potentially adverse tax consequences; and
- political and economic instability.

Our export sales are primarily denominated in United States dollars and in Euros for our sales to European distributors. Accordingly, an increase in the value of the United States dollar relative to foreign currencies could make our products more expensive and therefore potentially less competitive in foreign markets. Declines in the value of the Euro relative to the United States dollar may result in foreign currency losses relating to collection of Euro denominated receivables if left unhedged.

**Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, and other events beyond our control.**

Our corporate headquarters is located near an earthquake fault. The potential impact of a major earthquake on our facilities, infrastructure, and overall business is unknown. Additionally, we may experience electrical power blackouts or natural disasters that could interrupt our business. Should a disaster be widespread, such as a major earthquake, or result in the loss of key personnel, we may not be able to implement our disaster recovery plan in a timely manner. Any losses or damages incurred by us as a result of these events could have a material adverse effect on our business.

**Failure to maintain effective internal controls could have a material adverse effect on our business, operating results and stock price.**

We have evaluated and will continue to evaluate our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires an annual management assessment of the design and effectiveness of our internal control over financial reporting. If we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Moreover, effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly.



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**The sale of a substantial number of shares of our Common Stock could cause the market price of our Common Stock to decline.**

Sales of a substantial number of shares of our Common Stock in the public market could adversely affect the market price for our Common Stock. The market price of our Common Stock could also decline if one or more of our significant stockholders decided for any reason to sell substantial amounts of our Common Stock in the public market.

As of July 30, 2010, we had 3,800,339 shares of Common Stock outstanding. Substantially all of these shares are freely tradable in the public market, either without restriction or subject, in some cases, only to S-3 prospectus delivery requirements and, in other cases, only to manner of sale, volume, and notice requirements of Rule 144 under the Securities Act.

As of July 30, 2010, we had 1,270,309 shares of Common Stock subject to outstanding options under our stock option plans, and 94,103 shares of Common Stock were available for future issuance under the plans. We have registered the shares of Common Stock subject to outstanding options and reserved for issuance under our stock option plans. Accordingly, the shares of Common Stock underlying vested options will be eligible for resale in the public market as soon as the options are exercised.

As of July 30, 2010, we had 77,642 shares of Common Stock subject to outstanding warrants issued in a private placement. We have registered the resale of all shares of Common Stock subject to the warrants. Accordingly, the shares of Common Stock underlying these warrants will be eligible for resale in the public market as soon as the warrants are exercised, subject to S-3 prospectus delivery requirements.

**Volatility in the trading price of our Common Stock could negatively impact the price of our Common Stock.**

During the period from January 1, 2009 through July 30, 2010, our Common Stock price fluctuated between a high of $5.44 and a low of $1.32. Following a one-for-ten reverse stock split effected on October 23, 2008, which significantly decreased the Company's share float, we have experienced low trading volumes in our stock, and thus relatively small purchases and sales can have a significant effect on our stock price. The trading price of our Common Stock could be subject to wide fluctuations in response to many factors, some of which are beyond our control, including general economic conditions and the outlook of securities analysts and investors on our industry. In addition, the stock markets in general, and the markets for high technology stocks in particular, have experienced high volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our Common Stock.

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**Item 6. Exhibits**

Exhibits

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SOCKET MOBILE, INC.

Registrant

Date: August 6, 2010

/s/ Kevin J. Mills
Kevin J. Mills
President and Chief Executive Officer
(Duly Authorized Officer and Principal Executive Officer)

Date: August 6, 2010

/s/ David W. Dunlap
David W. Dunlap
Vice President of Finance and Administration and Chief Financial Officer
(Duly Authorized Officer and Principal Financial and Accounting Officer)



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**Index to Exhibits**

| Exhibit Number | Description |
|---|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |