PHOENIX TECHNOLOGIES LTD
Form 10-Q
August 02, 2007

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

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2007

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period to .

Commission file number 0-17111

PHOENIX TECHNOLOGIES LTD.
(Exact name of Registrant as specified in its charter)

Delaware	**04-2685985**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*

915 Murphy Ranch Road, Milpitas, CA 95035
(Address of principal executive offices, including zip code)

(408) 570-1000
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 þ NO o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the Registrant is a Shell Company (as defined in Rule 12b-2 of the Exchange Act). YES o NO þ

As of July 31, 2007, the number of outstanding shares of the registrant s common stock, $0.001 par value, was 26,738,548.

PHOENIX TECHNOLOGIES LTD.

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PART I FINANCIAL INFORMATION

ITEM 1. *FINANCIAL STATEMENTS*

PHOENIX TECHNOLOGIES LTD.

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2007	September 30, 2006
	(Unaudited) (In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 58,754	$ 34,743
Marketable securities		25,588
Accounts receivable, net of allowances	5,202	8,434
Other current assets	3,537	4,163
Total current assets	67,493	72,928
Property and equipment, net	2,842	4,247
Purchased technology and Intangible assets, net	542	1,458
Goodwill	14,433	14,433
Other assets	800	2,094
Total assets	$ 86,110	$ 95,160
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 896	$ 3,072
Accrued compensation and related liabilities	3,280	3,844
Deferred revenue	11,730	7,584
Income taxes payable	10,321	9,041
Accrued restructuring charges current	570	3,287
Other accrued liabilities	2,326	3,605
Total current liabilities	29,123	30,433
Accrued restructuring charges noncurrent	696	1,166
Other liabilities	2,735	3,385
Total liabilities	32,554	34,984
Stockholders equity:		
Common stock	34	34
Additional paid-in capital	200,596	191,519

Retained earnings	(54,640)	(38,899)
Accumulated other comprehensive loss	(756)	(800)
Less: Cost of treasury stock	(91,678)	(91,678)
Total stockholders equity	53,556	60,176
Total liabilities and stockholders equity	$ 86,110	$ 95,160

See notes to unaudited condensed consolidated financial statements

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PHOENIX TECHNOLOGIES LTD.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Nine Months Ended June 30, 2007	Nine Months Ended June 30, 2006
	(Unaudited) (In thousands, except per share amounts)			
Revenues:				
License fees	$ 10,678	$ 9,047	$ 26,077	$ 48,943
Services fees	1,902	1,403	5,275	3,208
Total revenues	12,580	10,450	31,352	52,151
Cost of revenues:				
License fees	201	1,540	693	4,088
Services fees	1,811	2,729	5,768	7,943
Amortization of purchased technology	333	1,142	916	2,818
Total cost of revenues	2,345	5,411	7,377	14,849
Gross Margin	10,235	5,039	23,975	37,302
Operating expenses:				
Research and development	5,204	5,858	14,056	17,735
Sales and marketing	2,554	9,548	9,399	28,258
General and administrative	3,615	5,896	12,254	16,025
Amortization of acquired intangible assets		17		52
Restructuring	(14)	1,887	3,082	1,887
Total operating expenses	11,359	23,206	38,791	63,957
Loss from operations	(1,124)	(18,167)	(14,816)	(26,655)
Interest and other income, net	479	440	1,514	1,325
Loss before income taxes	(645)	(17,727)	(13,302)	(25,330)
Income tax expense	1,129	833	2,439	4,318
Net loss	$ (1,774)	$ (18,560)	$ (15,741)	$ (29,648)
Loss per share:				
Basic and Diluted	$ (0.07)	$ (0.73)	$ (0.61)	$ (1.18)
Shares used in loss per share calculation:				
Basic and Diluted	26,001	25,333	25,719	25,152

See notes to unaudited condensed consolidated financial statements

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PHOENIX TECHNOLOGIES LTD.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended June 30, 2007	Nine Months Ended June 30, 2006
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net loss	$ (15,741)	$ (29,648)
Reconciliation to net cash used in operating activities:		
Depreciation and amortization	2,644	4,825
Stock-based compensation	3,924	3,881
Loss from disposal of fixed assets	51	2
Deferred income tax		790
Change in operating assets and liabilities:		
Accounts receivable	3,232	11,451
Prepaid royalties and maintenance	86	2,088
Other assets	1,835	232
Accounts payable	(2,177)	274
Accrued compensation and related liabilities	(874)	489
Deferred revenue	4,148	1,254
Income taxes	1,281	(954)
Accrued restructuring charges	(3,186)	1,519
Other accrued liabilities	(1,618)	(650)
Net cash used in operating activities	(6,395)	(4,447)
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	114,714	235,750
Purchases of marketable securities	(89,125)	(228,529)
Purchases of property and equipment	(373)	(1,482)
Acquisition of businesses, net of cash acquired		(500)
Net cash provided by investing activities	25,216	5,239
Cash flows from financing activities:		
Proceeds from stock purchases under stock option and stock purchase plans	5,154	3,206
Repurchase of common stock		(1,205)
Net cash provided by financing activities	5,154	2,001
Effect of changes in exchange rates	36	56
Net increase in cash and cash equivalents	24,011	2,849
Cash and cash equivalents at beginning of period	34,743	27,805

Cash and cash equivalents at end of period	$ 58,754	$ 30,654

See notes to unaudited condensed consolidated financial statements

PHOENIX TECHNOLOGIES LTD.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)**

Note 1. Summary of Significant Accounting Policies

Basis of Presentation. The condensed consolidated financial statements as of June 30, 2007 and for the three and nine month periods ended June 30, 2007 and 2006 have been prepared by Phoenix Technologies Ltd. (the Company), without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) and in accordance with the Company s accounting policies as described in its latest Annual Report on Form 10-K filed with the SEC and this Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The condensed consolidated balance sheet as of September 30, 2006 was derived from the audited financial statements but does not include all disclosures required by generally accepted accounting principles. These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2006.

In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (which include normal recurring adjustments in each of the periods presented) necessary for a fair presentation of the Company s results of operations and cash flows for the interim periods presented and financial condition of the Company as of June 30, 2007. The results of operations for interim periods are not necessarily indicative of results to be expected for the full fiscal year.

Reclassifications. The statement of cash flows for the nine month periods ended June 30, 2006 has been adjusted due to the reclassification of certain amounts from cash and cash equivalents to marketable securities to conform to the presentation as of June 30, 2007. As of September 30, 2005 and June 30, 2006, reclassifications from cash equivalents to marketable securities totaled $9.1 million and $9.2 million, respectively. These reclassifications had no impact on the Company s total assets, total liabilities, loss from operations or net loss for the nine months ended June 30, 2007 or 2006.

Use of Estimates. The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances.

On an on-going basis, the Company evaluates its accounting estimates, including but not limited to its estimates relating to: a) allowance for uncollectible accounts receivable and sales allowances; b) accruals for royalty revenues; c) accruals for employee benefits and restructuring and related costs; d) income taxes and realizability of deferred tax assets and the associated valuation allowances; and e) useful lives and/or realizability of carrying values for property and equipment, computer software costs, goodwill and intangibles, and prepaid royalties. Actual results could differ materially from those estimates.

Revenue Recognition. The Company licenses software under non-cancelable license agreements and provides services including non-recurring engineering, maintenance (consisting of product support services and rights to unspecified updates on a when-and-if available basis) and training.

Revenues from software license agreements are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. The Company uses the residual method to recognize revenue when an agreement includes one or more elements to be delivered at a future date and vendor specific objective evidence (VSOE) of fair value exists for each undelivered element. VSOE of fair value is generally the price charged when that element is sold separately or, for items not yet being sold, it is the price established by management that will not change before the introduction of the item into the marketplace. Under the residual method, the VSOE of fair value of the undelivered element(s) is deferred and the remaining portion of the arrangement fee is recognized as revenue. If VSOE of fair value of one or more undelivered elements

PHOENIX TECHNOLOGIES LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

does not exist, revenue is deferred and recognized when delivery of those elements occurs or when fair value can be established.

The Company recognizes revenue related to the delivered products or services only if the above revenue recognition criteria are met, any undelivered products or services are not essential to the functionality of the delivered products and services, and payment for the delivered products or services is not contingent upon delivery of the remaining products or services.

Pay-As-You-Go Arrangements

Under pay-as-you-go arrangements license revenues from original equipment manufacturers (OEMs) and original design manufacturers (ODMs) are generally recognized in each period based on estimated consumption by the OEMs and ODMs of products containing the Company s software, provided that all other revenue recognition criteria have been met. The Company normally recognizes revenue for all consumption prior to the end of the accounting period. Since the Company generally receives quarterly royalty reports from OEMs and ODMs approximately 30 to 60 days following the end of a quarter, it has put processes in place to reasonably estimate royalty revenues, including by obtaining estimates of production from OEM and ODM customers and by utilizing historical experience and other relevant current information. To date the variances between estimated and actual revenues have been immaterial.

Volume Purchase Arrangements

For periods ended on or before December 31, 2006, the Company recognized revenues from volume purchase arrangements (VPAs) for units estimated to be consumed by the end of the following quarter, provided the customer has been invoiced for such consumption prior to the end of the current quarter and provided all other revenue recognition criteria have been met. These estimates have historically been recorded based on customer forecasts.

Actual consumption that is subsequently reported by these same customers is regularly compared to the previous estimates to confirm the reliability of this method of determining projected consumption. The Company s examination of reports received from its customers during April 2007 regarding actual consumption of the Company s products during the three month period ended March 31, 2007 and a comparison of those consumption reports to forecasts previously provided by these customers, led the Company to the view that customer forecasts are no longer a reliable indicator of future consumption. Since the Company no longer considers the customer forecast to be a reliable estimate of future consumption, it is no longer appropriate to include future period consumption in current period revenue.

As a result of this determination, beginning with the three month period ended March 31, 2007, for volume purchase agreements (VPAs) with OEMs and ODMs, the Company recognizes license revenues for units consumed by the end of the current accounting quarter, to the extent that the customer has been invoiced for such consumption prior to the end of the current quarter and provided all other revenue recognition criteria have been met. If the agreement provides that the right to consume units lapses at the end of the term of the VPA, the Company recognizes royalty revenues ratably over the term of the VPA, if such amount is higher than that determined based on actual consumption by the end of the current accounting quarter. Amounts that have been invoiced under VPAs and relate to consumption beyond the current accounting quarter are recorded as deferred revenue.

Fully Paid-up License Arrangements

During fiscal years 2005 and 2006, the Company had increasingly relied on the use of software license agreements with its customers in which they paid a fixed upfront fee for an unlimited number of units, subject to certain Phoenix product or design restrictions (paid-up licenses). Revenues from such paid-up license

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

arrangements were generally recognized upfront provided all other revenue recognition criteria had been met. Effective September 2006, the Company decided to eliminate the practice of entering into paid-up licenses.

Services Arrangements

Revenues for non-recurring engineering services are generally on a time and materials basis and are recognized as the services are performed. Software maintenance revenues are recognized ratably over the maintenance period, which is typically one year. Training and other service fees are recognized as services are performed. Amounts billed in advance for licenses and services that are in excess of revenues recognized are recorded as deferred revenues.

Income Taxes. Income taxes are accounted for in accordance with Statement of Financial Accounting Standards No. 109 *Accounting for Income Taxes* (SFAS No. 109). Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period of enactment.

Stock-Based Compensation. On October 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment (SFAS No. 123(R)) using the modified prospective method. Under this method, compensation cost recognized during the three and nine month periods ended June 30, 2007 and 2006, includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of, October 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and amortized on a graded vesting basis over the options vesting period, and (b) compensation cost for all share-based payments granted subsequent to October 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R) and amortized on a straight-line basis over t