SOCKET MOBILE, INC.
Form 10-Q
August 13, 2008

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

# FORM 10-Q

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

**For the quarterly period ended June 30, 2008**

**OR**

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

For the transition period ____________ to ____________

**Commission file number 1-13810**

# SOCKET MOBILE, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

The number of shares of Common Stock ($0.001 par value) outstanding as of July 31, 2008 was 32,300,129 shares.

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Item 1. Financial Statements

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

| | June 30, |   | December 31, |   |
|---|---|---|---|---|

| | | 2008 (Unaudited) | | 2007* |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 3,085,207 | $ | 4,963,359 |
| Accounts receivable, net | | 4,117,341 | | 2,614,872 |
| Inventories | | 3,580,319 | | 2,438,033 |
| Prepaid expenses and other current assets |   | 515,764  |   | 282,867  |
| Total current assets |   | 11,298,631  |   | 10,299,131  |
|   | | | | |
| Property and equipment: | | | | |
| Machinery and office equipment | | 2,294,902 | | 2,391,991 |
| Computer equipment |   | 1,185,379  |   | 1,125,875  |
|   | | 3,480,281 | | 3,517,866 |
| Accumulated depreciation |   | (2,401,479) |   | (2,373,409) |
| Property and equipment, net |   | 1,078,802  |   | 1,144,457  |
|   | | | | |
| Intangible assets, net | | 410,360 | | 473,934 |
| Goodwill | | 9,797,946 | | 9,797,946 |
| Other assets |   | 259,001  |   | 258,444  |
| Total assets | $ | 22,844,740 | $ | 21,973,912 |
|   | | | | |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued expenses | $ | 3,416,775 | $ | 2,429,168 |
| Accrued payroll and related expenses | | 912,678 | | 852,185 |
| Bank line of credit | | 3,052,835 | | 2,622,009 |
| Deferred income on shipments to distributors | | 1,742,725 | | 1,744,560 |
| Term loan - short term portion | | 167,709 | | 160,439 |
| Current portion of capital leases and deferred rent |   | 35,473  |   | 42,964  |
| Total current liabilities |   | 9,328,195  |   | 7,851,325  |
|   | | | | |
| Term loan - long term portion | | 182,034 | | 266,543 |
| Long term portion of capital leases and deferred rent | | 125,869 | | 139,743 |
| Deferred income taxes |   | 198,292  |   | 182,322  |
| Total liabilities |   | 9,834,390  |   | 8,439,933  |
|   | | | | |
| Commitments and contingencies | | | | |
| Stockholders' equity: | | | | |
| Common stock, $0.001 par value: Authorized shares 100,000,000, | | | | |
| Issued and outstanding shares 32,300,129 at June 30, 2008 and 31,989,617 at December 31, 2007 | | 32,300 | | 31,990 |
| Additional paid-in capital | | 54,238,219 | | 53,654,483 |
| Accumulated deficit |   | (41,260,169) |   | (40,152,494) |
| Total stockholders equity |   | 13,010,350  |   | 13,533,979  |
| Total liabilities and stockholders equity | $ | 22,844,740 | $ | 21,973,912 |

* Derived from audited financial statements.

See accompanying notes.



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

| | | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | 2008** ** | | 2007 | | 2008** ** | | 2007** ** | |
| Revenues | $ | 7,492,564 | $ | 6,299,817 | $ | 13,662,433 | $ | 11,848,157 | |
| Cost of revenues | ** ** | 3,854,419** ** | ** ** | 3,215,959** ** | ** ** | 7,006,736** ** | ** ** | 5,979,732** ** | |
| Gross profit | ** ** | 3,638,145 | ** ** | 3,083,858 | ** ** | 6,655,697 | ** ** | 5,868,425 | |
|   | | | | | | | | | |
| Operating expenses: | | | | | | | | | |
| Research and development | | 1,144,941 | | 1,162,188 | | 2,331,763 | | 2,589,234 | |
| Sales and marketing | | 1,966,446 | | 1,970,297 | | 3,909,795 | | 3,729,317 | |
| General and administrative | | 621,980 | | 681,368 | | 1,427,447 | | 1,538,341 | |
| Amortization of intangible assets | ** ** | 31,787 | ** ** | 33,807 | ** ** | 63,574 | ** ** | 67,615 | |
|   Total operating expenses | | 3,765,154 | | 3,847,660 | | 7,732,579 | | 7,924,507 | |
| | | | | | | | | | |
| Operating loss |   | (127,009) |   | (763,802) |   | (1,076,882) |   | (2,056,082) | |
|   | | | | | | | | | |
| Interest income and other | | 4,220 | | 29,642 | | 16,148 | | 67,523 | |
| Interest expense | ** ** | (18,277) | ** ** | (2,648) | ** ** | (30,971) | ** ** | (6,062) | |

 
 
 

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net loss before deferred taxes | | (141,066) | | (736,808) | | (1,091,705) | | (1,994,621) |
| Deferred tax expense | ** ** | (7,985) | ** ** | (7,985) | ** ** | (15,970) | ** ** | (15,973) |
| Net loss | $ | (149,051) | $ | (744,793) | $ | (1,107,675) | $ | (2,010,594) |
| | ** ** | | ** ** | | ** ** | | ** ** | |
| Net loss per share: | | | | | | | | |
| Basic | $ | 0.00 | $ | (0.02) | $ | (0.03) | $ | (0.06) |
| Diluted | $ | 0.00 | $ | (0.02) | $ | (0.03) | $ | (0.06) |
|   | | | | | | | | |
| Weighted average shares outstanding: | | | | | | | | |
| Basic | | 32,129,321 | | 31,914,997 | | 32,071,060 | | 31,893,610 |
| Diluted | | 32,129,321 | | 31,914,997 | | 32,071,060 | | 31,893,610 |

See accompanying notes.



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

| | Six Months Ended June 30, | | | |
|---|---|---|---|---|
| | | 2008 | | 2007 |
| **Operating activities** | | | | |
| Net loss | $ | (1,107,675) | $ | (2,010,594) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | | | |
| Stock-based compensation | | 393,933 | | 534,728 |
| Depreciation and amortization | | 274,096 | | 277,053 |
| | | 63,574 | | 67,615 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Amortization of intangible assets | | | | | | |
| Net foreign currency transaction (gains) losses | | 21,401 | | | (20,737) | |
| Change in deferred rent | | (2,019) | | | 117,176 | |
| Deferred tax expense | | 15,970 | | | 15,973 | |
| ** ** | | | | | | |
| Changes in operating assets and liabilities: | | | | | | |
| Accounts receivable | | (1,529,949) | | | (394,115) | |
| Inventories | | (1,142,286) | | | 279,633 | |
| Prepaid expenses and other current assets | | (232,897) | | | (78,345) | |
| Other assets | | (557) | | | 16,067 | |
| Accounts payable and accrued expenses | | 1,004,768 | | | 499,645 | |
| Accrued payroll and related expenses | | 60,493 | | | 449,398 | |
| Deferred income on shipments to distributors | ** ** | (1,835) | | ** ** | 76,859 | ** ** |
| Net cash used in operating activities | ** ** | (2,182,983) | ** ** | ** ** | (169,644) | ** ** |
|   | | | | | | |
| **Investing activities** | | | | | | |
| Purchases of equipment and tooling | ** ** | (208,441) | | ** ** | (665,925) | |
| Net cash used in investing activities | ** ** | (208,441) | ** ** | ** ** | (665,925) | ** ** |
| ** ** | | | | | | |
| **Financing activities** | | | | | | |
| Payments on capital leases and equipment financing notes | | (19,346) | | | (4,206) | |
| Gross proceeds from borrowings under bank line of credit agreement | | 5,806,982 | | | 4,563,159 | |
| Gross repayments of borrowings under bank line of credit agreement | | (5,376,156) | | | (4,498,491) | |
| Proceeds from bank term loan | | --- | | | 500,000 | |
| Repayments of bank term loan | | (77,239) | | | --- | |
| Proceeds from the exercise of stock options and warrants | ** ** | 190,113 | ** ** | ** ** | 62,329 | ** ** |
| Net cash provided by financing activities | ** ** | 524,354 | ** ** | ** ** | 622,791 | ** ** |
| ** ** | | | | | | |
| Effect of exchange rate changes on cash and cash equivalents | ** ** | (11,082) | | ** ** | 7,199 | ** ** |
| | | (1,878,152) | | | (205,579) | |

| | | | | |
|---|---|---|---|---|
| Net decrease in cash and cash equivalents | | | | |
| Cash and cash equivalents at beginning of period | ** ** | 4,963,359** ** | ** ** | 6,104,277** ** |
| Cash and cash equivalents at end of period | $ | 3,085,207 | $ | 5,898,698 |
| | | | | |
| **Supplemental cash flow information** | | | | |
| Cash paid for interest | $ | 31,562 | $ | 6,062 |

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") (formerly Socket Communications, Inc.) 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 10 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, 2007.

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

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.

The Company makes adjustments to the value of inventory based on estimates of potentially excess and obsolete inventory after considering forecasted demand and forecasted average selling prices. However, forecasts are subject to revisions, cancellations, and rescheduling. Actual demand will inevitably differ from anticipated demand, and such differences may have a material effect on the Company's financial statements.

*Recent Accounting Pronouncements*
In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"), which establishes a framework for measuring fair value and enhances disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157," which provides for a one year deferral of the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value on a recurring basis. The Company adopted the provisions of SFAS 157 as of January 1, 2008, with respect to its financial assets and liabilities only. The adoption of SFAS 157 did not have a material impact on the Company's financial statements. Under SFAS 157, the definition of fair value focuses on the price that would be received upon the sale of an asset or the amount paid to transfer a liability. The fair value measurement should reflect all of the assumptions that market participants would use in pricing the asset or liability. SFAS 157 establishes a three-level hierarchy to prioritize the inputs used in valuation techniques for fair value consisting of: 1) observable inputs that reflect quoted prices in active markets; 2) inputs other than quoted prices with observable market data; and 3) unobservable data. SFAS 157 requires disclosures detailing the extent to which the Company measures assets and liabilities at fair value, the methods and assumptions used to measure fair value and the effect of fair value measurements on earnings.



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

The Company considers all highly liquid investments purchased with a maturity date of 90 days or less at date of purchase to be cash equivalents. At June 30, 2008, all of the Company's cash and cash equivalents consisted of amounts held in demand and money market deposits in banks. The Company regularly enters into forward foreign currency contracts to reduce exposures related to rate changes in certain foreign currencies. The Company's forward foreign currency contracts are recorded at fair value and are included in accrued liabilities at June 30, 2008. At June 30, 2008, none of these derivative instruments was accounted for as a hedge transaction, and accordingly, changes in the fair value of the forward foreign currency contracts were recorded in net income. At June 30, 2008, contracts with a notional amount of $470,160 to hedge Euros, were recorded as a liability with a fair value of $2,647, based on quotations from financial institutions.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), which permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS 159 as of January 1, 2008. The adoption of SFAS 159 did not have a material impact on the Company's financial statements.

**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, 2008 | December 31, 2007 |
|---|---|---|
| Raw materials and sub-assemblies | $ 3,083,192 | $ 2,012,745 |
| Finished goods |   497,127  |   425,288  |
| | $ 3,580,319 | $ 2,438,033 |

Increases in overall inventory balances at June 30, 2008 are due primarily to higher stocking levels of Bluetooth modules for the Company's OEM customers and higher stocking levels of the Company's mobile handheld computer.



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

**NOTE 4 - Bank Financing Arrangements**

On March 24, 2008, the Company agreed with its bank to extend the term of the existing credit facility by an additional year. The facility now expires on March 24, 2010. The credit facility allows the Company to borrow up to $4,000,000 based on the level of qualified domestic and international receivables, up to a maximum of $2,500,000 and $1,500,000, respectively, at the lender's index rate based on prime plus 0.5%. The rates in effect at June 30, 2008 were 5.5% on both the domestic and international lines. At June 30, 2008, outstanding amounts borrowed under the lines were $2,362,835 and $690,000, respectively, which were the approximate amounts available on the lines. Of these amounts outstanding at June 30, 2008, $1.8 million was repaid in early July 2008. In fiscal 2007 the Company used the credit facility only at the end of each quarter. At December 31, 2007, outstanding amounts borrowed under the lines were $1,752,459 and $869,550, respectively, which were the approximate amounts available on the lines. These amounts outstanding at December 31, 2007 were repaid in early January 2008. The rates in effect at December 31, 2007 were 7.75% on both the domestic and international lines. Under the terms of the credit agreement, beginning March 31, 2008, the Company must maintain a quarterly minimum tangible net worth of at least $2,500,000, plus beginning thereafter, 50% of net income. The Company was in compliance with the tangible net worth requirement at June 30, 2008.

Under the terms of a term loan agreement, the Company borrowed a principal amount of $500,000 on June 29, 2007. The term loan bears a fixed interest rate of 9.75%, equal to the prime rate plus 1.5% at the time of the advance, and is to be repaid by the Company in 36 equal monthly installments. At June 30, 2008, $349,743 was outstanding on the term loan, of which $167,709 and $182,034 is classified as short term debt and long term debt, respectively. Remaining payments of principal due in future periods are as follows: $80,377, $173,228, and $ 93,315, for the years ending December 31, 2008 (six months remaining), 2009 and 2010, respectively.

**NOTE 5 - Intangible Assets**

Intangible assets at June 30, 2008 consist of a patent purchased in 2004 for $600,000 covering the design and functioning of plug-in bar code scanners, bar code imagers, and radio frequency identification products, which is being amortized on a straight line basis over its estimated life of ten years, and intangible assets of $570,750 remaining from a prior acquisition in 2000 consisting of developed software and technology with estimated lives at the time of acquisition of 8.5 years.

Amortization of all intangible assets for the three and six months ended June 30, 2008 was $31,787 and $63,574, respectively, compared to $33,807 and $67,615, respectively, for the same periods in 2007. Intangible assets as of June 30, 2008 consisted of the following:

| | | Gross Assets | | Accumulated Amortization | | Net |
|---|---|---|---|---|---|---|
| Patent | $ | 600,000 | $ | 240,000 | $ | 360,000 |
| Project management tools |   | 570,750  |   | 520,390  |   | 50,360  |
| Total intangible assets | $ | 1,170,750 | $ | 760,390 | $ | 410,360 |



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

Intangible assets as of December 31, 2007 consisted of the following:

| | | Gross Assets | | Accumulated Amortization | | Net |
|---|---|---|---|---|---|---|
| Patent | $ | 600,000 | $ | 210,000 | $ | 390,000 |
| Project management tools |   | 570,750  |   | 486,816  |   | 83,934  |
| Total intangible assets | $ | 1,170,750 | $ | 696,816 | $ | 473,934 |

Based on definite lived intangible assets recorded at June 30, 2008, and assuming no subsequent impairment of the underlying assets, the annual amortization expense is expected to be as follows:

| Year | | Amount |
|---|---|---|
| 2008 (six months remaining) | $ | 63,573 |
| 2009 | | 76,787 |
| 2010 | | 60,000 |
| 2011 | | 60,000 |
| 2012 | | 60,000 |
| 2013 and beyond |   | 90,000  |
| | $ | 410,360  |

**NOTE 6 - Segment Information**

The Company operates in one segment-mobile systems solutions for businesses. Mobile systems solutions typically consist of a handheld computer, data collection and connectivity peripherals, and third party vertical applications software. The Company markets its products in the United States and foreign countries through its sales personnel, vertical industry partners, and distributors. Revenues for the geographic areas for the three and six months ended June 30, 2008 and 2007 are as follows:

| | | Three Months Ended June 30, | | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|---|---|
| Revenues: | | 2008 | | 2007 | | 2008 | | 2007 |
| United States | $ | 4,973,609 | $ | 4,134,620 | $ | 8,737,473 | $ | 7,398,880 |
| Europe | | 1,732,798 | | 1,708,146 | | 3,401,289 | | 3,471,891 |
| Asia and rest of world |   | 786,157  |   | 457,051  |   | 1,523,671  |   | 977,386  |
| Total revenues | $ | 7,492,564 | $ | 6,299,817 | $ | 13,662,433 | $ | 11,848,157 |

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.



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

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Tech Data Corp. | 14% | 25% | 15% | 24% |
| Ingram Micro, Inc. | 16% | 13% | 14% | 13% |
| Intermec, Inc. | * | * | 11% | * |
| Honeywell Imaging and Mobility (formerly Hand Held Products, Inc.) | 12% | * | * | * |

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

**NOTE 7 - Stock-Based Compensation**

The Company accounts for share-based awards in accordance with SFAS 123R. SFAS 123R requires all share-based awards to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Under SFAS 123R, the Company uses a binomial lattice valuation model to estimate the fair value of stock option grants made on or after January 1, 2006. 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.

The weighted average per share fair value of the individual options issued and outstanding during the three and six months ended June 30, 2008 was estimated at $0.74 and $0.86, respectively, compared to $1.60 and $1.56, respectively, for the three and six months ended June 30, 2007. The fair values were determined using a binomial lattice valuation model for options granted on or after January 1, 2006, and a Black-Scholes valuation model for options granted prior to January 1, 2006. Weighted average assumptions for options issued and outstanding during the three and six months ended June 30, 2008 and 2007 are shown below:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Risk-free interest rate (%) | 4.19% | 3.85% | 4.15% | 3.75% |
| Dividend yield | --- | --- | --- | --- |
| Volatility factor | 0.73 | 1.0 | 0.77 | 1.0 |
| Expected option life (years) | 4.9 | 4.7 | 4.8 | 4.7 |

At June 30, 2008, options issued to employees for 10,965,722 shares were outstanding, of which 7,612,192 were exercisable. At June 30, 2007, options issued to employees for 9,941,887 shares were outstanding, of which 7,108,923 were exercisable.



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

Total stock-based compensation expense recognized in the Company's statements of income for the three and six months ended June 30, 2008 and 2007 is shown below:

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| Income Statement Classification | | 2008 | | 2007 | | 2008 | | 2007 |
|  &nbspCost of revenues | $ | 11,013 | $ | 20,427 | $ | 20,209 | $ | 43,107 |
|  &nbspResearch and development | | 50,603 | | 65,512 | | 108,157 | | 128,478 |
|  &nbspSales and marketing | | 66,482 | | 92,541 | | 133,584 | | 172,185 |
|  &nbspGeneral and administrative |   | 46,769  |   | 74,580  |   | 131,983  |   | 190,958  |
|  &nbspTotal | $ | 174,867 | $ | 253,060 | $ | 393,933 | $ | 534,728 |

The decline in stock-based compensation expense in the three and six months ended June 30, 2008 compared to the same periods one year ago reflects older grants with higher valuations, compared to more current grants, becoming fully expensed.

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

The Company calculates earnings per share in accordance with Financial Accounting Standards Board Statement No. 128, *Earnings per Share*.

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

| | Three Months Ended June 30, | | Six Months Enc June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 20 |
| tor: | | | | |
| ss | $ (149,051) | $ (744,793) | $ (1,107,675) | $ (2,0 |
| nator: | | | | |
| ghted average common shares outstanding used in computing net loss per share: | | | | |
| sic | 32,129,321 | 31,914,997 | 32,071,060 | 31,8 |
| luted | 32,129,321 | 31,914,997 | 32,071,060 | 31,8 |
| loss per share: | | | | |
| sic | $ 0.00 | $ (0.02) | $ (0.03) | $ |
| luted | $ 0.00 | $ (0.02) | $ (0.03) | $ |

For the three and six months ended June 30, 2008 and 2007, 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 or warrants have been included in the net loss per share calculation, as their effect is anti-dilutive. Therefore, options and warrants to purchase 11,595,445 and 10,875,255 shares of Common Stock at June 30, 2008 and 2007, respectively, have been omitted from the diluted net loss per share calculation.



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

**NOTE 9 - Taxes**

Deferred income tax reflects the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Deferred tax expense of $7,985 and $15,970 for the three and six months ended June 30, 2008, respectively, and the corresponding deferred tax liability shown on the Company's balance sheet, is related entirely to the deferred tax liability on the portion of the Company's goodwill amortized for tax purposes. Deferred tax expense for the three and six months ended June 30, 2007 was $7,985 and $15,973, respectively. Due to the indefinite characteristic of this deferred tax liability, it cannot be offset against deferred tax assets, and furthermore, this deferred tax liability may never reverse. The Company has not generated taxable income in any periods in any jurisdiction, foreign or domestic. The Company maintains a full valuation allowance for all other components of deferred tax assets.

On January 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109," ("FIN 48"). FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements, and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition issues. There were no adjustments to the financial statements as a result of the adoption of FIN 48. At December 31, 2007, the Company has an unrecognized tax benefit of approximately $595,000, which did not change significantly during the six months ended June 30, 2008. The application of FIN 48 does not result in a change to retained earnings, as the unrecognized tax benefit would be fully offset by the application of a valuation allowance. Future changes in the unrecognized tax benefit will have no impact on the effective tax rate due to the existence of the valuation allowance. It is the Company's policy to include interest and penalties related to tax positions as a component of income tax expense. No interest was accrued for the three and six months ended June 30, 2008.

The Company files its tax returns as prescribed by the tax laws of the jurisdictions in which it operates. The Company is not currently under audit in any of its jurisdictions where income tax returns are filed. The tax years 1992 to 2007 remain open to examination by the major domestic taxing jurisdictions to which the Company is subject, and for the years 2001 to 2007 for the international taxing jurisdictions to which the Company is subject.



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

*This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include statements forecasting future financial results and 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: the risk of delays in the availability of our products due to technological, market or financial factors including the availability of necessary working capital; our ability to successfully develop, introduce and market future products; the change in gross margins between current and future products; our ability to effectively manage and contain our operating costs; the availability of announced third party handheld computer hardware and software that our products are intended to work with; product delays associated with new model introductions and product changeovers by the makers of products that our products are intended to work with; continued growth in demand for handheld computers; market acceptance of emerging standards such as Bluetooth and Wireless LAN and of our related connection, data collection, and mobile handheld computer products; the ability of our strategic relationships to benefit our business as expected; our ability to enter into additional distribution relationships; or other factors described in this Form 10-Q including "Part II, Item 1A. Risk Factors" and recent Form 8-K and Form 10-K reports filed with the Securities and Exchange Commission. We assume no obligation to update such forward-looking statements or to update the reasons why actual results could differ materially from those anticipated in such forward-looking statements.*

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

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**Revenues**

We produce mobile computing products which are combined with third party application software to create mobile system solutions that serve the Business Mobility market. Mobile systems solutions typically consist of a handheld computer, data collection and connectivity peripherals, and third party vertical applications software. We have historically offered a wide range of data collection, connectivity peripheral, and embedded products for use with mobile computing devices offered by third parties. In January 2007, we began doing business as Socket Mobile to emphasize our commitment to mobile computing, and formally changed our name to Socket Mobile, Inc. in April 2008. In June 2007, we introduced our first mobile handheld computer, the SoMo  650, and began offering this mobile handheld computer and our peripherals for use with third party vertical applications  software. Our data collection and connectivity peripheral products are used with a variety of handheld computers, including our SoMo 650 mobile handheld computer, and with tablet computers, notebook computers and handheld computers with integrated phones that use Windows Mobile, Windows XP, Windows Vista, RIM Blackberry, Palm, Symbian 60 and Symbian 80 operating systems.

Our overall company brand identity and positioning goal is to become the leading provider of easy-to-deploy Business Mobility systems and peripherals. The guiding principles that we follow in developing our mobile handheld and peripheral products for the Business Mobility computing market are stable and expandable computing devices with industry standard expansion form factors, compact design, low battery power consumption to extend time between charges, ease of use, interoperability, and quality. Our focus is business customers in the mobile marketplace. Our mobile handheld computing products have been designed to address the Business Mobility market for a handheld computer that is neither a consumer-oriented handheld device nor a heavy duty industrial device. Our mobile handheld computer is easy to customize and integrate with peripherals and information systems and has an expected product life cycle of three to five years which meets the needs of businesses for longer deployments than have been available with most consumer-oriented handheld devices.

We work with more than 200 software integration companies that are offering or developing vertical application software for use with handheld computers. Examples of these vertical applications include patient medication administration within the health care industry, retail merchandising such as managing inventory on retail store shelves, sales and field force automation involving the collection and processing of orders or service information from remote locations by sales and service personnel, asset management and inventory control for assets having bar codes or radio frequency identification tags, and mobile point of sale applications. These mobile solutions are designed to improve the productivity of business enterprises by automating manual tasks, improving the quality of information collected, and enhancing mobile productivity by processing and transferring information from remote locations and mobile devices to the business enterprise, and then if required, back to the remote locations and mobile devices.

Most of our products, except our OEM embedded products, are sold through distributors and resellers that serve business customers. Our OEM embedded products are sold directly to the manufacturers of devices in which our products are embedded. The geographic regions we serve include the Americas, Europe, the Middle East, Africa and Asia Pacific. Total revenues for the three and six months ended June 30, 2008 were $7.5 million and $13.7 million, respectively, which represented increases of 19% and 15% from revenues of $6.3 million and $11.8 million, respectively for the corresponding periods one year ago.

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

- Mobile handheld computer products;
- Mobile peripheral products, including
  - Data collection products,
  - Connectivity products,
  - Serial interface products, and
- OEM embedded products.

Our *mobile handheld computer products* have been designed to address the Business Mobility market for a handheld computer that is neither a consumer-oriented handheld device nor a heavy duty industrial device. Our initial model, the SoMo 650 (SoMo is derived from Socket Mobile), was introduced in June 2007 and featured the Microsoft Windows Mobile 5.0 for Pocket PC operating system to ensure a high level of mobile application compatibility and to give workers a familiar computing environment. We began offering Windows Mobile 6 Classic and multiple language support for the SoMo 650 in the second quarter of 2008 giving customers a choice of operating systems and languages to best fit their needs. The SoMo 650 is easy to customize and integrate with peripherals and information systems and has an expected product life cycle of three to five years which meets the needs of businesses for longer deployments than have generally been available with most consumer-oriented handheld devices. Our mobile handheld computer's features include Wireless LAN and Bluetooth, a fast processor, a large, bright screen display, large amounts of SDRAM and flash memory, extended battery life, programmable action buttons to activate peripheral devices, reinforced CompactFlash and SDIO card slots, and a durable case. Additional models are in development, including a radio-free configured SoMo 650 for high security applications to begin shipping in the third quarter of 2008, that will run the Windows Mobile 5 or Windows Mobile 6 Classic operating system, add additional multiple language support, enable extended outdoor use, and offer specialized capabilities oriented to the needs of specific vertical markets. The SoMo 650 was specifically designed without an integrated mobile phone as most solutions involving our products use Bluetooth or Wireless LAN connections for data communications and do not require an integrated mobile phone. Mobile handheld computer products represented approximately 14% and 13% of our revenues for the three and six month periods ended June 30, 2008, respectively, compared to 1% of our revenues in each of same periods one year ago.

Our mobile peripheral products consist of *data collection products*, *connectivity products*, and *serial interface products*, which together represented approximately 52% and 54% of our revenues for the three and six months ended June 30, 2008, respectively, compared to 71% and 75% of our revenues for the same periods one year ago.

Our *data collection products* enable the electronic collection of data from bar codes, Radio Frequency IDentification (RFID) tags, or magnetic stripes and consist of:

- bar code scanning products that plug into or connect wirelessly to handheld computers, tablet computers, notebook computers, and handheld computers with integrated phones that use Windows Mobile, Windows XP, Windows Vista, Windows Tablet, RIM Blackberry, Palm, or Symbian 60 or Symbian 80 operating systems, and turn these devices into portable bar code scanners that can be used in various retail and industrial workplaces;
- plug-in radio frequency identification products that read radio frequency identification tags;
- a combination plug-in bar code scanner and radio frequency identification reader; and
- a plug-in magnetic stripe reader.

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We have developed extensive bar code scanning software called SocketScan that supports all of our data collection products, and have software developer kits that assist third party developers in integrating our SocketScan software and our hardware products into their applications and solutions. Our bar code scanning products include CompactFlash and SDIO plug-in bar code scanners for linear and two-dimensional bar code scanning, along with a cordless handheld bar code scanner and a ring scanner worn on the index finger, both of which connect to computing systems using the Bluetooth standard for short-range wireless connectivity. Data collection products represented approximately 41% of our revenues in both the three and six months ended June 30, 2008, compared to 52% and 55% of our revenues for the same periods, respectively, one year ago.

Our *connectivity products* are connection devices that can be plugged into standard expansion slots in handheld computers, tablet computers, and notebook computers that use Windows Mobile, Windows XP, or Windows Tablet operating systems. These products allow users to connect their devices via Ethernet or telephone to communicate with other networks and devices such as desktop computers, other handheld, tablet, and notebook computers, handheld computers with integrated phones, and printers. Our connectivity products include:

- modems for telephone connections that connect over a cable, and a cordless modem that utilizes Bluetooth wireless technology to connect a telephone to a Bluetooth-enabled computer or other device;
- Ethernet cards for local area network connections that connect over a cable; and
- accessory products such as batteries and cables.

Connectivity products represented approximately 6% and 7% of our revenues for the three and six months ended June 30, 2008, respectively, compared to 12% of our revenues in each of the same periods one year ago.

Our *serial interface products* enable the connection of a mobile computer to electronic devices either as a plug-in card (one, two or four ports) connecting over cables, or wirelessly over a Bluetooth network. Our serial interface products are used primarily with Windows XP and Windows Vista based devices. We recently introduced a USB to serial connector to enable a serial connection through a USB interface. Serial interface products represented approximately 5% and 6% of our revenues in the three and six months ended June 30, 2008, respectively, compared to 7% and 8% of our revenues for the same periods one year ago.

Our *OEM embedded products* consist of Bluetooth and Wireless LAN modules and plug-in cards used primarily by OEMs of handheld computers and other devices to build wireless connection functions into their products using the Bluetooth and Wireless LAN standards for wireless connectivity. Our plug-in cards and modules using the Bluetooth standard for short-range wireless connectivity include extensive communications software enabling the use of these products, as do our plug-in cards for connecting to local wireless networks using the Wireless LAN 802.11b/g (or Wi-Fi) standards. We have recently added Cisco Compatible Extensions (CCX) 4.0 certification to our Wireless LAN software to enable our Wireless LAN products to be compatible with a Cisco Wireless LAN infrastructure. Bluetooth and Wireless LAN connection functions are being built into many third party mobile devices, which may reduce the demand for our plug-in products through expansion slots but may increase the demand for our Bluetooth and Wireless LAN modules and embedded plug-in cards. OEM embedded products represented approximately 34% and 33% of our revenues for the three and six months ended June 30, 2008, respectively, compared to 28% and 24% of our revenues for the same periods one year ago.

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Our revenues by product family for the three and six months ended June 30, 2008 and 2007, and the corresponding increase or decrease in revenues for the comparable periods are shown in the following table:

| *(revenues in thousands)* | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| Product family: | 2008 | 2007 | Increase (Decrease) | 2008 | 2007 | Increase (Decrease) |
| Mobile handheld computer products | $ 1,032 | $ 67 | 1440% | $ 1,707 | $ 67 | 2448% |
| Mobile peripheral products: | | | | | | |
| Data collection | 3,056 | 3,270 | (7%) | 5,561 | 6,505 | (15%) |
| Connectivity | 437 | 734 | (40%) | 906 | 1,423 | (36%) |
| Serial products | 405 | 434 | (7%) | 977 | 921 | 6% |
| OEM embedded products  | 2,563  |   1,795  | 43% |   4,512  |   2,932  | 54% |
| Total | $ 7,493 | $ 6,300 | 19% | $ 13,663 | $ 11,848 | 15% |

Our mobile handheld computer product revenues in the three and six months ended June 30, 2008 were $1,032,000 and $1,707,000, respectively, compared to $67,000 in each of the same periods one year ago. We began shipping our first mobile handheld computer, the SoMo 650, to customers in our distribution channel in the second quarter of 2007. In the third quarter of 2007 we completed our objectives of ramping up production and fully stocking our distribution channel to enable the commencement of widespread customer evaluation, qualification, and deployment. Increased revenues for our handheld computer in 2008 reflect higher sales volumes due to a growing customer base with larger average unit deployments.

Our data collection product revenues in the three and six months ended June 30, 2008 were $3.1 million and $5.6 million, a decrease of 7% and 15% compared to revenues of $3.3 million and $6.5 million, respectively, in the comparable periods one year ago. Declines in the comparable three month periods were due primarily to lower sales volumes of our Cordless Hand Scanner, SDIO In-Hand Scan card, and our Cordless Ring Scanner. Revenues related to our primary scanning product, the CompactFlash In-Hand Scan card, were flat in the comparable three month periods. Revenue decreases in the comparable six month periods of $0.6 million in sales of our primary scanning product, the CompactFlash In-Hand Scan card, decreases of $0.3 million in sales of our Cordless Ring Scanner, and decreases in sales volumes of our Cordless Hand Scanner were partially offset by increases in sales volumes of our SDIO In-Hand Scan card. Data collection revenues in the first half of 2008 were slowed in the first quarter but began to recover in the second quarter due in part to delayed availability of new handheld computer models originally announced by a major handheld computer manufacturer in the third quarter of 2007, which did not begin shipping until February 2008. Such announcements and delayed timing of product availability typically slow customer deployments of our peripheral products because of the time needed by customers to evaluate or adopt the new handheld computer models.



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Our connectivity product revenues in the three and six months ended June 30, 2008 were $437,000 and $906,000, respectively, declining 40% and 36% compared to revenues of $734,000 and $1,423,000, respectively, in the same periods one year go. The declines in each of the comparable periods resulted from reduced sales volumes of our Modem plug-in products and Ethernet plug-in products due to reduced corporate deployment of these wired connection solutions.

Our serial interface product revenues in the three and six months ended June 30, 2008 were $405,000 and $977,000, respectively, a decline of 6% and an increase of 6% compared to revenues of $433,000 and $920,000, respectively, in the comparable periods one year ago. Revenue increases in the comparable six month periods were from sales of our standard serial PC card products. Our standard peripheral connection cards are primarily sold to connect peripheral devices or other electronic equipment to notebook computers. Partially offsetting these increases in the comparable six months were declines in sales of our CompactFlash card product, which also declined in the comparable three month periods. Sales of our cordless Bluetooth serial adapter product were flat in the comparable periods.

Our OEM embedded product revenues in the three and six months ended June 30, 2008 were $2.6 million and $4.5 million, respectively, an increase of 43% and 54% compared to $1.8 million and $2.9 million, respectively, in the comparable periods one year ago. Revenue increases of $0.8 million and $1.7 million in sales of our Bluetooth modules in the three and six months of 2008 were due to a recovery in market conditions that existed in early 2007. In the first quarter of 2007 our customers in the industrial ruggedized market segment experienced pronounced increased competition due to a short-term aggressive price discounting by a major competitor, a trend which adversely affected our related Bluetooth module revenues in the first quarter of 2007, but improved steadily in the following second, third, and fourth quarters of 2007, and through the first half of 2008, following cessation of the aggressive discounting by the competition. Additional revenue increases in the three and six month periods were from sales our Wireless LAN plug-in card products and were due primarily to increased sales volumes of these products in the second quarter of 2008. Partially offsetting these increases were declines in revenues related to our Bluetooth plug-in cards in each of the comparable periods, primarily due to this wireless technology becoming increasingly a standard feature built-in by handheld computer manufacturers.

**Gross Margins**

Gross margins in both the three and six month periods ended June 30, 2008 were 49% compared to margins of 49% and 50%, respectively, in each of the comparable periods in 2007. We generally price our products as a markup from our cost, and we offer discount pricing for higher volume purchases. Reductions in overall margins in the first half of 2008 compared to the same period one year ago are due primarily to discounts on volume purchases of our Bluetooth modules by customers in our OEM embedded business segment and increased sales of our mobile handheld computer which began shipping late in the second quarter of 2007. Margins on our mobile handheld computer product are below our average product margins. We expect a more significant reduction in our overall gross margins as the volumes of our mobile handheld computer products increase.



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**Research and Development Expense**

Research and development expense for the three months ended June 30, 2008 was $1,145,000, a decrease of 1% compared to research and development expense of $1,162,000 in the corresponding period one year ago. Research and development expense for the six months ended June 30, 2008 was $2.3 million, a decline of 10% compared to research and development expense of $2.6 million in the corresponding period one year ago. The decrease in the comparable three months is attributable to reduced consulting and professional fees. Decreases of $0.2 million in the comparable six months are attributable to the costs incurred in the first quarter of 2007 related to the development of our SoMo 650 mobile handheld computer, the development of which was begun in the fourth quarter of 2006 with the majority of the development expense concluded by the end of the first quarter of 2007. Additional decreases in the comparable six months were from reductions in consulting and professional fees related to fewer projects requiring the use of external technical expertise, and from reductions in equipment costs due to higher amounts of depreciation expense related to capitalized tooling in the first quarter of 2007. Partially offsetting these decreases were increases in personnel costs from staffing in-house expertise for technical skills formally obtained from outside consulting and professional service providers. Research and development expenses are expected to increase in the third quarter of 2008 from second quarter levels.

**Sales and Marketing Expense**

Sales and marketing expense in each of the three month periods ended June 30, 2008 and 2007 was $2.0 million. Sales and marketing expense for the six month period ended June 30, 2008 was $3.9 million, an increase of 5% compared to sales and marketing expense of $3.7 million in the corresponding period one year ago. Increases in personnel costs in the comparable three and six month periods were due to the additions of key personnel beginning in the second quarter of 2007, including our Senior VP of Sales & Marketing, as we added sales resources in North America to begin selling our new SoMo 650 mobile handheld computer, which began shipping late in the second quarter of 2007, and to recruit and develop new third party channel partners. Additional increases in the comparable six month periods were related to higher levels of participation at key tradeshows in the first half of 2008 compared to the same period one year ago. The increased personnel expense in the comparable three month periods were offset by reductions in advertising and promotion expense, and reduced travel expense. Sales and marketing expense is expected to increase in the third quarter of 2008 from second quarter levels due to increased personnel costs and promotional activities.

**General and Administrative Expense**

General and administrative expense for the three months ended June 30, 2008 was $622,000, a decrease of 9% compared to general and administrative expense of $682,000 in the corresponding period one year ago. General and administrative expense for the six month period ended June 30, 2008 was $1.4 million, a decrease of 7% compared to general and administrative expense of $1.5 million in the corresponding period one year ago. Decreases in the comparable three and six month periods were primarily from reduced stock-based compensation expense as older grants with higher valuations compared to more current grants, became fully expensed. General and administrative expense in the third quarter of 2008 is expected to continue at levels similar to those in the second quarter of 2008.

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**Amortization of Intangibles**
In July 2004 we acquired a patent which covers the design and functioning of plug-in bar code scanners, bar code imagers, and radio frequency identification products. The patent was purchased for $600,000 and has been capitalized as an intangible asset. The patent is being amortized on a straight line basis over a ten-year period. Intangible assets of $571,000 remaining from a prior acquisition in 2000 consist of developed software and technology with estimated lives at the time of acquisition of 8.5 years. Amortization charges for the three and six months ended June 30, 2008 for all acquired intangibles were $32,000 and $64,000, respectively, compared to $34,000 and $68,000 for the same periods one year ago.

**Interest Income and Expense**
Interest income reflects interest earned on cash balances. Interest income of $4,000 and $16,000 in the three and six month periods ended June 30, 2008, respectively, declined from interest income of $30,000 and $68,000, respectively, in the comparable periods one year ago. Lower interest income in the comparable periods reflects lower average cash balances combined with lower average rates of return.

Interest expense of $18,000 and $31,000 for the three and six months ended June 30, 2008, respectively, increased from interest expense of $3,000 and $6,000, respectively, for the comparable periods one year ago. Interest expense is related to interest on amounts drawn on our bank lines of credit and term loan, and interest on equipment lease financing obligations. Higher interest expense in the comparable periods is due to higher average balances outstanding on our bank lines of credit partially offset by lower interest rates, and higher average amounts outstanding on our bank term loan compared to the same periods one year ago. In the second quarter of 2008, average amounts outstanding on our bank lines of credit increased from prior quarters' levels. Prior to the second quarter of 2008 we used our bank lines of credit only at the end of the quarter in the first quarter of 2008 and at the end of each quarter in 2007. The term loan was advanced at the end of the second quarter of 2007 and is being repaid in 36 monthly installments which began in July of 2007. Interest expense is expected to increase in the third quarter of 2008 from second quarter levels due to higher average amounts outstanding anticipated on our bank lines of credit to finance working capital increases related to anticipated growth.

**Taxes**
Deferred income tax reflects the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Deferred tax expense of $8,000 and $16,000 in the three and six month periods ended June 30, 2008 and 2007, and the corresponding deferred tax liability shown on the Company's balance sheet, 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, and furthermore, this deferred tax liability may never reverse. The Company maintains a full valuation allowance for all other components of deferred tax assets. The Company has not generated taxable income in any periods in any jurisdiction, foreign or domestic.



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In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" ("FIN 48"), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements.

FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 as of January 1, 2007, as required. There were no adjustments to the financial statements as a result of the adoption of FIN 48. For additional information on taxes see Note 9 to the Condensed Financial Statements.

**Liquidity and Capital Resources**

We were unprofitable in the first two quarters of 2008. We were unprofitable in each of the quarters of fiscal years 2007 and 2006. We were profitable in two quarters in 2005, but unprofitable for fiscal year 2005. Fiscal year 2004 was the first profitable year in our history, but only to the extent of $288,000. Prior to 2004, we incurred significant operating losses in each financial period since our inception. We may continue to be unprofitable in the foreseeable future. Historically we have financed our operations through the sale of equity securities, equipment financing, and revolving bank lines of credit. Since our inception we have raised approximately $51 million in equity capital to fund our operations.

Cash used in operating activities was $2.2 million in the first half of 2008, compared to cash used in operating activities of $0.2 million in the first half of 2007. Cash used in the first half of 2008 resulting from our net loss adjusted for non-cash items was $0.3 million compared to cash used of $1.0 million in the first half of 2007 from our net loss adjusted for non-cash items. Adjustments for non-cash items consisting of depreciation and amortization, amortization of intangibles, gains and losses on foreign currency transactions, changes in deferred rent, deferred tax expense, and stock-based compensation expense, totaled $0.8 million in the first half of 2008 compared to $1.0 million in the first half of 2007. Changes in working capital balances in the first half of 2008 resulted in a use of cash of $1.8 million, and were primarily from increases in accounts receivable due to the timing of shipments late in the second quarter of 2008 and the timing of collections from key distributors concentrated at the end of the fourth quarter of 2007, and increases in inventories due primarily to stocking higher quantities of our Bluetooth modules for our OEM customers, and stocking higher quantities of our mobile handheld computer, partially offset by increases in accounts payable related to the purchases that led to the increased levels of inventories. Changes in working capital balances in the first half of 2007 resulted in a source of cash of $0.8 million, and were primarily from increases in accounts payable and accrued expenses attributable to development costs of our mobile handheld computer and the purchase of the related initial quantities of units late in the second quarter, increased accrued payroll expenses related to additions of key sales personnel as we staffed the sales team to begin selling our new mobile handheld computer, and reductions in levels of inventories primarily due to increased shipments of our Bluetooth modules in the second quarter of 2007, partially offset by increases in accounts receivable due to higher overall shipments in the second quarter of 2007.

Cash used in investing activities was $0.2 million in the first half of 2008 compared to $0.7 million in the first half of 2007. Higher amounts of investing activities in the first half of 2007 reflect the costs of leasehold improvements related to our corporate headquarters into which we moved at the beginning of the first quarter of 2007. Remaining investing activities in each of the periods reflects the costs of new computer hardware and software, and tooling costs.



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Cash provided from financing activities was $0.5 million in the first half of 2008, compared to $0.6 million during the first half of 2007. Financing activities in the first half of 2008 consisted primarily of a net increase in the amounts drawn on our bank lines of credit at the end of the quarter, proceeds from the exercise of warrants and stock options, and repayments on our bank term loan, which was advanced at the end of June 2007 and is being repaid in 36 monthly installments beginning in July 2007. Financing activities in the first half of 2007 consisted primarily of proceeds from a term loan advanced at the end of the second quarter of 2007, a net increase in the amounts drawn on our bank lines of credit, and proceeds from the exercise of stock options.

Our cash balances at June 30, 2008 were $3.1 million, including cash of $3.1 million drawn against our bank line of credit and a net balance of $0.4 million from the bank term loan, which is being repaid monthly over three years beginning in July 2007. In March 2008, we extended our bank line of credit agreement, which will now expire on March 24, 2010. We have employee stock options outstanding that, if exercised, would further increase our cash and equity balances. We believe our existing cash, plus our ability to reduce costs, and our bank line will be sufficient to meet our funding requirements at least through June 30, 2009. If we can return to profitability and revenue growth, we anticipate requirements for cash will include funding of higher receivable and inventory balances, and increasing expenses, including more employees to support our growth and increases in salaries, benefits, and related support costs for employees. If we cannot return to 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. Should the need arise, there are no assurances that additional capital will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. Although we do not anticipate the need to raise additional capital at this time to fund our operations, we may raise additional capital if market conditions are appropriate.

Our contractual cash obligations at June 30, 2008 are outlined in the table below:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| Contractual Obligations ** ** | Total | Less than 1 year | 1 to 3 years | 4 to 5 years | More than 5 years |
| Capital leases | $ 44,500 | $ 23,700 | $ 20,800 | $ --- | $ --- |
| Operating leases | 1,523,000 | 363,300 | 763,400 | 396,300 | --- |
| Term loan, principal and interest | 349,700 | 167,700 | 182,000 | --- | --- |
| Unconditional purchase obligations with contract manufacturers | ** ** 5,373,100 | ** ** 5,373,100 | ** ** --- | ** ** --- | ** ** --- |
| Total contractual cash obligations | $ 7,290,300 | $ 5,927,800 | $ 966,200 | $ 396,300 | $ --- |

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements as defined in Item 303 of Regulation S-K.

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**Recent Accounting Pronouncements**
In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"), which establishes a framework for measuring fair value and enhanced disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157," which provides for a one year deferral of the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value on a recurring basis. We adopted the provisions of SFAS 157 as of January 1, 2008, with respect to our financial assets and liabilities only. The adoption of this statement did not have a material impact on our financial statements. For additional discussion on fair value measurements see Note 1 to the Condensed Financial Statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), which permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We adopted SFAS 159 as of January 1, 2008. The adoption of SFAS 159 did not have a material impact on our financial statements.



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**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. 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, 2008, a decline of 1% in interest rates would not have had a material affect on our quarterly interest income.

Our bank credit line facilities of up to $4.0 million have variable interest rates based upon the lender's index rate plus 0.5% for both the domestic line (up to $2.5 million) and the international line (up to $1.5 million). Accordingly, interest rate increases would increase our interest expense on outstanding credit line balances. We utilized only a portion our credit line facility during the second quarter of 2008. In the first quarter of 2008 and in each quarter of fiscal year 2007 we utilized the credit line facility only at the end of the quarter and therefore did not subject ourselves to significant interest rate exposure in such quarters. Based on a sensitivity analysis, an increase of 1% in the interest rate would increase our borrowing costs by $10,000 for each $1 million of borrowings, if outstanding for the entire year, against our bank credit facility or a maximum of $40,000 if we utilized our entire 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, we pay the expenses of our European employees in Euros and British pounds, and we may enter into selected future purchase commitments with foreign suppliers that may be paid in the local currency of the supplier. We hedge a significant portion of our European receivables balance denominated in Euros to reduce the foreign currency risk associated with these assets, and we have not been subject to significant losses from material foreign currency fluctuations. Based on a sensitivity analysis of our net foreign currency denominated assets and subsidiary expenses at the beginning, during and at the end of the quarter ended June 30, 2008, an adverse change of 10% in exchange rates would result in a decrease in our net income for the second quarter of approximately $63,000, if left unprotected. For the second quarter of 2008 the total net adjustment for the effects of changes in foreign currency on cash balances, collections, payables, and derivatives was a net loss of $19,700. We will continue to monitor, assess, and mitigate through hedging activities, the risk associated with these exposures.



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**Item 4T. Controls and Procedures**

*Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures*

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

*Changes in Internal Control Over Financial Reporting*

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



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**PART II. OTHER INFORMATION**

**Item 1A. Risk Factors**

There are no material changes to the risk factors described in Part I, "Item 1A. Risk Factors," in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007. The risk factor titled, "*Our Common Stock will become ineligible for listing on the NASDAQ Capital Market if it does not trade at or above $1.00, which would materially adversely affect the liquidity and price of our Common Stock*," has been updated to reflect that our listing has transferred to the NASDAQ Capital Market from the NASDAQ Global Market, and has been expanded to include information regarding the approval by stockholders of a proposal which grants to the Board of Directors the authority to initiate a reverse stock split in a range from one-for-five to one-for-ten any time through December 31, 2008. The presentation of numerical amounts and percentages in the following risk factors below titled: "*A significant portion of our revenue currently comes from two distributors, and any decrease in revenue from these distributors could harm our business;" "Our operating results could be harmed by economic, political, regulatory and other risks associated with export sales;" "The sale of a substantial number of shares of our Common Stock could cause the market price of our Common Stock to decline;" and "Volatility in the trading price of our Common Stock could negatively impact the price of our Common Stock*," have been updated to reflect the second quarter of 2008 information.

The risks described in our Annual Report on Form 10-K and updated in this 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.

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

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



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

Although we do not anticipate the need to raise additional capital during the next twelve months to fund our operations, we may incur operating losses in future quarters and may need to raise capital to fund these losses. Our forecasts are highly dependent on factors beyond our control, including market acceptance of our products and sales of handheld computers. 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. In addition, the availability of our bank line is dependent upon our maintaining minimum levels of tangible net worth. Future operating losses could cause us to lose the availability of our bank line as a result of becoming non-compliant with this covenant.

**Our Common Stock will become ineligible for listing on the NASDAQ Capital Market if it does not trade at or above $1.00, which would materially adversely affect the liquidity and price of our Common Stock.**

On June 10, 2008 we transferred our listing to the NASDAQ Capital Market from the NASDAQ Global Market, an action taken in response to a previously announced staff deficiency notice we received on December 10, 2007 from the Listing Qualifications Department of the NASDAQ Stock Market. The deficiency notice stated that our stock would have to achieve a minimum closing bid price of at least $1.00 for at least 10 consecutive business days within 180 calendar days, or by June 9, 2008 in order to maintain our listing on the NASDAQ Global Market, and should our stock not regain compliance for continued listing on the NASDAQ Global market, we may transfer our listing to the NASDAQ Capital Market if our stock satisfies all criteria, other than compliance with the minimum bid price requirement, for initial inclusion on such market. Upon transfer to the NASDAQ Capital Market we have been afforded an additional 180 calendar days from the original June 9, 2008 deadline, or until December 8, 2008, to regain compliance with NASDAQ's minimum bid price requirement of $1.00 per share. As of July 31, 2008, our Common Stock has not achieved the minimum closing bid price of $1.00 on any single day since transferring to the NASDAQ Capital Market.

On April 23, 2008 at the Annual Meeting of Stockholders, our stockholders approved a proposal to give the Board of Directors the authority to initiate a reverse stock split in a range from one-for-five to one-for-ten any time through December 31, 2008, which if implemented, would have the effect of increasing the trading price of our Common Stock. The NASDAQ Stock Exchange views the use of a reverse stock split as an acceptable method to achieve compliance with the minimum closing bid price requirement.

If our Common Stock becomes ineligible for listing on the NASDAQ Capital Market, and is thereafter traded only on the over-the-counter market, our stockholders' abilities to purchase and sell our Common Stock could be less orderly and efficient and more costly. Furthermore, a delisting of our Common Stock could have a materially adverse impact on our business operations by damaging our general business reputation, impairing our ability to obtain additional capital, reducing the incentives that equity ownership is intended to provide to our employees, and causing a loss of confidence by investors, suppliers and employees. As a result of the negative impact on the liquidity of our Common Stock and on our business, a delisting would also likely decrease the market price of our Common Stock and increase the volatility of our stock price.



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

Our success has been dependent upon the ability of third parties in the mobile personal computer industry to complete development of 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 Windows mobile products, particularly the standard Pocket PC handhelds, phone-integrated devices, and tablets, and other phone-integrated devices including those from Palm, Nokia, and Blackberry, for use with our plug-in and wireless peripherals, and the adoption of these mobile computer devices for business use. If manufacturers are unable or choose not to ship new products such as Pocket PC and other Windows mobile devices, or experience difficulties with new product transitions that cause delays in the market as we experienced in the past three years, or if these products, including our new line of mobile handheld computers, the first model of which we began shipping in June 2007, fail to achieve or maintain market acceptance, the number of our potential new customers would be reduced and we would not be able to meet our sales expectations.

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

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

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

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

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



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

A significant portion of our revenue comes from two distributors, Tech Data Corp. and Ingram Micro, Inc., which together represented approximately 29% and 37% of our worldwide revenue in the first six months of 2008 and fiscal year 2007, respectively. We expect that a significant portion of our revenue will continue to depend on sales to Tech Data Corp. and Ingram Micro, Inc. We do not have long-term commitments from Tech Data Corp. or Ingram Micro, Inc. to carry our products. Either could choose to stop selling some or all of our products at any time, and each of these companies also carries our competitors' products. If we lose our relationship with Tech Data Corp. or Ingram Micro, Inc., we would experience disruption and delays in marketing our products.

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

Substantially all of our peripheral products are designed for use with mobile personal computers, including handhelds, notebook computers, tablets and handheld computers with integrated phones. If the mobile personal 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, as we experienced in the past three years, or if the markets for our mobile handheld computers do not grow, we will not achieve our sales projections.

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

Many of our products use new technologies, such as 2D bar code scanning and radio frequency identification, which are not yet widely adopted in the market. If these technologies fail to become widespread, or are adopted slower than expected, our sales will suffer.

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

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

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

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



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

The demand for our products depends on many factors and is difficult to forecast. We expect that it will become more difficult to forecast demand as we introduce and support more products and as competition in the market for our products intensifies. 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.

If demand is lower than forecasted levels, we could have excess production resulting in higher inventories of finished products and components, which could lead to write-downs or write-offs of some or all of the excess inventories, and reductions in our cash balances. Lower than forecasted demand could also result in excess manufacturing capacity at our third party manufacturers and in our failure to meet minimum purchase commitments, each of which may lower our operating results.

**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.

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, particularly since we seek to continually introduce new and enhanced products and are likely to face increasing price competition.



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

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

We have devoted significant research and development resources to design activities for Windows-mobile products, Palm and Blackberry devices, handheld computers with integrated phones using Windows Mobile and Symbian System 60 and 80 operating systems, and more recently, to develop our own family of mobile handheld computers. Such design activities have diverted financial and personnel resources from other development projects. These design activities are not undertaken pursuant to any agreement under which Microsoft, Palm, Research In Motion, or Symbian is obligated to continue the collaboration or to support the products produced from the collaboration. Consequently, these organizations may terminate their collaborations with us for a variety of reasons, including our failure to meet agreed-upon standards or for reasons beyond our control, such as changing market conditions, increased competition, discontinued product lines, and product obsolescence.

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

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

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



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

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

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

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

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



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

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

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

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

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

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

- the demand for our products;
- the size and timing of customer orders;
- unanticipated delays or problems in our introduction of new products and product enhancements;
- the introduction of new products and product enhancements by our competitors;

- the timing of the introduction of new products that work with our connection products;
- changes in the revenues attributable to royalties and engineering development services;
- product mix;
- timing of software enhancements;
- changes in the level of operating expenses;
- competitive conditions in the industry including competitive pressures resulting in lower average selling prices; and
- timing of distributors' shipments to their customers.



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Because we base our staffing and other operating expenses on anticipated revenues, 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.

**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 thirteen to sixteen 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.

**Beginning January 1, 2006 we began to expense options granted under our employee stock plans as compensation, and as a result our net income and earnings per share were negatively affected, we may continue to have net losses as a result of the requirement to expense options, and may find it necessary to change our business practices to attract and retain employees.**

Historically, we have used stock options as a key component of our employee compensation packages. We believe that stock options provide an incentive to our employees to maximize long-term stockholder value and, through the use of vesting, encourage valued employees to remain with us. The expensing of employee stock options adversely affected our net income and earnings per share in the first two quarters of 2008 and in each of the quarters of fiscal years 2007 and 2006, will continue to adversely affect future quarters, and will make profitability harder to achieve or make our future profits or net losses worse. 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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**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.

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

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

**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 36% of our revenue in the first half of 2008 and 35% of our revenue in the fiscal year 2007. 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.



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**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 controls 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 controls 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.

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

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

As of July 31, 2008, we had 32,300,129 shares of Common Stock outstanding. Substantially all of these shares are freely tradable in the public market, either without restriction or subject, in some cases, only to S-3 prospectus delivery requirements and, in other cases, only to manner of sale, volume, and notice requirements of Rule 144 under the Securities Act.

As of July 31, 2008, we had 11,011,106 shares subject to outstanding options under our stock option plans, and 1,075,991 shares were available for future issuance under the plans. We have registered the shares of Common Stock subject to outstanding options and reserved for issuance under our stock option plans. Accordingly, shares underlying vested options will be eligible for resale in the public market as soon as the options are exercised.



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

During the period from January 1, 2007 through July 31, 2008, our Common Stock price fluctuated between a high of $1.40 and a low of $0.43. The trading price of our Common Stock could be subject to wide fluctuations in response to many factors, some of which are beyond our control, including general economic conditions and the outlook of securities analysts and investors on our industry. In addition, the stock markets in general, and the markets for high technology stocks in particular, have experienced high volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our Common Stock.

**Item 6. Exhibits**

Exhibits

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

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

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



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**SIGNATURES**

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

SOCKET MOBILE, INC.
Registrant

Date: August 13, 2008

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

Date: August 13, 2008

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



(Index)

**Index to Exhibits**

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