

SOCKET MOBILE, INC.
Form 10-Q
August 13, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2013

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 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

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

The number of shares of Common Stock (\$0.001 par value) outstanding as of August 9, 2013 was 4,867,063 shares.

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Index**PART I****Item 1. Financial Statements**SOCKET MOBILE, INC.
CONDENSED BALANCE SHEETS

	June 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$659,834	\$390,513
Accounts receivable, net	2,469,574	1,509,094
Inventories	1,032,166	941,067
Prepaid expenses and other current assets	119,457	129,434
Total current assets	4,281,031	2,970,108
Property and equipment:		
Machinery and office equipment	1,827,487	1,865,137
Computer equipment	1,146,240	1,204,957
	2,973,727	3,070,094
Accumulated depreciation	(2,677,228)	(2,727,323)
Property and equipment, net	296,499	342,771
Intangible assets, net	60,000	90,000
Goodwill	4,427,000	4,427,000
Other assets	91,518	91,518
Total assets	\$9,156,048	\$7,921,397
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$3,713,192	\$3,771,763
Accrued payroll and related expenses	560,981	478,084
Bank line of credit	1,145,053	810,686
Deferred income on shipments to distributors	1,024,275	854,159
Related party and other short term notes payable	550,000	95,289
Related party convertible notes payable	725,000	750,000
Short term portion of deferred service revenue	198,567	214,537
Short term portion of capital leases and deferred rent	22,555	17,400
Total current liabilities	7,939,623	6,991,918
Long term portion of deferred service revenue	120,794	153,877
Long term portion of capital leases and deferred rent	254,998	227,022

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Deferred income taxes	95,365	79,395
Total liabilities	8,410,780	7,452,212
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.001 par value: Authorized – 20,000,000 shares, Issued and outstanding – 4,867,063 shares at June 30, 2013 and 4,861,063 at December 31, 2012	4,867	4,861
Additional paid-in capital	61,124,271	60,966,505
Accumulated deficit	(60,383,870)	(60,502,181)
Total stockholders' equity	745,268	469,185
Total liabilities and stockholders' equity	\$9,156,048	\$7,921,397

See accompanying notes.

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

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Revenues	\$4,435,431	\$4,037,502	\$8,700,606	\$7,991,261
Cost of revenues	2,630,841	2,539,251	5,187,931	4,969,941
Gross profit	1,804,590	1,498,251	3,512,675	3,021,320
Operating expenses:				
Research and development	594,140	739,860	1,118,890	1,523,905
Sales and marketing	585,088	982,405	1,144,287	1,942,432
General and administrative	448,695	496,541	909,757	1,109,699
Total operating expenses	1,627,923	2,218,806	3,172,934	4,576,036
Operating income (loss)	176,667	(720,555)	339,741	(1,554,716)
Interest expense and other, net	(125,173)	(26,860)	(205,460)	(56,488)
Net income (loss) before income taxes	51,494	(747,415)	134,281	(1,611,204)
Income tax expense	(7,985)	(7,985)	(15,970)	(15,970)
Net income (loss)	\$43,509	\$(755,400)	\$118,311	\$(1,627,174)
Net income (loss) per share:				
Basic	\$0.01	\$(0.16)	\$0.02	\$(0.34)
Diluted	\$0.01	\$(0.16)	\$0.02	\$(0.34)
Weighted average shares outstanding:				
Basic	4,864,953	4,854,179	4,863,008	4,846,197
Diluted	4,987,156	4,854,179	4,946,155	4,846,197

See accompanying notes.

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

	Six Months Ended June 30,	
	2013	2012
Operating activities		
Net income (loss)	\$ 118,311	\$(1,627,174)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Stock-based compensation	151,292	363,460
Depreciation and amortization	132,732	183,303
Deferred income tax expense	15,970	15,970
Changes in operating assets and liabilities:		
Accounts receivable	(960,480)	1,285,061
Inventories	(91,099)	(304,602)
Prepaid expenses and other current assets	9,977	58,608
Other assets	—	(1,442)
Accounts payable	(58,570)	417,088
Accrued payroll and related expenses	82,897	43,383
Deferred income on shipments to distributors	170,116	(402,354)
Deferred service revenue	(49,054)	12,314
Change in deferred rent	28,187	(8,043)
Net cash (used in) provided by operating activities	(449,721)	35,572
Investing activities		
Purchases of equipment	(41,860)	(205,827)
Net cash used in investing activities	(41,860)	(205,827)
Financing activities		
Payments on capital leases	(9,656)	(6,202)
Proceeds from borrowings under bank line of credit agreement	4,422,333	3,896,718
Repayments of borrowings under bank line of credit agreement	(4,087,966)	(4,108,903)
Stock options exercised	6,480	14,015
Warrants exercised	—	29,999
Proceeds from the issuance of related party and other short term notes payable	550,000	—
Repayment of short term note payable	(95,289)	—
Redemption of related party convertible note payable	(25,000)	—
Net cash provided by (used in) financing activities	760,902	(174,373)
Net increase (decrease) in cash and cash equivalents	269,321	(344,628)
Cash and cash equivalents at beginning of period	390,513	957,022

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Cash and cash equivalents at end of period	\$659,834	\$612,394
Supplemental cash flow information		
Cash paid for interest	\$163,998	\$61,319

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, 2012. The financial statements in the Company’s annual report on Form 10-K were prepared on a going concern basis.

Liquidity and Going Concern

The Company was profitable in each of the first two quarters in 2013, but only to the extent of \$118,311 in total. In the year ended December 31, 2012, the Company incurred a net loss of \$3,298,082. As of June 30, 2013, the Company has an accumulated deficit of \$60,383,870. The Company’s cash balances at June 30, 2013 were \$659,834, including \$1,145,053 advanced on its bank lines of credit. At June 30, 2013, the Company had additional unused borrowing capacity of approximately \$410,000 on its bank lines of credit. The Company’s balance sheet at June 30, 2013 has a current ratio (current assets divided by current liabilities) of 0.5 to 1.0, and a working capital deficit of \$3,658,592 (current assets less current liabilities). These circumstances raise substantial doubt about the Company’s ability to continue as a going concern.

In the last three years the Company has taken actions to reduce its expenses and to align its cost structure with economic conditions. The Company has the ability to further reduce expenses if necessary. Steps taken by the

Company to reduce operating losses and achieve profitability include reduction of headcount to manage payroll costs, the introduction of new products, and continued close support of the Company's distributors and application development partners as they establish their mobile applications in key vertical markets. The Company completed additional financing during the first quarter of 2013 (see "NOTE 5 — Related Party and Other Short Term Notes Payable" for more information). The Company believes it will be able to further improve its liquidity and secure additional sources of financing by managing its working capital balances, use of its bank lines of credit, and raising additional capital as needed including development funding from development partners and the issuance of additional equity securities. 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. The Company's bank lines of credit may be terminated by the bank or by the Company at any time, and expire on October 11, 2013 unless renewed (see "NOTE 6 — Bank Financing Arrangements"). If the Company cannot maintain profitability, it will not be able to support its operations from positive cash flows, and would use its existing cash to support operating losses. If the Company is unable to secure the necessary capital for its business, it may need to suspend some or all of its current operations.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

If the Company can maintain revenue growth and attain ongoing profitability, it 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 our growth and increases in salaries, benefits, and related support costs for employees.

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 the Company's inability to continue as a going concern.

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.

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, 2013 and December 31, 2012, 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.

NOTE 3 — Inventories

Inventories consist principally of raw materials and sub-assemblies, which are stated at the lower of cost (first-in, first-out) or market.

	June 30, 2013	December 31, 2012
Raw materials and sub-assemblies	\$957,083	\$921,677
Finished goods	75,083	19,390
	\$1,032,166	\$941,067

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 4 — Related Party Convertible Notes Payable

On August 1, 2012, the Company issued to select officers and directors of the Company \$400,000 in convertible subordinated notes. The net proceeds of \$400,000 are being used for working capital purposes. The notes have a term of two years that accrue interest at 8% per annum and mature on August 1, 2014. Accrued interest is payable upon redemption. The notes and accrued interest may be redeemed after six months. The notes are convertible into common stock at the option of the holder at \$2.44 per share as long as warrants previously issued to Hudson Bay Capital Master Fund are outstanding, or at \$2.00 per share if the Hudson Bay warrants are no longer outstanding. The Hudson Bay Capital Master Fund warrants expire on May 20, 2016. The notes are secured by all of the assets of the Company and are subordinated to amounts outstanding under the Company's working capital bank line of credit with Silicon Valley Bank. During the quarter ended June 30, 2013, \$25,000 of these convertible notes were redeemed, resulting in a balance of \$375,000 outstanding at June 30, 2013.

On November 5, 2012, the Company's Board of Directors approved the issue of up to \$350,000 in convertible subordinated notes to its Chairman to be used for working capital purposes. At various dates beginning November 7, 2012 through December 12, 2012 the Company issued in total \$350,000 of such notes to its Chairman. The notes are identical to the notes issued on August 1, 2012 as described above. The notes are two-year notes that accrue interest at 8% and mature on August 1, 2014. Accrued interest is payable upon redemption. The notes and accrued interest may be redeemed after six months. The notes are convertible into common stock at the option of the holder at \$2.44 per share as long as warrants previously issued to Hudson Bay Capital Master Fund are outstanding, or at the fair market value per share at the time each note was issued if the Hudson Bay Warrants are no longer outstanding. The weighted average fair market value conversion price is \$1.04 per share. The notes are secured by all of the assets of the Company and are subordinated to amounts outstanding under the Company's working capital bank line of credit with Silicon Valley Bank.

Accrued interest expense at June 30, 2013 related to all convertible subordinated notes outstanding was \$44,734.

NOTE 5 — Related Party and Other Short Term Notes Payable

On January 31, 2013, the Company's Board of Directors approved a subordinated line of credit of up to \$1,000,000. The term of the credit agreement is six months ending August 1, 2013, unless extended by both parties. Interest accrues at the rate of 1% per week and is to be paid weekly. Balances outstanding under the line of credit are to be repaid in full on or before the maturity date. Balances under the line of credit are secured by all of the assets of the Company and are subordinated to amounts outstanding under the Company's working capital bank line of credit with Silicon Valley Bank. Additionally, the Company's Board of Directors approved an advance under the line by the Company's Chairman of up to \$550,000. The funds raised are being used for working capital purposes. In the first quarter of 2013, the Company raised a total of \$550,000 in funds under such terms, of which \$300,000 and \$50,000 are from the Company's Chairman and Chief Executive Officer, respectively, and \$200,000 from other sources. Interest expense in the three and six months ended June 30, 2013 related to the line of credit was \$71,500 and \$106,786, respectively. In July 2013, the credit agreements were amended to extend the maturity date to December 1, 2013.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

On August 31, 2012, the Company issued a promissory note to a lender for \$400,000. The promissory note matured on January 31, 2013 and had an implied monthly compounded interest rate of 9.7%. The Company was required to pay a total of \$528,000 principal and interest on the promissory note in weekly installments of approximately \$25,000. The note was secured by substantially all the Company's assets including intangible assets. This promissory note was subordinated to the bank financing arrangement as described in Note 6. During the first quarter 2013, the Company completed the repayment of the remaining principle and interest in the amounts of \$95,289, and \$7,711, respectively.

NOTE 6 — Bank Financing Arrangements

On October 12, 2011, the Company entered into a new credit facility agreement with Silicon Valley Bank (the "Bank"). This credit facility 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. Advances against the domestic line are calculated at 80% of qualified receivables except for receivables from distributors which are calculated at 60%. Advances against the international line are calculated at 90% against qualified hedged receivables and 70% against qualified non-hedged receivables and receivables from distributors. Borrowings under the lines bear an annual interest rate equal to the greater of (i) the Bank's prime rate plus 1%, or (ii) 5%. The rate in effect has been 5% to date. There is also a collateral handling fee of 0.25% per month of the financed receivable balance outstanding. The applicable interest and fees are calculated based on the full amount of the accounts receivable provided as collateral for the actual amounts borrowed. The effective rate (interest plus all applicable fees) on actual cash advances in the first half of 2013 was 13.7% per annum. The credit facility agreement expires on October 12, 2013 unless renewed. The agreement may be terminated by the Company or by the Bank at any time. Upon such termination, the Bank would no longer make advances under the credit agreement and outstanding advances would be repaid as receivables are collected. All advances are at the Bank's discretion and the Bank is not obligated to make advances. In addition, the Company must maintain a minimum liquidity ratio at all times based on quick assets (unrestricted cash equivalents at the Bank plus net eligible accounts receivable) to outstanding obligations to the Bank of not less than 2.0 to 1.0. The outstanding amounts borrowed under the domestic and international lines at June 30, 2013 were \$792,692 and \$352,361, respectively, and the full amounts of accounts receivable provided as collateral were \$1,253,446, and \$499,128, respectively. The outstanding amounts borrowed under the domestic and international lines at December 31, 2012 were \$479,647 and \$331,039, respectively, and the full amounts of accounts receivable provided as collateral were \$777,987, and \$464,731, respectively. Interest expense on the amounts drawn during the three and six months ended June 30, 2013 was \$32,800 and \$59,827, respectively. Accrued interest related to the amounts outstanding at June 30, 2013 and December 31, 2012 was \$9,656 and \$7,237, respectively.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 7 — 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 or other mobile device such as a smartphone or tablet, some with data collection peripherals, and third-party vertical applications software. The Company markets its products in the United States and foreign countries through its sales personnel and distributors. Revenues for the geographic areas were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Revenues:				
United States	\$3,226,442	\$2,255,519	\$5,804,072	\$4,478,578
Europe	611,185	1,160,557	1,484,332	2,390,052
Asia and rest of world	597,804	621,426	1,412,202	1,122,631
Total revenues	\$4,435,431	\$4,037,502	\$8,700,606	\$7,991,261

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

Customers who accounted for at least 10% of the Company's total revenues in the three and six month periods ended June 30, 2013 and 2012 were as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Ingram Micro, Inc.	19%	19%	18%	17%
ScanSource, Inc.	21%	18%	20%	20%
BlueStar, Inc.	15%	*	12%	*
CF Company	*	*	11%	*

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

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

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 liquidity ratio of the bank line agreement. 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. Customers who accounted for at least 10% of the Company's accounts receivable balances at June 30, 2013 and December 31, 2012 were as follows:

	June 30, 2013	December 31, 2012	
Company A	29%	28	%
Company B	19%	12	%
Company C	13%	16	%
Company D	*	11	%
Company E	*	12	%

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

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 increased demand, or to an interruption of supply. Suppliers may choose to restrict credit terms or require advance payments causing delays in the procurement of essential materials. If the Company were unable to procure certain of such materials, it could have a material adverse effect upon its results. At June 30, 2013 and December 31, 2012, 32% in each of the periods of the Company's accounts payable balances were

concentrated in a single supplier. For the three months ended June 30, 2013, this and another supplier accounted for 48% of the inventory purchases.

NOTE 8 — 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 for the three and six months ended June 30, 2013 was \$57,557 and \$151,292, respectively. Total stock-based compensation expense for the three and six months ended June 30, 2012 was \$185,527 and \$363,460, respectively. In the three and six months ended June 30, 2013, 189,700 and 194,500, stock options were granted, respectively, at weighted average per share fair values estimated at \$0.73 and \$0.72, respectively.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 9 — Net Income (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		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Numerator:				
Net income (loss)	\$43,509	\$(755,400)	\$118,311	\$(1,627,174)
Denominator:				
Weighted average common shares outstanding used in computing net income (loss) per share:				
Basic	4,864,953	4,854,179	4,863,008	4,846,197
Diluted	4,987,156	4,854,179	4,946,155	4,846,197
Net income (loss) per share:				
Basic	\$0.01	\$(0.16)	\$0.02	\$(0.34)
Diluted	\$0.01	\$(0.16)	\$0.02	\$(0.34)

For the three and six months ended June 30, 2012, 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 2,207,454 shares of common stock at June 30, 2012, have been omitted from the net loss per share calculation.

NOTE 10 — Taxes

Income tax expense during the three and six months ended June 30, 2013 and 2012, and the deferred income tax amounts shown on the Company's Condensed Balance Sheets, is 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 cannot be offset against deferred tax assets. As a result, the Company recognized deferred tax expense of \$7,985 and \$15,970 in each of the three and six month periods ended June 30, 2013 and 2012.

At December 31, 2012, the Company has an unrecognized tax benefit of approximately \$633,000, which did not change significantly during the three and six months ended June 30, 2013. Future changes in the unrecognized tax benefit are unlikely to have an impact on the effective tax rate due to the full valuation allowance recorded on the Company's deferred tax assets, as realization of the deferred tax assets is dependent upon future taxable income.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 11 — Commitments and Contingencies*Operating Lease*

The Company operates its headquarters under a non-cancelable operating lease which provides for the lease by the Company of approximately 37,100 square feet of space in Newark, California. The base rent under the facilities lease was \$29,705 per month for the period from July 1, 2012 through June 30, 2013. The base rent increases annually thereafter at a rate of four percent per year for the remaining five years ending June 30, 2018. On December 28, 2012, the Company further amended its commercial building lease agreement to extend the term of the lease to June 30, 2021. The Company's base rent under the amendment shall be \$37,586 per month for the period from July 1, 2018 through June 30, 2019. The base rent increases annually thereafter at a rate of four percent per year for the remaining three years ending June 30, 2022.

Future minimum lease payments under all operating leases are as shown below:

Annual minimum payments:	Amount
2013 (July 1, 2013 to December 31, 2013)	\$ 185,358
2014	378,130
2015	393,255
2016	408,986
2017 to 2022	2,557,481
Total minimum payments	\$3,923,210

Rental expense under all operating leases for the three and six month periods ended June 30, 2013 was \$107,093 and \$213,850, respectively. Rental expense under all operating leases for the three and six month periods ended June 30, 2012 was \$92,419 and \$183,629, respectively. The amount of deferred rent at June 30, 2013 and December 31, 2012 was \$207,715 and \$179,527, respectively.

Capital Lease Obligations

The Company leases certain of its equipment under capital leases. The leases are collateralized by the underlying assets. At June 30, 2013 and December 31, 2012, property and equipment with a cost of \$87,946 and \$73,275, respectively, were subject to such financing arrangements. Related accumulated amortization at June 30, 2013 and December 31, 2012, amounted to \$16,971 and \$8,380, respectively.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

Future minimum payments under capital lease and equipment financing arrangements as of June 30, 2013, are as follows:

Annual minimum payments:	Amount
2013 (July 1, 2013 to December 31, 2013)	\$12,758
2014	25,516
2015	25,516
2016	11,442
Total minimum payments	75,232
Less amount representing interest	(5,394)
Present value of net minimum payments	69,838
Short term portion of capital leases	(22,555)
Long term portion of capital leases	\$47,283

Legal Matters

The Company is subject to disputes, claims, requests for indemnification and lawsuits arising in the ordinary course of business. In April 2013, a lawsuit was filed in the State of Delaware against the Company by Wyncomm LLC claiming infringement of a patent involving WiFi technology. They have filed similar lawsuits against a number of other companies. In August 2013, the Company reached a settlement agreement with Wyncomm whereby the Company, its suppliers and customers are granted an irrevocable, worldwide, non-exclusive and non-transferable license to the underlying patent held by Wyncomm. The settlement is not material to the Company's operations. Under the indemnification provisions of the Company's customer agreements, the Company routinely agrees to indemnify and defend its customers against infringement of any patent, trademark, copyright, trade secrets, or other intellectual property rights arising from customers' legal use of the Company's products or services. The exposure to the Company under these indemnification provisions is generally limited to the total amount paid for the indemnified products. However, certain indemnification provisions potentially expose the Company to losses in excess of the aggregate amount received from the customer. To date, there have been no claims against the Company by its customers pertaining to such indemnification provisions, and no amounts have been recorded.

Index**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 product components and 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 and barcode scanners; 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 "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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The Company

We are a producer of mobile handheld computers and barcode scanning products serving the business mobility markets. Our products are designed for the mobile worker, and run or enhance mobile applications that enable the accessing, collection and processing of data by workers while mobile. We offer a family of cordless barcode scanning products that connect over Bluetooth with smartphones, tablets and computers running operating systems from Apple (iOS), Google (Android), Blackberry and Microsoft (Windows/Windows Mobile). Our cordless barcode scanners include two dimensional (2D) and linear (1D) barcode scanners in both durable and ruggedized cases. We also offer wearable cordless ring scanners for hands free barcode scanning. We offer a family of handheld computer products in standard or antimicrobial cases running the Windows Mobile operating system. Handheld computer accessories include plug-in 1D and 2D barcode scanners, cradles, radio frequency identification (RFID) readers and magnetic stripe readers. Our handheld computers are designed with wireless LAN (802.11 b/g/n) and Bluetooth connectivity for use with applications that do not require phones. We also offer handheld computers without wireless connectivity for secure environments. Our newest family of handheld computers, SoMo Model 655, commenced sales in June 2012, replacing the SoMo650 introduced in 2007. Our SoMo655 handheld computers run Microsoft's Windows Embedded Handheld operating system 6.5. Microsoft recently announced their commitment to continue supporting this operating system through the beginning of 2020. Extended warranty programs are available for all of our barcode scanning products and handheld computer products.

We strongly support software application developers offering or developing software applications for use with our family of barcode scanners and our mobile handheld computer. For our family of barcode scanners we offer a software developers kit ("SDK") with our own set of Application Program Interfaces (APIs) which enable developers to easily integrate our scanners into their applications, as well as control data captured by the scanners being delivered to software applications. The market segments with the highest level of adoption of our mobile barcode scanners are retail point of sale, healthcare, and commercial services. For our mobile handheld computer we offer to application developers our SDK enabling greater control over the hardware. Healthcare and hospitality are two of the primary areas of focus for software application developers who have developed applications for use on our handheld computers, and a significant portion of our handheld computer sales now come from organizations within these two market segments. Other vertical markets benefiting from mobile solutions include inspections, automotive, government and education.

We believe growth in the mobile workforce and pervasive use of the mobile Internet are resulting from technical advances in mobile technologies and cost reductions in mobile devices, building a growing demand for our products. Our products are designed to address the growing need for mobile computing and barcode scanning by today's mobile workers to access business data or collect and process data while mobile, thereby enhancing their productivity and allowing them to exploit time sensitive opportunities and improve customer satisfaction.

We subcontract the manufacturing of all of our products to independent third-party contract manufacturers located in the U.S., Mexico, China and Taiwan, who have the equipment, know-how and capacity to manufacture products to our specifications. Our cordless handheld barcode scanners and related accessories, and our mobile handheld

computers and related accessories 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.

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Liquidity and Going Concern

We were profitable in each of the first two quarters in 2013, but only to the extent of \$118,000 in total. We incurred a net loss of \$3.3 million in fiscal year 2012. As of June 30, 2013, we have an accumulated deficit of \$60.4 million. Our cash balances at June 30, 2013 were \$0.7 million, including \$1.1 million advanced on our bank lines of credit. At June 30, 2013, we had additional unused borrowing capacity of approximately \$0.4 million on our bank lines of credit. Our balance sheet at June 30, 2013 has a current ratio (current assets divided by current liabilities) of 0.5 to 1.0, and a working capital deficit of \$3.7 million (current assets less current liabilities). These circumstances raise substantial doubt about our ability to continue as a going concern.

In the last three years we have taken actions to reduce our expenses and to align our cost structure with economic conditions. We have the ability to further reduce expenses if necessary. Steps taken by us to reduce operating losses and achieve profitability include reduction of headcount to manage payroll costs, the introduction of new products, and continued close support of our distributors and our application development partners as they establish their mobile applications in key vertical markets. We completed additional financing in the first quarter of 2013 (see “NOTE 5 — Related Party and Other Short Term Notes Payable” for more information). We believe that we will be able to further improve our liquidity and secure additional sources of financing by managing our working capital balances, use of our bank lines of credit, and raising additional capital as needed including development funding from development partners and the issuance of additional equity securities. 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. Our bank line of credit may be terminated by the bank or by us at any time, and expires on October 11, 2013 unless renewed (see “NOTE 6 — Bank Financing Arrangements”). If we cannot maintain profitability, we will not be able to support our operations from positive cash flows, and we would use our existing cash to support operating losses. If we are unable to secure the necessary capital for our business, we may need to suspend some or all of our current operations.

If we can maintain revenue growth and attain ongoing profitability, we anticipate 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 our growth and increases in salaries, benefits, and related support costs for employees.

The accompanying financial statements have been prepared assuming that we 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 our inability to continue as a going concern.

Products

We classify our primary products into two broad product families:

- Cordless barcode scanning products and related accessories and service;
- Mobile handheld computer products and related accessories and service;

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Our ***cordless barcode scanning products*** are designed to enable the electronic collection of data from 2D (imager) and 1D (laser and linear imager) barcodes. The products are designed as durable devices for commercial use enabling a wide variety of accurate and rapid scans over a full work shift. All of the products come with SocketScan software that allows data to be edited when scanned and provides an easy-to-use interface for developers to build barcode scanning into their applications using our Software Developer Kit. Data may also be scanned without editing where SocketScan has not been integrated into an application. Products are available in both standard and antimicrobial cases.

Our cordless barcode scanning products consist of:

Cordless Hand Scanners: two dimensional (2D) and linear (1D) scanning used primarily with smartphones, tablets and other mobile computers

· Wearable cordless ring scanner for industrial applications needing two hands free

Our ***Cordless Hand Scanners*** use Bluetooth technology as the connection interface. The scanners are available with two dimensional (2D) imagers and one dimensional lasers/imagers (1D) linear scanning engines. The scanners are available in standard cases or antimicrobial cases. The Cordless Hand Scanners are lightweight, ergonomically designed for ease of use and rapid repetitive scanning and are durable, lightweight and compact. Our SocketScan software enables the use of our Cordless Hand Scanners with a wide variety of smartphones, tablets and mobile computers using operating systems from Apple (iOS), Google (Android), Blackberry and Microsoft (Windows/Windows Mobile).

Our ***ring scanner*** is an industrial strength barcode scanner that is worn on the index finger and connects via Bluetooth to mobile or fixed data collection computing devices. The device enables a worker to scan while having two hands available and is designed for applications such as warehousing and pick-and-pack operations.

Our ***mobile handheld computer products*** are designed to be durable, lightweight and dependable devices which meet the requirements of the healthcare, hospitality and other 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 featured the Microsoft Windows Mobile operating system, Version 6. We introduced the SoMo655 as a replacement for the SoMo650 in June 2012 running Microsoft's Windows Embedded Handheld 6.5 operating system. Windows Embedded Handheld is the industry standard OS for mobile handheld computer applications thereby ensuring that the SoMo is compatible with a large number of business applications, giving workers and businesses a familiar computing environment. Our mobile handheld computers are easy to customize for a particular application with peripherals and accessories. The SoMo products are designed with an expected product life cycle of five years which addresses the needs of our customers who are deploying mobile

solutions. Microsoft recently announced their commitment to support the Windows Embedded Handheld 6.5 operating system until early 2020.

The SoMo 655's features include wireless LAN (802.11 b/g/n) and Bluetooth, a faster processor, a large, bright screen display enabling its use outdoors, larger amounts of SDRAM and flash memory (4 GB), an extended battery, programmable action buttons to activate peripheral devices, reinforced CompactFlash and microSD card slots, and a durable case. The SoMo is available with multiple language support. The SoMo family of handheld computers 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 tableside ordering in the hospitality market, most of which use Bluetooth or wireless LAN connections for data communications. Additionally, we offer a software developer kit which enables greater control by developers over the SoMo655 handheld computer.

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The SoMo family of products includes a standard model SoMo655, a model SoMo655RX with an antimicrobial case 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, and a model SoMo650DX without Bluetooth or Wireless LAN for use in secure environments. Accessories and peripherals include a charger, stylus, rugged protective case, CompactFlash plug-in barcode 1D and 2D scanners, RFID readers and magnetic stripe readers.

Our *SocketCare program* provides extended warranty and accidental breakage coverage for our handheld computers and our barcode scanners. Premium service purchased at the time of product purchase provides coverage for up to three years. We will also repair products that are out of warranty for a fee. Service revenues are included in the revenue totals for handheld computer and data collection products as described in the table that follows further below.

Other revenues include our OEM and embedded products, and our connectivity products. Our OEM and embedded products consist of our Bluetooth and wireless LAN plug-in cards used primarily by Original Equipment Manufacturers (OEMs) of electronic products to build wireless connection functions into their products using the Bluetooth and wireless LAN standards for wireless connectivity. Our connectivity products consist of our legacy products including modem and Ethernet plug-in cards, and accessory products including adapters and cables.

Revenues

Total revenues for the three and six months ended June 30 2013 were \$4.4 million and \$8.7 million, respectively, an increase of 10% and 9% from revenues of \$4.0 million and \$8.0 million, respectively, in the comparable periods one year ago. Our revenues are classified into two primary product families. Additionally, we sell OEM embedded products to third parties, and we continue to carry legacy plug-in connectivity products. Our product revenues and the corresponding increase or decrease in revenues for the comparable three and six month periods are shown in the following table:

(revenues in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2013	June 30, 2012	Increase (Decrease)	June 30, 2013	June 30, 2012	Increase (Decrease)
Product family:						
Cordless barcode scanning and related products and service	\$2,640	\$1,593	66 %	\$5,070	\$3,107	63 %
	1,666	2,269	(27 %)	3,114	4,612	(32 %)

Mobile handheld computer and related products and service

Other	129	176	(27 %)	516	272	90 %
Total	\$4,435	\$4,038	10 %	\$8,700	\$7,991	9 %

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Our *cordless barcode scanning and related products and service* revenues in the three and six months ended June 30, 2013 were \$2.6 million and \$5.1 million, an increase of 66% and 63% compared to revenues of \$1.6 million and \$3.1 million in the comparable periods one year ago. Revenue increases of \$0.9 million and \$1.8 million in the comparable three and six month periods were from increased sales volumes of our new entry level Apple certified cordless handheld barcode scanning product model 7Ci. Slight revenue increases due to increased sales volumes of our Apple certified imager based cordless handheld scanner model 7Xi, and slight increases in sales of our other cordless handheld scanning models, were partially offset by declines in sales of our cordless ring scanner due to lower sales volumes in the comparable three and six month periods.

Our *mobile handheld computer and related products and service* revenues in the three and six months ended June 30, 2013 were \$1.7 million and \$3.1 million, a decrease of 27% and 32% compared to revenues of \$2.3 million and \$4.6 million in the corresponding periods one year ago. Mobile handheld computer revenues (excluding revenues from the related plug-in products, accessories, and services) declined by \$0.7 million and \$1.5 million in the three and six month comparable periods reflecting lower overall sales volumes of our next generation SoMo 655 models compared to our previous SoMo 650 models in effect in the same periods one year ago. We commenced shipping our next generation mobile handheld computers into our distribution channel beginning in June 2012. Product transitions such as this tend to slow customer deployments because of the time needed by customers and integrators to evaluate and qualify the new models with their applications. The transition to the new models of our standard mobile handheld computer was substantially completed in the third quarter 2012 with the last shipments of available units of the older models. Additionally, sales of our new SoMo 655 models have been affected by the uncertainty surrounding Microsoft's support of the Windows Embedded Handheld 6.5 operating system, which they recently clarified by their announced commitment to this operating system until early 2020, as discussed previously. Remaining declines in the comparable three and six month periods were from declines in sales of our companion plug-in data collection products due primarily to lower sales volumes of CompactFlash plug-in barcode scanners, and from reduced sales of SocketCare services and warranty services, reflective of the overall lower sales volumes of our mobile handheld computers in the comparable three and six month periods in 2013 compared to 2012, as described previously. Partially offsetting these declines in companion plug-in sales and SocketCare sales in the comparable three month periods, and fully offsetting these declines in the comparable six month periods, were increased sales of our mobile handheld computer related accessories.

Service revenues were \$142,000 or 3% of our revenues in the second quarter 2013 compared to \$0.2 million or 5% of our revenues in same quarter one year ago. Service revenues were \$0.3 million or 4% of our revenues in the first half of 2013 compared to \$0.4 million or 5% of our revenues in same period one year ago. Declines in service revenues in the three and six month periods ended June 30, 2013, are due to declines in SocketCare service revenues reflecting declines in unit sales of our mobile handheld computers compared to the same periods one year ago, as described previously, and declines in the levels of general out-of-warranty service revenues. Service revenues have been allocated to the respective products serviced in the table above.

Other revenues in the second quarter 2013 were \$129,000, a decrease of 27% compared to revenues of \$176,000 in the comparable period one year ago. Other revenues in the second half of 2013 were \$0.5 million, an increase of 90%

compared to revenues of \$0.3 million in the comparable period one year ago. Revenues in the three and six month periods in 2013 were primarily related one-time buys of legacy products including our Bluetooth modules and wireless LAN plug-in cards primarily within the first quarter 2013 by OEM customers, and to a lesser extent in the second quarter 2013.

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Gross Margins

Our gross margins in the three and six months ended June 30, 2013 were 41% and 40%, compared to margins of 37% and 38%, 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. Improvements in overall margins in three and six months ended June 30, 2012 are due primarily to a change in mix of products sold favoring a greater proportion of sales of our cordless handheld barcode scanner models which overall have slightly higher than average margins, and a lower proportion of sales of our mobile handheld computers which have slightly lower than average margins. Additional margin improvements were due to reduced overhead costs in the second quarter and first half of 2013 compared to the same periods last year.

Research and Development Expense

Research and development expense in the three months ended June 30, 2013 was \$0.6 million, a decrease of 20% compared to \$0.7 million in the corresponding period one year ago. Research and development expense for the six months ended June 30, 2013 was \$1.1 million, a decrease of 27% compared to research and development expense of \$1.5 million in the corresponding period one year ago. Reductions in the level of research and development expense in the three and six month comparable periods were primarily due to reductions in personnel costs as a result of compensation expense reduction programs initiated in late 2012 and in effect through the first quarter 2013, declines in headcount levels in the comparable periods, and from lower levels of outside development activities in the first two quarters of 2013 compared to 2012 reflecting in 2012 the completion of the development of our next generation SoMo series of mobile handheld computers. Research and development expense in the third quarter of 2013 is expected to increase slightly from second quarter levels.

Sales and Marketing Expense

Sales and marketing expense for the three months ended June 30, 2013 was \$0.6 million, a decrease of 40% compared to sales and marketing expense of \$1.0 million in the corresponding period one year ago. Sales and marketing expense for the six month period ended June 30, 2013 was \$1.1 million, a decrease of 41% compared to sales and marketing expense of \$1.9 million in the corresponding period one year ago. Decreases in sales and marketing expense in the three and six months ended June 30, 2013 of \$0.3 million and \$0.6 million, were due to declines in personnel costs due primarily to lower overall comparable headcount. Remaining declines in the comparable three and six month comparable periods were due to declines in advertising and promotional costs, and decreased use of outside services. Sales and marketing expense in the third quarter of 2013 is expected to increase slightly from second quarter levels.

General and Administrative Expense

General and administrative expense for the three months ended June 30, 2013 was \$449,000, a decrease of 10% compared to general and administrative expense of \$497,000 in the corresponding period one year ago. General and administrative expense for the six month period ended June 30, 2013 was \$910,000, a decrease of 18% compared to general and administrative expense of \$1,110,000 in the corresponding period one year ago. Declines in the comparable three month periods were due primarily to lower stock compensation expense. Declines in the six month comparable periods were primarily from reductions in personnel costs as a result of compensation expense savings programs initiated in late 2012 and in effect through the first quarter 2013, lower stock compensation expense, and declines in consulting and professional service fees and outside services. General and administrative expense is expected to moderately increase in the third quarter of 2013 from second quarter levels.

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Interest Expense and Other, Net of Interest Income and Other

Interest expense and other, net of interest income and other, in the three and six months ended June 30, 2013 was \$125,000 and \$205,000, respectively, compared to \$27,000 and \$56,000, respectively, in the same periods one year ago. Interest expense in the three and six months ended June 30, 2013 was related primarily to interest on amounts advanced under short term credit agreements, interest on amounts drawn on our bank lines of credit, and interest on our convertible notes payable issued in 2012 (see “NOTE 4 — Related Party Convertible Notes Payable” and “NOTE 5 — Related Party and Other Short Term Notes Payable” for more information). Interest expense in the three and six months ended June 30, 2012 was related primarily to interest on amounts drawn on our bank lines of credit. Additionally, interest expense in each of the comparable periods includes interest on equipment lease financing obligations. Other income and expense includes foreign currency transaction gains and losses, which were nominal in each of the periods presented.

Interest income reflects interest earned on cash balances. Interest income was nominal in each of the comparable periods, reflecting low average cash balances combined with low average rates of return.

Income Taxes

Deferred tax expense in the first half of 2013 and 2012 and the corresponding deferred tax liability shown on our balance sheet, is 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 cannot be offset against deferred tax assets. We maintain a full valuation allowance for all other components of deferred tax assets. There can be no assurance that the deferred tax assets subject to the valuation allowance will be realized. We have not generated taxable income in any periods in any jurisdiction, foreign or domestic.

Cash Flows and Contractual Obligations

As reflected in our Statements of Cash Flows, net cash used in operating activities was \$450,000 in the first half of 2013, compared to cash provided by operating activities of \$36,000 in the comparable period a year ago. We calculate net cash provided by or used in operating activities by increasing our net income, or reducing our net loss (\$118,000 net income in the first half of 2013, and \$1.6 million net loss in the first half of 2012) 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, amortization of intangible assets, and deferred tax expense. These amounts totaled \$0.3 million and \$0.6 million in the first half of 2013 and 2012, respectively. 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 2013 changes in operating assets and liabilities resulted in a net use of cash of \$0.9 million and were primarily from net increases in accounts receivable due to higher overall shipments to our distributors in the second quarter of 2013 compared to the fourth quarter of last year. Additional uses in the first half of 2013 were from increases in inventory and decreases in accounts payable. These uses of cash were partially offset by increases in the inventory levels in our distribution

channel due to the higher shipments just mentioned, and increases in accrued payroll and related expenses due primarily to the elimination of salary reduction programs at the beginning of the second quarter 2013. In the first half of 2012 changes in operating assets and liabilities resulted in a net source of cash of \$1.1 million and were primarily from reductions in accounts receivables due to lower overall shipments to our distributors in the second quarter of 2012 compared to the fourth quarter of last year, increases in accounts payables due to increased inventory purchases of our mobile handheld computers and the timing of vendor payments, partially offset by the increases in inventory due to the purchases just mentioned.

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Cash used in investing activities was \$42,000 in the first half of 2013 compared to \$206,000 in the first half of 2012. Investing activities in the first half of 2013 is related to primarily to expenditures on product tooling and purchases of computer equipment. Investing activities in the first half of 2012 is related primarily to expenditures on tooling for our next generation mobile handheld computer which we began shipping into our distribution channel in June 2012.

Cash provided by financing activities was \$0.8 million in the first half of 2013 compared to cash used of \$0.2 million in the first half of 2012. Financing activities in the first half of 2013 consisted primarily of proceeds from the issuance of related party and other short term notes payable in the first quarter and net amounts advanced on our bank lines of credit, partially offset by repayment of a short term note originally advanced on August 31, 2012 with final repayment completed in January 2013, and a related party convertible note holder redemption.

Our contractual cash obligations at June 30, 2013 are outlined in the table below:

Contractual Obligations	Total	Payments Due by Period			
		Less than 1 year	1 to 3 years	4 to 5 years	More than 5 years
Unconditional purchase obligations with contract manufacturers	\$3,267,000	\$3,267,000	\$—	\$—	\$—
Operating leases	3,924,000	371,000	787,000	851,000	1,915,000
Short term notes payable	550,000	550,000	—	—	—
Capital leases	70,000	23,000	47,000	—	—
Total contractual obligations	\$7,811,000	\$4,211,000	\$834,000	\$851,000	\$1,915,000

We have outstanding amounts borrowed under our domestic and international lines of credit with Silicon Valley Bank at June 30, 2013 of approximately \$793,000 and \$352,000, respectively. Accrued interest related to the amounts outstanding at June 30, 2013 was approximately \$10,000. The credit facility agreement expires on October 12, 2013 unless renewed. The agreement may be terminated by us or by the Bank at any time. Upon such termination, the Bank would no longer make advances under the credit agreement and outstanding advances would be repaid as receivables are collected. All advances are at the Bank's discretion and the Bank is not obligated to make advances.

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Additionally, at June 30, 2013 the Company had outstanding \$725,000 in convertible subordinated notes issued to select officers and directors of the Company. The notes have a term of two years that accrue interest at 8% per annum and mature on August 1, 2014. Accrued interest is payable upon redemption. The notes and accrued interest may be redeemed at the discretion of the note holder. The notes are convertible into common stock at the option of the holder at \$2.44 per share as long as warrants previously issued to Hudson Bay Capital Master Fund are outstanding, or at \$2.00 per share if the Hudson Bay warrants are no longer outstanding. The Hudson Bay Capital Master Fund warrants expire on May 20, 2016. Accrued interest expense at June 30, 2013 was approximately \$45,000. The notes are secured by all of the assets of the Company and are subordinated to amounts outstanding under the Company's working capital bank line of credit with Silicon Valley Bank.

Off-Balance Sheet Arrangements

As of June 30, 2013, we have no off-balance sheet arrangements as defined in Item 303 of Regulation S-K.

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, 2013, 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 5% or the lender's prime rate plus 1%, 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 during the quarter ended June 30, 2013, an increase of 1% in the interest rate would have increased our borrowing costs by approximately \$4,000 (in cases where the applicable interest rate is greater than 5%). The credit line agreement also specifies a fixed collateral handling fee of 0.25% per month on the full amount of the accounts receivable provided as collateral for the outstanding balances advanced under the credit line.

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 and we pay the expenses of our European employees in Euros and British pounds. 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, 2013, an adverse change of 10% in exchange rates would have resulted in a reduction in our net income for the second quarter 2013 of approximately \$34,000 if left unprotected. For the second quarter of 2013 the total net adjustment for the effects of changes in foreign currency on cash balances, collections, payables, and derivatives used to hedge foreign currency risks, was a net loss of \$5,000. We will continue to monitor, assess, and mitigate through hedging activities, our risks related to foreign currency fluctuations.

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Item 4. 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 the last fiscal quarter ended June 30, 2013 and 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

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 ongoing profitable operations and to raise additional capital.

Our historical operating losses and declines in our working capital balances are conditions that raise substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern is dependent upon our ability to maintain ongoing profitable operations and to raise additional capital as needed. We have been taking steps intended to improve operating results and achieve future 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, use of our bank lines of credit, 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 our inability to continue as a going concern.

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

We were profitable in the first half of 2013 but only to the extent of \$118,000. We have been unprofitable in every quarter during the past three fiscal years. 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 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 on reasonable terms, if at all, 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, delays in deployments by businesses of applications that use our handheld computers and our data collection products as we experienced in the third quarter of 2012 due to the transition of our mobile computer product line to new models. Even if we maintain profitable operating levels, we may need to raise capital to provide sufficient working capital to fund our growth. 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.

Global economic conditions may continue to have a negative impact on our business and financial condition in ways that we currently cannot predict, and may further limit our ability to raise additional funds.

Continued tight credit and related strains in the global financial system, particularly in Europe, 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 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.

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 or in the manufacture of products relating to orders received, 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;

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- 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;
- delays in supplies of key components used in the manufacturing of our products, 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.

In order to maintain the availability of our bank lines of credit we must remain in compliance with the covenants as specified under the terms of the credit agreements and the bank may exercise discretion in making advances to us.

Our credit agreements with our bank requires us to maintain cash and qualified receivables that are at least two times amounts borrowed and outstanding under the credit agreements. The agreements contain customary representations, warranties, covenants and events of default that limit our ability to incur additional liens or indebtedness, make distributions to our stockholders and make investments. The events of default entitle our bank to accelerate our obligations and require repayment of our outstanding indebtedness thereunder. These events of default include a breach of our payment obligations or covenants, a material impairment in our financial condition or ability to repay any indebtedness to our bank and the commencement of dissolution or insolvency proceedings. The agreement may be terminated by us or by our bank at any time. Upon such termination, our bank would no longer make advances under the credit agreement and outstanding advances would be repaid as receivables are collected. All advances are at our bank's discretion and our bank is not obligated to make advances. Our bank has been granted a first priority security interest in all of our assets, including our intellectual property.

Goodwill comprises a significant portion of our assets and may be subject to impairment write-downs in future periods which would substantially increase our losses, make it more difficult to achieve profitability, and could cause our stock price to decline.

We review our goodwill for impairment at least annually as of September 30th, and more often if factors suggest potential impairment. Many factors are considered in evaluating goodwill including our market capitalization, comparable companies within our industry, our estimates of our future performance, and discounted cash flow

analysis. Many of these factors are highly subjective and may be negatively impacted by our financial results and market conditions in the future. We may incur goodwill impairment charges in the future and any future write-downs of our goodwill would adversely affect our operating results, make it more difficult to maintain profitability, and as a result the market price of our common stock could be adversely affected.

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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 barcode scanning modules, and our line of mobile handheld computers, are produced by one or a limited number of suppliers. Shortages or delays could occur in these essential components due to an interruption of supply or increased demand in the industry. Suppliers may choose to restrict credit terms or require advance payment causing delays in the procurement of essential materials. 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.

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 Apple, Google, and Blackberry, with which our wireless and plug-in 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 Windows Mobile devices, or experience difficulties with new product transitions that cause delays in the market, 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.

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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.

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

A significant portion of our revenue comes from a limited number of distributors. ScanSource, Inc., Ingram Micro Inc., and BlueStar, Inc., together represented approximately 50% and 48% of our worldwide revenues in the first half of 2013 and fiscal year 2012, respectively. We expect that a significant portion of our revenue will continue to depend on sales to a limited number of distributors. Additionally, CF Company represented approximately 11% of our revenues in the first half of 2013. We do not have long-term commitments from our distributors to carry our products, and any of our distributors may from quarter to quarter comprise a significant concentration of our revenues. Any 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 ScanSource, Inc. or Ingram Micro Corporation, or any of our other significant distributors, we would experience disruption and delays in marketing our products.

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. Current global financial conditions 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.

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

Substantially all of our 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.

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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 barcode 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 manufacturers of tablets, mobile phones and handheld computers offer products with built-in functions, such as Bluetooth wireless technology, Wi-Fi, or barcode 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.

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. In particular, we completed the transition of our mobile handheld computer product line from the SoMo 650 series to the SoMo 655 series in the third quarter 2012. If demand is lower than forecasted levels, such as demand for our SoMo series products, 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.

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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.

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.

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We have devoted significant research and development resources to design products to work with a number of operating systems used in mobile devices including Windows Mobile, Windows CE, Windows 7/Vista/XP, Windows Embedded Handheld, Apple, Google's Android, RIM Blackberry, and 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, Apple, Google or Research In Motion is obligated to collaborate or to support the products produced from such 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.

Effective copyright, trademark, and trade secret protection may be unavailable or limited in certain foreign countries.

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.

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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 April 2013, a lawsuit was filed in the State of Delaware against the Company by Wyncomm LLC claiming infringement of a patent involving WiFi technology. They have filed similar lawsuits against a number of other companies. In August 2013, we reached a settlement agreement with Wyncomm whereby the Company, its suppliers and customers are granted an irrevocable, worldwide, non-exclusive and non-transferable license to the underlying patent held by Wyncomm. The settlement is not material to our operations.

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.

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.

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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 eighteen to twenty-one 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 affects our net income and earnings per share, 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.

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.

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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 33% and 40% of our revenues in the first half of 2013 and fiscal 2012, 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. Furthermore, the recent economic instability of the Eurozone could have a material adverse affect on our business, including the ability of our distributors to sell our products and our ability the collect the related Euro receivables.

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.