PUMATECH INC
Form 10-Q
December 15, 2003

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 October 31, 2003

OR

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

For the transition period from __________ to __________

Commission File Number 0-21709

PUMATECH, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**77-0349154**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification Number)**

2550 North First Street, San Jose, California 95131

(Address of principal executive office and zip code)

(408) 321-7650

(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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of December 5, 2003: 49,516,232

Table of Contents

PUMATECH, INC.

10-Q REPORT

INDEX

Table of Contents

PUMATECH, INC.

PART I FINANCIAL INFORMATION

Item 1. Unaudited Condensed Consolidated Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

(Unaudited)

	October 31, 2003	July 31, 2003
Assets		
Current assets:		
Cash and cash equivalents	$ 4,969	$ 7,842
Short-term investments	20,186	19,317
Accounts receivable, net of allowance for doubtful accounts of $378 and $340	6,179	5,469
Inventories, net	253	113
Other current assets	667	882
Total current assets	32,254	33,623
Property and equipment, net	1,261	1,153
Goodwill	5,713	2,731
Other intangible assets, net	4,049	2,734
Restricted cash	296	296
Other assets	975	630
Total assets	$ 44,548	$ 41,167
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 2,413	$ 2,619
Accrued liabilities	3,896	3,816
Current portion of obligations under capital lease	44	
Deferred revenue	2,078	2,015
Total current liabilities	8,431	8,450
Obligations under capital lease	137	
Other liabilities	712	921
Total liabilities	9,280	9,371
Commitments and contingencies (Note 8)		

Stockholders equity:		
Preferred stock, $0.001 par value; 2,000 shares authorized; none issued and outstanding at October 31, 2003 and July 31, 2003		
Common stock, $0.001 par value; 80,000 shares authorized; 49,484 and 47,753 shares issued and outstanding at October 31, 2003 and July 31, 2003	49	48
Additional paid-in capital	160,299	153,986
Receivable from stockholders	(138)	(112)
Deferred stock compensation	(1,039)	(459)
Accumulated deficit	(123,922)	(121,661)
Accumulated other comprehensive income (loss)	19	(6)
Total stockholders equity	35,268	31,796
Total liabilities and stockholders equity	$ 44,548	$ 41,167

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

1

Table of Contents

PUMATECH, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended October 31,	
	2003	**2002**
Revenue		
License	$ 5,270	$ 4,063
Services	2,746	947
Total revenue	8,016	5,010
Cost and operating expenses:		
Cost of revenue (includes non-cash stock compensation of $121 and $0)	1,634	824
Research and development (includes non-cash stock compensation of $46 and $29)	2,193	1,781
Sales and marketing (includes non-cash stock compensation of $291 and $0)	3,280	2,634
General and administrative (includes non-cash stock compensation of $798 and $33)	2,385	1,121
Amortization of intangibles	259	149
In-process research and development	469	
Other charges	76	
Total cost and operating expenses	10,296	6,509
Operating loss	(2,280)	(1,499)
Other income, net	126	211
Loss before income taxes	(2,154)	(1,288)
Provision for income taxes	(107)	(88)
Net loss	$ (2,261)	$ (1,376)
Basic and diluted net loss per common share	$ (0.05)	$ (0.03)
Shares used in computing basic and diluted net loss per common share	48,266	45,383

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

2

Table of Contents

PUMATECH, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended October 31,	
	2003	**2002**
Cash flows from operating activities:		
Net loss	$ (2,261)	$ (1,376)
Adjustments to reconcile net loss to net cash used in operating activities:		
In-process research and development	469	
Allowance for (recovery of) doubtful accounts	40	(142)
Inventory reserves	30	30
Depreciation	238	382
Amortization	259	149
Non-cash stock compensation	1,256	62
Realized gain on sale of investments		(10)
Changes in operating assets and liabilities:		
Accounts receivable	(750)	214
Inventories	(170)	(29)
Other current assets	215	(36)
Accounts payable	(206)	(160)
Accrued liabilities	(2,148)	(546)
Deferred revenue	63	38
Other assets and liabilities	(317)	(2)
Net cash used in operating activities	(3,282)	(1,426)
Cash flows from investing activities:		
Purchase of property and equipment	(328)	(48)
Purchase of short-term investments	(4,073)	(5,141)
Proceeds from the sales of short-term investments	2,175	6,844
Proceeds from the maturities of short-term investments	1,000	3,100
Net cash provided by (used in) investing activities	(1,045)	4,755
Cash flows from financing activities:		
Principal payments on borrowings		(2,000)
Note repayments from stockholders		330
Proceeds upon exercise of stock options	1,307	1
Proceeds from ESPP shares issued	147	92

Net cash provided by (used in) financing activities	1,454	(1,577)
Net increase (decrease) in cash and cash equivalents	(2,873)	1,752
Cash and cash equivalents at beginning of period	7,842	4,331
Cash and cash equivalents at end of period	$ 4,969	$ 6,083

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

3

Table of Contents

PUMATECH, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Basis of Presentation and Summary of Significant Accounting Policies

The accompanying condensed consolidated financial statements of Pumatech, Inc. (the Company) as of October 31, 2003 and for the three months ended October 31, 2003 and 2002 are unaudited and reflect all normal recurring adjustments which are, in the opinion of management, necessary for their fair presentation. These condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended July 31, 2003. The condensed consolidated balance sheet as of July 31, 2003 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The results of operations for the interim period ended October 31, 2003 are not necessarily indicative of results to be expected for the full year.

Liquidity and Capital Resources

The Company has incurred losses and negative cash flows since inception. The Company incurred a net loss of approximately $2,261,000 for the three months ended October 31, 2003 and negative cash flows from operations of approximately $3,282,000 for the three months ended October 31, 2003. The Company s cash balances may decline further, although the Company believes that the effects of its strategic actions implemented to improve revenue as well as control costs along with existing cash resources will be adequate to fund its operations for at least the next 12 months. Failure to generate sufficient revenues or control spending could adversely affect the Company s ability to achieve its business objectives.

Use of Estimates and Assumptions

The preparation of the condensed consolidated financial statements in conformity with generally accepted accounting principles requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. On an on-going basis, the Company evaluates its estimates, including those related to provision for doubtful accounts, channel inventory and product returns, valuation of intangibles, investments and other long-lived assets, restructuring accruals, license and service revenue recognition and contingencies, among others. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for taking judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Revenue Recognition

Revenue is derived from software licenses and related services, which include implementation and integration of software solutions, post contract support, training and consulting.

Transactions involving the sale of software products are accounted for under the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 97-2, Software Revenue Recognition, as amended by SOP No. 98-9, Modification of 97-2, Software Revenue Recognition with Respect to Certain Transactions. For contracts with multiple elements, and for which vendor-specific objective evidence of fair value for the undelivered elements exists, revenue is recognized for the delivered elements based upon the residual contract value as prescribed by SOP No. 98-9. The Company has accumulated relevant information from contracts to use in determining the availability of vendor-specific objective evidence and believes that such information complies with the criteria established in SOP No. 97-2 as follows:

Customers are required to pay separately for annual maintenance. Optional stated future renewal rates are included as a term of the contracts. The Company uses the renewal rate as vendor-specific objective evidence of fair value for maintenance.

Table of Contents

The Company charges standard hourly rates for consulting services, when such services are sold separately, based upon the nature of the services and experience of the professionals performing the services.

For training, the Company charges standard rates for each course based upon the duration of the course, and such courses are separately priced in contracts. The Company has a history of selling such courses separately.

Revenue from license fees is recognized when persuasive evidence of an arrangement exists, delivery of the product has occurred, no significant Company obligations with regard to implementation or integration exist, the fee is fixed or determinable and collectibility is probable. Arrangements for which the fees are not deemed probable for collection are recognized upon cash collection. Arrangements for which the fees are not deemed fixed or determinable are recognized in the period they become due. Payments from customers received in advance of revenue recognition are recorded as deferred revenue.

Services revenue primarily comprises revenue from consulting fees, maintenance contracts and training. Services revenue from consulting and training is recognized as the service is performed. Maintenance contracts include the right to unspecified upgrades and ongoing support. Maintenance revenue is deferred and recognized ratably as services are provided over the maintenance period.

License and services revenue on contracts involving significant implementation, customization or services, that are essential to the functionality of the software is recognized over the period of each engagement, primarily using the percentage-of-completion method. Labor hours incurred is generally used as the measure of progress towards completion as prescribed by SOP No. 81-1, Accounting for Performance of Construction-Type and Certain Product-Type Contracts. Revenue for these arrangements is classified as license revenue and services revenue based upon estimates of fair value for each element, and the revenue is recognized based on the percentage-of-completion ratio for the arrangement. A provision for estimated losses on engagements is made in the period in which the loss becomes probable and can be reasonably estimated. The Company considers a project completed at the go-live date. When the Company sells additional licenses, revenue is recognized after the go-live date if the products or seats have been delivered and no remaining obligations exist.

The Company currently sells its products directly to individuals, small businesses and corporations, to original equipment manufacturers (OEMs) and to distributors and value-added resellers in North America, Europe, the Asia-Pacific region, South America and Africa. Revenue from products distributed indirectly through major distributors and resellers is recognized at the time these distributors and resellers sold the products to their customers. Agreements with the Company s major distributors and resellers contain specific product return privileges for stock rotation and obsolete products that are generally limited to contractual amounts. Reserves for estimated future returns are provided for upon revenue recognition. Product returns are recorded as a reduction of revenues. Accordingly, the Company has established a product returns reserve composed of 100% of product inventories held at the Company s distribution partners, as well as an estimated amount for returns from customers of the distributors and other resellers as a result of stock rotation and obsolete products, among others. Such reserves are based on:

- historical product returns and inventory levels on a product by product basis;
- current inventory levels and sell through data on a product by product basis as reported by the Company s major distributors worldwide;
- demand forecast by product in each of the principal geographic markets, which is impacted by the Company s product release schedule, seasonal trends and analyses developed by the Company s internal sales and marketing group; and
- general economic conditions.

Revenue from OEMs under minimum guaranteed royalty arrangements, which are not subject to future obligations, is recognized when such royalties are earned and become payable. Royalty revenue that is subject to

5

Table of Contents

future obligations is recognized when such obligations are fulfilled. Royalty revenue that exceeds minimum guarantees is recognized in the period earned.

Stock-Based Compensation

The Company accounts for non-cash stock-based employee compensation using the intrinsic method in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and Related Interpretations, and complies with the disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation and SFAS No. 148, Accounting for Stock-Based Compensation, Transition and Disclosures. Stock and other equity instruments issued to non-employees is accounted for in accordance with SFAS No. 123 and Emerging Issues Task Force Issue (EITF) No. 96-18, Accounting for Equity Instruments Issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services and valued using the Black Scholes model. Expense associated with stock-based compensation is being amortized on an accelerated basis over the vesting period of the individual award consistent with the method described in Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 28.

If compensation cost for the Company s stock plans had been determined consistent with SFAS No. 123 Accounting for Stock-Based Compensation, the Company s net loss and loss per common share would have been adjusted to the pro-forma amounts indicated below (in thousands, except per common share data):

	Three Months Ended October 31,	
	2003	**2002**
Net loss as reported	$ (2,261)	$ (1,376)
Add: Stock-based employee compensation expense included in reported net loss	1,256	62
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards	(558)	(158)
Pro forma net loss	(1,563)	(1,472)
Basic and diluted net loss per common share as reported	$ (0.05)	$ (0.03)
Basic and diluted pro forma net loss per common share	$ (0.03)	$ (0.03)

The stock-based employee compensation expense included in reported net loss reflects the effect of an increase in the Company s stock price during the first quarter of fiscal 2004 on stock options accounted for using variable accounting.

Because the Black-Scholes option valuation model was developed for traded options and requires the input of subjective assumptions and the number of future shares to be issued or cancelled is not known, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

Note 2 Recently Issued Accounting Pronouncement

Consolidation of Variable Interest Entities

In January 2003, the FASB issued FIN No. 46, Consolidation of Variable Interest Entities. FIN No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. A variable interest entity often holds financial assets, including loans or receivables, real estate or other property. A variable interest entity may be essentially passive or it may engage in research and development or other activities on behalf of another company.

Table of Contents

FIN No. 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN No. 46 were required to be applied for the first interim or annual period beginning after June 15, 2003. However, in October 2003, the FASB deferred the effective date of FIN No. 46 to the end of the first interim or annual period ending after December 15, 2003 for those variable interest entities created or acquired prior to February 1, 2003. As a result, the Company has not adopted FIN No. 46 as of October 31, 2003. The Company is currently studying the impact of FIN No. 46 on its consolidated financial position, results of operations and cash flows.

Note 3 Balance Sheets Components

Inventories, net, consist of the following (in thousands):

	October 31, 2003	July 31, 2003
Raw materials	$ 232	$ 61
Finished goods and work-in-process	21	52
Inventories	$ 253	$ 113

Property and equipment, net, consist of the following (in thousands):

	October 31, 2003	July 31, 2003
Computer equipment and software	$ 5,209	$ 4,895
Furniture and office equipment	1,540	1,511
Leasehold improvements	795	792
	7,544	7,198
Less: Accumulated depreciation and amortization	(6,283)	(6,045)
Property and equipment, net	$ 1,261	$ 1,153

Property and equipment includes assets financed under capital lease obligations of approximately $181,000 and zero, net of accumulated depreciation, as of October 31, 2003 and 2002, respectively. Refer to Note 8. The depreciation expense for the three months ended October 31, 2003 and 2002 was $238,000 and $382,000, respectively.

Table of Contents

Note 4 Acquisitions

Spontaneous Technology, Inc.

On September 17, 2003, the Company consummated the acquisition of substantially all of the assets of Spontaneous Technology, Inc. of Salt Lake City, Utah, a provider of enterprise Virtual Private Network (sVPN) software designed to extend existing corporate applications to most wireless devices. Under the terms of the agreement, the Company issued a total of 869,259 shares of Pumatech s common stock valued at approximately $2,999,000 using the five-trading-day average price surrounding the date the acquisition was announced of $3.45 per share, less estimated registration costs. The number of shares were calculated using the average price of the Company s common stock for ten consecutive trading days ended three business days prior the date of acquisition. There are 224,417 additional shares held in escrow that are contingently issuable upon satisfaction of a pre-acquisition clause. Additionally, depending upon the Company s revenues associated with sales of its products including certain technology of Spontaneous Technology during the period ending September 30, 2004, the Company may be required to pay Spontaneous Technology additional consideration of up to $7,000,000 in shares of Pumatech s common stock.

The condensed consolidated financial statements include the results of operations of Spontaneous Technology since the date of acquisition. Under the purchase method of accounting, the total purchase price was allocated to Spontaneous Technology s net tangible and intangible assets based upon their estimated fair value as of the acquisition date. The purchase price of $3,299,000 (including estimated acquisition costs of $300,000) was assigned to the fair value of the assets acquired, including the following (in thousands):

Tangible assets acquired	$ 18
Liabilities assumed	(1,726)
In-process research and development	469
Developed and core technology	889
Patents	168
Customer base	499
Goodwill	2,982
	$ 3,299

The allocation of purchase price was based on a valuation of assets acquired and liabilities assumed determined with the assistance of an independent appraiser. This allocation was generally based on the fair value of these assets determined using the income approach.

Of the total purchase price, $1,556,000 was allocated to amortizable intangibles included in the above list. The amortizable intangible assets are being amortized using the straight-line method over the estimated useful life of the respective assets of 4 years. Refer to Note 5.

As of the acquisition date, technological feasibility of the in-process technology had not been established and the technology had no alternative future use. Accordingly, the Company expensed the in-process research and development at the date of the acquisition.

The amount of the purchase price allocated to in-process research and technology was based on established valuation techniques used in the high-technology software industry. The fair value assigned to the acquired in-process research and development was determined using the income approach, which discounts expected future cash flows to present value. The key assumptions used in the valuation include, among others, expected completion date of the in-process projects identified as of the acquisition date, estimated costs to complete the projects, revenue contributions and expense projections assuming the resulting product has entered the market, and discount rate based on the risks associated with the development life cycle of the in-process technology acquired. The discount rate used in the present value calculations are normally obtained from a weighted-average cost of capital analysis, adjusted upward to account for the inherent uncertainties surrounding the successful development of the in-process research and development, the expected profitability levels of such technology, and the uncertainty of technological advances that could potentially impact the estimates. The Company assumes the pricing model for the resulting product of the acquired in process research and technology to be standard within its industry. The Company, however, did not take into consideration any consequential amount of expense reductions from integrating the acquired in-process technology with other existing in-process or completed technology. Therefore, the valuation assumptions do not include significant anticipated cost savings.

The key assumptions underlying the valuation of acquired in-process research and development from Spontaneous Technology are as follows (in thousands):

Project names: Version upgrade of Spontaneous Technology s secure Virtual Private Network (sVPN)

Percent completed as of acquisition date: 60%

Estimated costs to complete technology at acquisition date: $125,000

Risk-adjusted discount rate: 22%

First period expected revenue: calendar year 2004

The development of above technology remains highly dependent on the remaining efforts to achieve technical viability, rapidly changing customer markets, uncertain standards for a new product, and significant competitive threats from several companies. The nature of the efforts to develop this technology into a commercially viable product consists primarily of planning, designing, experimenting, and testing activities necessary to determine that the technology can meet market expectations, including functionality and technical requirements. Failure to bring the product to market in a timely manner could result in a loss of market share or a lost opportunity to capitalize on emerging markets, and could have a material adverse impact on the Company s business and operating results.

Subsequent to the acquisition of Spontaneous Technology, there have been no significant developments related to the current status of the acquired in-process research and development project that would result in material changes to the assumptions.

A preliminary estimate of $2,982,000 has been allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* goodwill will not be amortized but will be tested for impairment (a tax deductible charge) at least annually.

Loudfire, Inc.

In July 2003, the Company signed and closed an agreement to acquire substantially all of the assets of Loudfire, Inc. of Tulsa, Oklahoma, developer of LoudPC software (recently rebranded and repackaged and now called Intellisync goAnywhere). Intellisync goAnywhere allows anyone with an Internet browser or Web-enabled phone to enjoy real-time access to email and PIM (personal information management) data located in either Microsoft Outlook or Outlook Express. The product also provides secure access to pre-specified files residing on a host PC. Under the terms of the asset purchase agreement, the Company paid $1,000,000 in cash and issued $500,000 worth of shares of the Company s common stock. The 134,445 shares issued were calculated using the average price of the Company s common stock for a ten-day period ended three business days prior the date of acquisition. Additionally, depending upon the Company s revenues associated with sales of its products including certain technology of Loudfire during the 12 months following the closing of the asset purchase, the Company may be required to pay Loudfire additional consideration of up to $3,500,000 in cash or, at the Company s election, shares of its common stock.

The Loudfire acquisition has been accounted for as an asset purchase. The consolidated financial statements include the results of operations of Loudfire since the date of acquisition. The initial purchase price of $1,600,000 (including acquisition costs of $100,000) was assigned to the fair value of the assets acquired, including the following (in thousands):

Developed technology	$ 1,308
Customer base	153
Covenant not-to-compete	100
Customer contracts	39
	$ 1,600

The intangible assets acquired are amortized using the straight-line method over the estimated useful life of the assets ranging from nine months to four years.

Starfish Software, Inc.

In March 2003, the Company signed and closed a purchase agreement with Motorola, Inc. of Schaumburg, Illinois to acquire all of capital stock of Starfish Software, Inc., a wholly owned subsidiary of Motorola headquartered in Scotts Valley, California. Starfish is a provider of end-to-end mobile infrastructure solutions based on integrated platforms composed of server, desktop and device software for mobile data synchronization, wireless connectivity and device management. Under the terms of the stock purchase agreement, the Company initially paid a total of $1,501,000 in cash, subject to further adjustment based on actual working capital as of the closing date. The Company further paid $178,000 based on subsequent adjustments made to Starfish s working capital.

The Starfish acquisition has been accounted for as a purchase business combination. The consolidated financial statements include the results of operations of Starfish since the date of acquisition. The purchase price of $1,831,000 (including acquisition costs of $152,000) was assigned to the fair value of the assets acquired, including the following (in thousands):

Tangible assets acquired	$ 1,133
Liabilities assumed	(986)
In-process research and development	406
Developed technology	675
Patents	202
Trademarks	52
Customer base	278
Existing contracts	71
	$ 1,831

Of the total purchase price, $1,278,000 was allocated to amortizable intangibles included in the above list. The amortizable intangible assets are being amortized using the straight-line method over the estimated useful life of the respective assets of nine months to four years.

As of the acquisition date, technological feasibility of the in-process technology had not been established and the technology had no alternative future use. Accordingly, the Company expensed the in-process research and development at the date of the acquisition.

The amount of the purchase price allocated to in process-research and technology was based on established valuation techniques used in high-technology computer software industry. The fair value assigned to the acquired in-process research and development was determined using the income approach, which discounts expected future cash flows to present value. The key assumptions used in the valuation include, among others, expected completion date of the in-process projects identified as of the acquisition date, estimated costs to complete the projects, revenue contributions and expense projections assuming the resulting product have entered the market, and discount rate based on the risks associated with the development life cycle of the in-process technology acquired. The discount rate used in the present value calculations are normally obtained from a weighted-average cost of capital analysis, adjusted upward to account for the inherent uncertainties surrounding the successful development of the in-process research and development, the expected profitability levels of such technology, and the uncertainty of technological advances that could potentially impact the estimates. The Company assumes the pricing model for the resulting product of the acquired in process research and technology to be standard within its industry. The Company, however, did not take into consideration any consequential amount of expense reductions from integrating the acquired in-process technology with other existing in-process or completed technology. Therefore, the valuation assumptions do not include significant anticipated cost savings.

The key assumptions underlying the valuation of acquired in-process research and development from Starfish are as follows (in thousands):

Project name: Mercury platform technology

Percent completed as of acquisition date: 70%

Estimated costs to complete technology at acquisition date: $375,000

Risk-adjusted discount rate: 30%

First period expected revenue: calendar year 2004

Subsequent to the acquisition of Starfish, there have been no significant developments related to the current status of the acquired in-process research and development project that would result in material changes to the assumptions.

The following unaudited pro-forma consolidated financial information reflects the results of operations for the three months ended October 31, 2003 and 2002, as if the asset acquisition of Spontaneous Technology and Starfish had occurred on the beginning of each period presented and after giving effect to purchase accounting adjustments. Loudfire s results of operations have been excluded from the pro forma financial information as amounts are considered immaterial to the Company. These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what operating results would have been had the acquisitions actually taken place on the beginning of each period presented. In addition, these results are not intended to be a projection of future results and do not reflect any synergies that might be achieved from the combined operations (in thousands, except per share data):

	Three Months Ended October 31,

	2003	2002
Pro forma revenue	$ 8,016	$ 5,066
Pro forma net loss	$ (1,792)	$ (3,360)
Pro forma basic and diluted net loss per common share	$ (0.04)	$ (0.07)

The in-process research and development of $469,000 relating to Spontaneous Technology is charged to operations on the acquisition date during the first quarter of fiscal 2004. The in-process research and development charge has not been included in the above pro forma financial information as it represents a non-recurring charge directly related to the acquisition.

Table of Contents

Synchrologic, Inc.

On September 15, 2003, the Company announced that it had entered into a definitive merger agreement dated September 14, 2003 to purchase all of the issued and outstanding stock of Synchrologic, Inc. headquartered in Atlanta, Georgia. Under the terms of the agreement, each share of Synchrologic capital stock will be converted into the right to receive the number of shares (or the fraction of a share) of the Company s common stock corresponding to the exchange ratio applicable to the class and series of Synchrologic capital stock being converted. The total number of shares of the Company s common stock to be issued in the merger will be determined by dividing $60,000,000 by the average closing price of the shares of the Company s common stock for the thirty consecutive trading days ending on the last complete trading day immediately preceding the closing date of the merger (which amount is subject to adjustment based on the transaction expenses incurred by Synchrologic in connection with the merger), provided that the number of shares of the Company s common stock shares shall not exceed 19,800,000 or be fewer than 16,200,000 (in each case subject to adjustment based on the transaction expenses incurred by Synchrologic in connection with the merger). The Company will also assume certain liabilities equaling approximately $5,093,065 and incur direct transaction costs of approximately $650,000. Further, upon the execution of the definitive agreement, the Company and Synchrologic agreed to dismiss the Company s outstanding litigation against Synchrologic with prejudice as of September 17, 2003, thereby permanently ending this specific suit. Completion of the acquisition is subject to approval by the Company s and Synchrologic s shareholders, as well as customary regulatory approvals and other post-signing conditions. The Company anticipates completion of the transaction by the end January 2004. Synchrologic s product line provides mobile access to enterprise applications, email and personal information management (PIM) data, file content, intranet sites, and Web content, while giving information technology (IT) groups the tools to manage mobile devices remotely. A licensing agreement signed by both companies enables the Company to market and sell Synchrologic s Mobile Suite platform immediately as the Company s server-based synchronization solution for enterprise customers. Should the merger fail to occur, the licensing will continue through the end of the three-year term of the agreement. In the event that the merger is not completed, the Company may be required to pay Synchrologic a termination fee of $3,000,000, and even if the merger is not completed, costs related to the proposed merger, such as legal, accounting, and some advisory fees, must be paid.

Note 5 Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* goodwill is not amortized but will be tested for impairment at least annually. The Company performs the annual impairment tests in the fourth quarter of each fiscal year. The Company currently only has one reporting unit, therefore all of the goodwill has been assigned to the enterprise as a whole. As of October 31, 2003, goodwill amounted to $5,713,000, of which $2,982,000 resulted from the acquisition of substantially all of the assets of Spontaneous Technology during the first quarter of fiscal 2004.

Other intangible assets, net, consist of the following (in thousands, except weighted average useful life):

		October 31, 2003			July 31, 2003		
	Weighted Average Useful Life	**Gross**	**Accumulated Amortization**	**Net**	**Gross**	**Accumulated Amortization**	**Net**
Developed technology	4 years	$ 8,805	$ (6,133)	$ 2,672	$ 7,900	$ (5,980)	$ 1,920
Patents	4 years	370	(35)	335	202	(17)	185
Trademarks	3 years	52	(10)	42	52	(6)	46
Customer base	4 years	931	(67)	864	431	(25)	406
Covenant not-to-compete	2 years	101	(14)	87	100	(1)	99
Existing contracts	9 months	310	(261)	49	310	(232)	78

	$ 10,569	$ (6,520)	$ 4,049	$ 8,995	$ (6,261)	$ 2,734

Other intangibles as of October 31, 2003 include a total of approximately $1,556,000 amortizable identifiable intangibles obtained from the Company s acquisition of substantially all of the assets of Spontaneous Technology

Table of Contents

during the first quarter of fiscal 2004 and an $18,000 adjustment to the amortizable identifiable intangibles obtained from the Company s asset purchase of Loudfire, Inc. during fiscal 2003.

The amortization of other intangible assets for the first quarter of fiscal 2004 and 2003 amounted to $259,000 and $149,000, respectively. Of the total amortization of other intangible assets, $153,000 and, $147,000 relate to developed technology for the first quarter of fiscal 2004 and 2003, respectively. The Company continues to amortize other intangible assets and is required to review such assets for impairment under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, reassess their useful lives and make any necessary adjustments. Based on acquisitions completed as of October 31, 2003, the estimated future amortization expense of other intangible assets is as follows (in thousands):

Nine months ending July 31, 2004	$ 867
Fiscal year ending July 31,	
2005	1,133
2006	1,059
2007	941
2008	49
	$ 4,049

Note 6 Related Party Transactions

On September 30, 2003, the Company s board of directors approved change of control agreements with three of the Company s officers that provides for 12 months acceleration of vesting of each individual s options held at the time of the change of control. In addition, the Company granted these individuals options to purchase an aggregate of an additional 425,000 shares of the Company s common stock. As of the date of grant, the option shares will vest over four years, with 25% vesting after one year and then 1/48th vesting monthly thereafter. The Company accounts for these options using the guidance prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees and Related Interpretations, and EITF No. 00-23, Issues Relating to Accounting for Stock Compensation Under APB Opinion No. 25 and FASB Interpretation No. 44.

Note 7 Restructuring Accrual

The Company implemented a number of cost-reduction plans aimed at reducing costs that were not integral to its overall strategy, better aligning its expense levels with current revenue levels and ensuring conservative spending during periods of economic uncertainty. These initiatives included a reduction in workforce and facilities consolidation.

The following table sets forth the activity in the restructuring accrual account for the three months ended October 31, 2003 (in thousands):

	Consolidation of Excess Facilities

Balance at July 31, 2003	$	1,766
Cash payments		(382)
Balance at October 31, 2003	$	1,384

The remaining unpaid amount as of October 31, 2003 of $1,384,000, related to the net lease expense due to the consolidation of excess facilities, will be paid over the respective lease terms through May 2006 using cash from operations. The current and long-term portions of the underlying accrual of $925,000 and $459,000 are classified as

Table of Contents

Accrued Liabilities and Other Liabilities, respectively, in the condensed consolidated balance sheet as of October 31, 2003.

The Company continually evaluates the balance of the restructuring reserve it records in prior periods based on the remaining estimated amounts to be paid. Differences, if any, between the estimated amounts accrued and the actual amounts paid will be reflected in operating expenses in future periods.

Note 8 Commitments and Contingencies

Leases

During the first quarter of fiscal 2004, the Company entered into a capital lease agreement for a phone system, which expires in November 2007. Assets and future obligations related to the capital lease are included in the accompanying condensed consolidated balance sheet as of October 31, 2003 in property and equipment and liabilities, respectively. Depreciation of assets held under the capital lease is included in depreciation and amortization expense. Future minimum lease payments for the non-cancelable capital lease agreement at October 31, 2003, were as follows (in thousands):

	Capital Lease
Nine months ending July 31, 2004	$ 36
Fiscal year ending July 31,	
2005	47
2006	47
2007	47
2008	12
Total minimum future lease payments for capital lease	189
Amount representing interest	(8)
Present value of minimum lease payments	181
Current portion of obligations under capital lease	44
Long-term obligations under capital lease	$ 137

The Company leases its facilities under operating leases that expire at various dates through June 2006. The leases provide for escalating lease payments. Future minimum lease payments for all operating lease agreements at October 31, 2003, were as follows (in thousands):

	Operating Leases	Proceeds from Subleases	Future Minimum

			Lease Payments
Nine months ending July 31, 2004	$ 2,299	$ (507)	$ 1,792
Fiscal year ending July 31,			
2005	2,679	(502)	2,177
2006	1,717	(18)	1,699