

SOCKET MOBILE, INC.  
Form 10-Q  
August 14, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2012**

OR

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

For the transition period \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 1-13810

**SOCKET MOBILE, INC.**

(Exact name of registrant as specified in its charter)

Delaware

94-3155066

(State of incorporation) (IRS Employer Identification No.)

**39700 Eureka Drive, Newark, CA 94560**

(Address of principal executive offices including zip code)

**(510) 933-3000**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES [ 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 August 10, 2012 was 4,861,063 shares.

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

|  | June 30,<br>2012<br>(unaudited) | December 31,<br>2011 |
|--|---------------------------------|----------------------|
| <b>ASSETS</b>  |                                 |                      |
| Current assets:  |                                 |                      |
| Cash and cash equivalents                              | \$612,394                       | \$957,022            |
| Accounts receivable, net                               | 1,506,488                       | 2,791,549            |
| Inventories  | 1,765,654                       | 1,461,052            |
| Prepaid expenses and other current assets              | 160,254                         | 218,862              |
| Total current assets                                   | 4,044,790                       | 5,428,485            |
| Property and equipment:                                |                                 |                      |
| Machinery and office equipment                         | 2,115,752                       | 2,212,178            |
| Computer equipment                                     | 1,375,805                       | 1,324,696            |
|  | 3,491,557                       | 3,536,874            |
| Accumulated depreciation                               | (3,066,606 )                    | (3,225,231 )         |
| Property and equipment, net                            | 424,951                         | 311,643              |
| Intangible assets, net                                 | 120,000                         | 150,000              |
| Goodwill   | 4,427,000                       | 4,427,000            |
| Other assets   | 81,518                          | 80,076               |
| Total assets   | \$9,098,259                     | \$10,397,204         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>            |                                 |                      |
| Current liabilities:                                   |                                 |                      |
| Accounts payable                                       | \$3,683,852                     | \$3,266,764          |
| Accrued expenses                                       | 94,554                          | 94,554               |
| Accrued payroll and related expenses                   | 608,363                         | 564,980              |
| Bank line of credit                                    | 897,415                         | 1,109,600            |
| Deferred income on shipments to distributors           | 1,169,190                       | 1,571,544            |
| Short term portion of deferred service revenue         | 236,194                         | 247,174              |
| Short term portion of capital leases and deferred rent | 16,972                          | 17,731               |
| Total current liabilities                              | 6,706,540                       | 6,872,347            |

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|   |              |              |
|---|--------------|--------------|
| Long term portion of deferred service revenue   | 190,770      | 167,476      |
| Long term portion of capital leases and deferred rent   | 231,639      | 184,341      |
| Deferred income taxes   | 63,425       | 47,455       |
| Total liabilities   | 7,192,374    | 7,271,619    |
| Commitments and contingencies   |              |              |
| Stockholders' equity:   |              |              |
| Common stock, \$0.001 par value: Authorized – 10,000,000 shares,<br>Issued and outstanding – 4,861,063 shares at June 30, 2012<br>and 4,832,079 shares at December 31, 2011 | 4,861        | 4,832        |
| Additional paid-in capital  | 60,732,297   | 60,324,852   |
| Accumulated deficit   | (58,831,273) | (57,204,099) |
| Total stockholders' equity  | 1,905,885    | 3,125,585    |
| Total liabilities and stockholders' equity  | \$9,098,259  | \$10,397,204 |

See accompanying notes.

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

|                                      | Three Months Ended |              | Six Months Ended |               |
|--------------------------------------|--------------------|--------------|------------------|---------------|
|                                      | June 30,           |              | June 30,         |               |
|                                      | 2012               | 2011         | 2012             | 2011          |
| Revenues                             | \$4,037,502        | \$4,352,611  | \$7,991,261      | \$8,392,053   |
| Cost of revenues                     | 2,539,251          | 2,526,072    | 4,969,941        | 5,051,804     |
| Gross profit                         | 1,498,251          | 1,826,539    | 3,021,320        | 3,340,249     |
| Operating expenses:                  |                    |              |                  |               |
| Research and development             | 739,860            | 647,558      | 1,523,905        | 1,317,333     |
| Sales and marketing                  | 982,405            | 857,976      | 1,942,432        | 1,685,942     |
| General and administrative           | 496,541            | 532,475      | 1,109,699        | 1,128,032     |
| Total operating expenses             | 2,218,806          | 2,038,009    | 4,576,036        | 4,131,307     |
| Operating loss                       | (720,555 )         | (211,470 )   | (1,554,716)      | (791,058 )    |
| Interest expense, net                | (26,860 )          | (172,722 )   | (56,488 )        | (513,409 )    |
| Net loss before income taxes         | (747,415 )         | (384,192 )   | (1,611,204)      | (1,304,467)   |
| Deferred income tax expense          | (7,985 )           | (7,985 )     | (15,970 )        | (15,970 )     |
| Net loss                             | \$(755,400 )       | \$(392,177 ) | \$(1,627,174)    | \$(1,320,437) |
| Net loss per share:                  |                    |              |                  |               |
| Basic and diluted                    | \$(0.16 )          | \$(0.09 )    | \$(0.34 )        | \$(0.32 )     |
| Weighted average shares outstanding: |                    |              |                  |               |
| Basic and Diluted                    | 4,854,179          | 4,233,519    | 4,846,197        | 4,084,395     |

See accompanying notes.

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

|   | Six Months Ended June 30, |               |
|---|---------------------------|---------------|
|   | 2012                      | 2011          |
| Operating activities  |                           |               |
| Net loss  | \$(1,627,174)             | \$(1,320,437) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                           |               |
| Stock-based compensation  | 363,460                   | 360,161       |
| Depreciation and amortization   | 183,303                   | 207,607       |
| Amortization of debt discount to interest expense                           | —                         | 468,956       |
| Non cash interest expense on convertible note                               | —                         | 4,244         |
| Deferred income tax expense   | 15,970                    | 15,970        |
| Changes in operating assets and liabilities:                                |                           |               |
| Accounts receivable   | 1,285,061                 | (711,501 )    |
| Inventories   | (304,602 )                | 501,523       |
| Prepaid expenses and other current assets                                   | 58,608                    | (65,651 )     |
| Other assets  | (1,442 )                  | 48,055        |
| Accounts payable  | 417,088                   | 309,930       |
| Accrued payroll and related expenses  | 43,383                    | 13,135        |
| Deferred income on shipments to distributors                                | (402,354 )                | 118,555       |
| Deferred service revenue  | 12,314                    | (68,174 )     |
| Deferred rent   | (8,043 )                  | (5,964 )      |
| Net cash provided by (used in) operating activities                         | 35,572                    | (123,591 )    |
| Investing activities  |                           |               |
| Purchases of equipment and tooling  | (205,827 )                | (40,488 )     |
| Net cash used in investing activities                                       | (205,827 )                | (40,488 )     |
| Financing activities  |                           |               |
| Payments on capital leases  | (6,202 )                  | (6,439 )      |
| Reduction in restricted cash requirement                                    | —                         | 710,797       |
| Proceeds from borrowings under bank line of credit agreement                | 3,896,718                 | —             |
| Repayments of borrowings under bank line of credit agreement                | (4,108,903)               | —             |
| Stock options exercised   | 14,015                    | 14,118        |
| Warrants exercised  | 29,999                    | —             |
| Net cash provided by (used in) financing activities                         | (174,373 )                | 718,476       |
| Net increase (decrease) in cash and cash equivalents                        | (344,628 )                | 554,397       |
| Cash and cash equivalents at beginning of period                            | 957,022                   | 460,833       |
| Cash and cash equivalents at end of period                                  | \$612,394                 | \$1,015,230   |
| Supplemental cash flow information  |                           |               |
| Cash paid for interest  | \$61,319                  | \$32,572      |
| Non-cash investing and financing activities:                                |                           |               |



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|  |     |           |
|--|-----|-----------|
| Issuance of common stock for reduction in accounts payable balance                 | \$— | \$499,998 |
| Beneficial conversion feature associated with senior convertible note payable      | \$— | \$273,904 |
| Conversion of senior convertible note payable and accrued interest to common stock | \$— | \$229,244 |

See accompanying notes.

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

NOTE 1 — Basis of Presentation

The accompanying unaudited condensed financial statements of Socket Mobile, Inc. (the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring accruals considered necessary for fair presentation have been included. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted.

These condensed financial statements should be read in conjunction with the audited financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011. The financial statements in the Company’s annual report on Form 10-K were prepared on a going concern basis.

*Liquidity*

During the six months ended June 30, 2012, and the year ended December 31, 2011, the Company incurred net losses of \$1,627,174 and \$2,422,361, respectively. As of June 30, 2012, the Company has an accumulated deficit of \$58,831,273. The Company’s cash balances at June 30, 2012 were \$612,394 including \$897,415 advanced on its bank lines of credit. At June 30, 2012 the Company had additional unused borrowing capacity of approximately \$423,000 on its bank lines of credit (approximately \$117,000 and \$306,000, respectively, on the domestic and international credit lines). The Company’s balance sheet at June 30, 2012 has a current ratio (current assets divided by current liabilities) of 0.6 to 1.0, a working capital deficit of \$2,661,750 (current assets less current liabilities).

In the last three years the Company has taken actions to reduce its expenses and to align its cost structure with economic conditions. The Company has the ability to further reduce expenses if necessary. Additional steps by management intended to reduce operating losses and achieve profitability include the introduction of new products, and continued close support of the Company’s distributors and its application partners as they establish their mobile applications in key vertical markets. On August 1, 2012, the Company issued \$400,000 in convertible subordinated notes to increase its working capital balances (see “NOTE 11 — Subsequent Event” for more information). Management believes its existing cash balances, plus its ability to reduce costs and manage its working capital balances, and its bank lines of credit will be sufficient to meet its funding requirements at least through June 30, 2013.

If the Company can return to revenue growth and attain profitability, the Company anticipates requirements for cash will include funding of higher receivable and inventory balances, and increased expenses, including an increase of costs relating to new employees to support the Company's growth and increases in salaries, benefits, and related support costs for employees. If the Company cannot attain profitability, the Company will not be able to support its operations from positive cash flows, and the Company would use its existing cash to support operating losses. The Company may also find it necessary to raise additional capital to fund its operations, however, there can be no assurance that additional capital will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. If the Company is unable to secure the necessary capital for its business, the Company may need to suspend some or all of its current operations.

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

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

*Use of Estimates*

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

*Cash Equivalents and Fair Value of Financial Instruments*

The Company considers all highly liquid investments purchased with an original maturity date of 90 days or less at date of purchase to be cash equivalents. At June 30, 2012 and December 31, 2011, all of the Company's cash and cash equivalents consisted of amounts held in demand and money market deposits in banks. The carrying value of the Company's cash and cash equivalents, accounts receivable, accounts payable, debt and foreign exchange contracts approximate fair value due to the relatively short period of time to maturity.

**NOTE 3 — Inventories**

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

|                                  | June 30,<br>2012 | December<br>31,<br>2011 |
|----------------------------------|------------------|-------------------------|
| Raw materials and sub-assemblies | \$ 1,670,632     | \$ 1,432,696            |
| Finished goods                   | 95,022           | 28,356                  |
|                                  | \$ 1,765,654     | \$ 1,461,052            |

**NOTE 4 — Bank Financing Arrangements**

On October 12, 2011, the Company entered into a new credit facility agreement with Silicon Valley Bank (the “Bank”). This credit facility allows the Company to borrow up to \$2,500,000 based on the level of qualified domestic and international receivables, up to a maximum of \$1,500,000 and \$1,000,000, respectively. Advances against the domestic line are calculated at 80% of qualified receivables except for receivables from distributors which are calculated at 60%. Advances against the international line are calculated at 90% against qualified hedged receivables and 70% against qualified non-hedged receivables and receivables from distributors. Borrowings under the lines bear an annual interest rate equal to the greater of (i) the Bank’s prime rate plus 1%, or (ii) 5%. The rate in effect has been 5% to date. There is also a collateral handling fee of 0.25% per month of the financed receivable balance outstanding. The applicable interest and fees are calculated based on the full amount of the accounts receivable provided as collateral for the actual amounts borrowed. The credit facility agreement expires on October 12, 2013 unless renewed. The agreement may be terminated by the Company or by the Bank at any time. Upon such termination, the Bank would no longer make advances under the credit agreement and outstanding advances would be repaid as receivables are collected. All advances are at the Bank’s discretion and the Bank is not obligated to make advances. In addition, the Company must maintain a minimum liquidity ratio calculated at the end of each month of quick assets (unrestricted cash equivalents at the Bank plus net eligible accounts receivable) to outstanding obligations to the Bank of not less than 2.0 to 1.0. The outstanding amounts borrowed under the domestic and international lines at June 30, 2012 were \$586,572 and \$310,843, respectively, and the full amounts of accounts receivable provided as collateral were \$959,012, and \$439,160, respectively. The outstanding amounts borrowed under the domestic and international lines at December 31, 2011 were \$921,621 and \$187,979, respectively, and the full amounts of accounts receivable provided as collateral were \$1,481,039, and \$266,006, respectively. Interest expense on the amounts drawn during the three and six months ended June 30, 2012 were \$26,056 and \$55,549, respectively. Accrued interest related to the amounts outstanding at June 30, 2012 and December 31, 2011 was \$5,127 and \$10,477, respectively.

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During 2011 and prior to the Company entering into the credit agreement as described above, the Company had a senior convertible note outstanding (see “NOTE 7 — Senior Convertible Note” for more information).

**NOTE 5 — Segment Information and Concentrations***Segment Information*

The Company operates in one segment—mobile systems solutions for businesses. Mobile systems solutions typically consist of a handheld computer or other mobile device such as a smartphone or tablet, some with data collection peripherals, and third-party vertical applications software. The Company markets its products in the United States and foreign countries through its sales personnel and distributors. Revenues for the geographic areas were as follows:

|                        | Three Months Ended |             | Six Months Ended |             |
|------------------------|--------------------|-------------|------------------|-------------|
|                        | June 30,<br>2012   | 2011        | June 30,<br>2012 | 2011        |
| Revenues:              |                    |             |                  |             |
| United States          | \$2,255,519        | \$2,902,614 | \$4,478,578      | \$5,827,059 |
| Europe                 | 1,160,557          | 1,104,711   | 2,390,052        | 1,978,880   |
| Asia and rest of world | 621,426            | 345,286     | 1,122,631        | 586,114     |
| Total revenues         | \$4,037,502        | \$4,352,611 | \$7,991,261      | \$8,392,053 |

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*

Customers who accounted for at least 10% of the Company's total revenues in the three and six month periods ended June 30, 2012 and 2011 were as follows:

|                   | Three<br>Months<br>Ended<br>June 30, |      | Six Months<br>Ended<br>June 30, |      |
|-------------------|--------------------------------------|------|---------------------------------|------|
|                   | 2012                                 | 2011 | 2012                            | 2011 |
| Ingram Micro Inc. | 19%                                  | 13%  | 17%                             | 15%  |
| ScanSource, Inc.  | 18%                                  | 14%  | 20%                             | 12%  |
| Epocal Inc.       | *                                    | 11%  | *                               | 16%  |

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

*Concentration of Credit Risk*

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. The Company invests its cash in demand and money market deposit accounts in banks. To the extent of the amounts recorded on the balance sheet, cash is concentrated at the Company's bank to the extent needed to comply with the minimum liquidity ratio of the bank line agreement. To date, the Company has not experienced losses on these investments. The Company's trade accounts receivables are primarily with distributors and OEMs. The Company performs ongoing credit evaluations of its customers' financial conditions but the Company generally requires no collateral. Reserves are maintained for potential credit losses, and such losses have been within management's expectations. Customers who accounted for at least 10% of the Company's accounts receivable balances at June 30, 2012 and December 31, 2011 were as follows:

|           | June<br>30,<br>2012 | December<br>31,<br>2011 |
|-----------|---------------------|-------------------------|
| Company A | 33%                 | 11%                     |
| Company B | 20%                 | *                       |

|           |     |    |   |
|-----------|-----|----|---|
| Company C | 13% | 10 | % |
| Company D | *   | 33 | % |

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

#### Concentration of Suppliers

Several of the Company's component parts are produced by a sole or limited number of suppliers. Shortages could occur in these essential materials due to increased demand, or to an interruption of supply such as the Company experienced in the fourth quarter 2010 and to a progressively lesser extent over the first, second, and third quarters of 2011 with the delays in availability of LCD touch screens used in the manufacture of the Company's mobile handheld computer. If the Company were unable to procure certain of such materials, it would be required to reduce its operations, which could have a material adverse effect upon its results. At June 30, 2012 and December 31, 2011, 37% and 56%, respectively, of the Company's accounts payable balances were concentrated in a single supplier. For the quarter ended June 30, 2012, this and another supplier accounted for 61% of the inventory purchases.

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

**NOTE 6 — Stock-Based Compensation**

The Company recognizes stock-based compensation in the financial statements for all share-based awards to employees, including grants of employee stock options, based on their fair values. The Company uses a binomial lattice valuation model to estimate the fair value of stock option grants. The binomial lattice model incorporates calculations for expected volatility, risk-free interest rates, employee exercise patterns and post-vesting employment termination behavior, and these factors affect the estimate of the fair value of the Company's stock option grants. Total stock-based compensation expense for the three and six months ended June 30, 2012 was \$185,527 and \$363,460, respectively. Total stock-based compensation expense for the three and six months ended June 30, 2011 was \$181,658 and \$360,161, respectively. In the three and six months ended June 30, 2012, 64,000 and 215,300 stock options were granted, respectively, at weighted average per share fair values estimated at \$1.28 and \$1.29, respectively.

**NOTE 7 — Senior Convertible Note**

On November 19, 2010, the Company issued a senior secured convertible note having a principal amount of \$1,000,000 in a private placement financing. The convertible note was recorded on the Company's balance sheet net of the associated debt discount. During the six month period ended June 30, 2011, the holder converted in total a \$225,000 principal amount plus unpaid accrued interest which resulted in the issuance of 152,830 shares of common stock. Amortization of the debt discount during the three and six months ended June 30, 2011, totaled \$152,740 and \$468,956, respectively, which is classified as interest expense in the Company's Condensed Statement of Operations. Interest expense on the note principal for the three and six months ended June 30, 2011 was \$19,590 and \$43,619, respectively. On September 6, 2011, the remaining balance of the note was converted to common stock.

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

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

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|  | Three Months Ended |              | Six Months Ended |               |
|--|--------------------|--------------|------------------|---------------|
|  | June 30,           |              | June 30,         |               |
|  | 2012               | 2011         | 2012             | 2011          |
| Numerator:   |                    |              |                  |               |
| Net loss   | \$(755,400 )       | \$(392,177 ) | \$(1,627,174)    | \$(1,320,437) |
| Denominator:   |                    |              |                  |               |
| Weighted average common shares outstanding used in computing net loss per share: |                    |              |                  |               |
| Basic and Diluted  | 4,854,179          | 4,233,519    | 4,846,197        | 4,084,395     |
| Net loss per share:  |                    |              |                  |               |
| Basic and Diluted  | \$(0.16 )          | \$(0.09 )    | \$(0.34 )        | \$(0.32 )     |

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

For the three and six months ended June 30, 2012 and 2011, the diluted net loss per share is equal to the basic net loss per share because the Company experienced losses in these periods. Thus no potential common shares underlying stock options and warrants have been included in the net loss per share calculation, as their effect is anti-dilutive. Options and warrants to purchase 2,207,454 shares and 2,053,078 shares of common stock at June 30, 2012, and 2011, respectively, have been omitted from the net loss per share calculation.

**NOTE 9 — Common Stock Financing**

On February 23, 2011, the Company issued 282,485 shares of its common stock to settle trade payables due to AboCom Systems. The shares were priced at a closing bid price of \$1.77 per share as reported on February 23, 2011 for a total of \$499,998.

**NOTE 10 — Taxes**

Income tax expense during the three and six months ended June 30, 2012 and 2011, and the deferred income tax amounts shown on the Company's Condensed Balance Sheets, is related entirely to the deferred tax liability on the portion of the Company's goodwill amortized for tax purposes. Due to the indefinite characteristic of this deferred tax liability, it cannot be offset against deferred tax assets. As a result, the Company recognized deferred tax expense of \$7,985 and \$15,970 in each of the three and six month periods ended June 30, 2012 and 2011.

At December 31, 2011, the Company has an unrecognized tax benefit of approximately \$635,000, which did not change significantly during the three and six months ended June 30, 2012. Future changes in the unrecognized tax benefit are unlikely to have an impact on the effective tax rate due to the full valuation allowance recorded on the Company's deferred tax assets, as realization of the deferred tax assets is dependent upon future taxable income.

**NOTE 11 — Subsequent Event**

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

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

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

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

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**The Company**

We are a producer of mobile handheld computers and data collection products serving the business mobility markets and designed for the mobile worker. We offer a family of general purpose handheld computer products running the Windows Mobile operating system and a wide range of data collection products including two dimensional (2D) and linear (1D) bar code scanners, Radio Frequency Identification (RFID) readers, and magnetic stripe readers. We also offer wearable ring scanners, customized versions of our handheld computers, embedded wireless LAN cards and Bluetooth modules as OEM products to third party companies. Our companion plug-in data collection products work with our handheld computers and our cordless handheld barcode scanners work with many third-party mobile handheld devices including smartphones, tablet computers, ultra-mobile personal computers (UMPCs), notebooks and desktop systems, adding data collection capabilities to these devices. Our products are designed to run or enhance mobile applications that enable the accessing, collection and processing of data by workers while mobile. Our 2D (imager) and 1D (linear) barcode scanners are designed to work with a wide range of Smartphones and tablets running Apple iOS, Google Android, RIM BlackBerry and Microsoft Windows/Windows Mobile operating systems. Our mobile computing products utilize popular Bluetooth and wireless LAN connection technologies using management software we developed for ease of use.

We work closely with software application developers offering or developing software applications for use with our Windows Mobile handheld computers. Healthcare and hospitality are two of the primary areas of focus for software application developers who have developed applications for use on our mobile handheld computers, and a significant portion of our mobile handheld computer sales now come from organizations within these two market segments. Other vertical markets benefiting from mobile solutions include retail merchandising, automotive, government and education. These mobile solutions are designed to improve the productivity of business enterprises and service providers by automating manual tasks, improving the quality of information collected, and enhancing mobile productivity by processing and transferring information from remote locations and mobile devices to the business or medical enterprise, and then if required, back to the remote locations and mobile devices. We also closely support software application developers offering or developing software applications for use with our companion plug-in data collection devices and our cordless handheld barcode scanners. We offer software developer kits to enable developers to easily integrate bar code scanning with our products into their applications.

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

We also make available to original equipment manufacturers ("OEMs") customized versions of our handheld computers and companion plug-in data collection products, our cordless hand scanners, our wearable ring scanners, and component Bluetooth and wireless LAN technologies. We customize these products and components for our use in our own products and leverage that investment through the sale of modified versions or modules and plug-in cards to

OEM manufacturers to embed into their products, including driver and device management software that is designed to simplify the ability of mobile employees to get and stay connected with Wi-Fi as well as with Bluetooth.

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We subcontract the manufacturing of all of our products to independent third-party contract manufacturers located in the U.S., China and Taiwan who have the equipment, know-how and capacity to manufacture products to our specifications. Our mobile handheld computers and related companion plug-in data collection products, and our cordless handheld barcode scanners are sold through a worldwide network of distributors and resellers, vertical industry partners, and value added resellers (VARs). Our OEM products are sold directly to the original equipment manufacturers. The geographic regions we serve include the Americas, Europe, the Middle East, Africa and Asia Pacific.

*Liquidity*

During the six months ended June 30, 2012, and the year ended December 31, 2011, we incurred net losses of \$1.6 million and \$2.4 million, respectively. We have a history of operating losses and we may continue to be unprofitable in the foreseeable future. As of June 30, 2012, we have an accumulated deficit of \$58.8 million. 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 \$42 million in equity capital to fund our operations. Our cash balances at June 30, 2012 were \$0.6 million, including \$0.9 million advanced on our bank lines of credit. At June 30, 2012 we had additional unused borrowing capacity of approximately \$0.4 million on our bank lines of credit. Our balance sheet at June 30, 2012 has a current ratio (current assets divided by current liabilities) of 0.6 to 1.0, a working capital deficit of \$2.7 million (current assets less current liabilities).

We have taken steps in the last three years to reduce our overall expenses and to align our cost structure with current economic conditions. We have the ability to further reduce expenses if necessary. We have taken additional steps intended to reduce operating losses and achieve profitability including the introduction of new products, and continued close support of our distributors and application partners as they establish their mobile applications in key vertical markets. In August 2012, we issued \$400,000 in convertible subordinated notes to increase our working capital balances (see "NOTE 11 — Subsequent Event" for more information). We believe our existing cash, plus our ability to reduce costs and manage our working capital balances, and our bank lines of credit will be sufficient to meet our funding requirements at least through June 30, 2013.

If we can achieve 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 achieve 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. There can be no assurance that additional capital will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. If we are unable to secure the necessary capital for our business, we may need to suspend some or all of our current operations.





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**Revenues**

Total revenues for the three and six months ended June 30, 2012 were \$4,038,000 and \$7,991,000, respectively, a decrease of 7% and 5% from revenues of \$4,353,000 and \$8,392,000, respectively, in the comparable periods one year ago. In 2012 we began classifying our revenues into two broad product families:

- Mobile handheld computer and related products; and,
- Cordless handheld barcode scanning products;

In the table that follows, revenues in the comparable three and six months of 2011 have been reclassified to conform to the current quarter presentation.

Our *mobile handheld computer and related products* include our *SoMo*<sup>®</sup> series mobile handheld computers (SoMo is derived from Socket Mobile), and the related peripheral plug-in data collection products and other accessories. Our SoMo series and related peripherals are designed to be durable, lightweight and dependable devices which meet the requirements of the healthcare, hospitality and other markets we serve. Our initial model, the *SoMo 650*, was introduced in June 2007 with initial volume shipments in September 2007, and features the Microsoft Windows Mobile operating system (currently Version 6.1). Windows Mobile is an industry standard OS for mobile applications thereby ensuring that the SoMo series is compatible with a large number of business applications, giving workers and businesses a familiar computing environment. Our mobile handheld computers are easy to customize for a particular application with peripherals such as our plug-in data collection devices and accessories, and are designed with an expected product life cycle of three to five years which meets the needs of our customers who are deploying mobile solutions. The SoMo 650's other features include wireless LAN and Bluetooth, a fast processor, a large, bright screen display enabling its use outdoors, large amounts of SDRAM and flash memory, an extended battery, a durable case, multiple language support, reinforced CompactFlash and SDIO card slots, and programmable action buttons to activate peripheral devices such as our companion plug-in data collection products. Our plug-in data collection products are of CompactFlash form factor, are used primarily with our SoMo series mobile handheld computers, and are designed to extend the functionality of the SoMo series of mobile handheld computers to enable the electronic collection of data from barcodes, radio frequency identification (RFID) tags or magnetic stripes. These plug-in data collection products have been designed to compliment our SoMo series of handheld computers and are similarly durable devices for commercial use enabling a wide variety of accurate and rapid scans over a full work shift, and come with SocketScan software that allows data to be edited when scanned and provides an easy-to-use interface for developers to build barcode scanning into their applications. The SoMo 650 was specifically designed without an integrated mobile phone to serve the market for business mobility applications that are not mobile phone centric such as medication dispensing in the healthcare market or tableside ordering in the hospitality market, most of which use Bluetooth or wireless LAN connections for data communications.

In late 2008, we introduced the *SoMo 650 Rx Model* made with antimicrobial materials added to the case plastics to provide an extra layer of protection to the device to aid against the multiplication and spread of potentially harmful

bacteria and microbes found in healthcare environments. We expanded the use of this material and began offering antimicrobial versions of the SoMo related peripheral plug-in data collection devices. We also introduced a *SoMo 650 DX Model* without Bluetooth or wireless LAN for high security environments. We have also developed accessory products such as a back pack to enable direct connections to mobile phone networks using network phone cards and a durable case to provide additional protection in the event the computer is dropped. In addition, we work with third-party accessory providers who have qualified to make a number of accessory products that work with the SoMo family of products including headsets, battery chargers, keyboards, printers and smartcard readers.

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In January 2012 we announced the *SoMo 655* as an improved version of the *SoMo 650*, to be available in the second quarter of 2012, with expanded wireless LAN (802.11b/g/n in the *SoMo 655* vs. 802.11b/g in the *SoMo 650*), more memory (4 GB vs. 1 GB), an upgraded Windows Mobile operating system to Windows Embedded Handheld 6.5 (formerly known as Windows Mobile 6.5), micro SD and CompactFlash expansion card slots, and improvements in durability and other features. In June 2012 we began shipping the *SoMo 655* in standard and antimicrobial (Rx) models, and plan to release the no wireless LAN (DX) model as current models of the *SoMo 650DX* are exhausted. The *SoMo 655* models are expected to be available for three to five years and to replace the *SoMo 650* series during the second half of 2012.

Our ***cordless handheld barcode scanning products*** use Bluetooth technology as the connection interface. The scanners are ergonomically designed for ease of use and accurate repetitive rapid scanning over a full work shift, are durable, lightweight and compact. These scanners are available with 2D (imager) and 1D (linear) scanning engines, and are available in standard or antimicrobial cases. Our cordless handheld barcode scanners come with our SocketScan software which enables the use of these scanners with a wide variety of smartphones and tablets using operating systems from Apple (iOS), Google (Android), Research in Motion (Blackberry) and Microsoft Windows/Windows Mobile devices. We offer a software developer's kit which enables developers to add commercial-grade barcode scanning capabilities to their applications, and we began offering Apple certified versions of our 2D scanner in both standard and antimicrobial versions beginning in late 2011 and, beginning in the second quarter of 2012, began shipping Apple certified versions of our 1D scanner.

Our ***SocketCare services*** provide extended warranty and accidental breakage coverage for selected products including our *SoMo* series of mobile handheld computers, our cordless handheld barcode scanners, and our CompactFlash plug-in data collection products. Service purchased at the time of product purchase provides for coverage in two-year and three-year terms. We additionally offer comprehensive coverage and program term extensions. We will also repair products that are out of warranty for a fee. Service revenues related to our SocketCare program and out-of-warranty services represented approximately 5% of our revenues in each of the three and six month periods ended June 30, 2012, compared to 6% in each of the comparable periods one year ago. Service revenues are included within the related product revenues in the table that follows.

Other revenues include our OEM and embedded products, and our connectivity products. Our OEM and embedded products consist of our Bluetooth and wireless LAN plug-in cards used primarily by Original Equipment Manufacturers (OEMs) of electronic products to build wireless connection functions into their products using the Bluetooth and wireless LAN standards for wireless connectivity, and our cordless ring scanner which is an industrial strength barcode scanner that is worn on the index finger and connects via Bluetooth to mobile or fixed data collection computing devices. The cordless ring scanner enables a worker to scan while having two hands available and is designed for applications such as warehousing and pick-and-pack operations. Our connectivity products consist of our legacy products including our modems and accessory products including our Mobile Power Pack, adapters and cables. Other revenues represented approximately 6% and 5% of our revenues in the three and six month periods ended June 30, 2012, respectively, compared to 14% and 17% in the comparable periods one year ago.



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Our revenues by product family for the three and six months ended June 30, 2012 and 2011, and the corresponding increase or decrease in revenues for the comparable periods are shown in the following table:

| (revenues in thousands)                       | Three Months Ended |         |                        | Six Months Ended |         |                        |      |
|---|--------------------|---------|------------------------|------------------|---------|------------------------|------|
|   | June 30,           |         | Increase<br>(Decrease) | June 30,         |         | Increase<br>(Decrease) |      |
| Product family:                               | 2012               | 2011    |                        | 2012             | 2011    |                        | 2012 |
| Mobile handheld computer and related products | \$2,212            | \$2,877 | (23 %)                 | \$4,522          | \$5,296 | (15 %)                 |      |
| Cordless handheld barcode scanning products   | 1,578              | 847     | 86 %                   | 3,092            | 1,683   | 84 %                   |      |
| Other   | 248                | 629     | (61 %)                 | 377              | 1,413   | (73 %)                 |      |
| Total   | \$4,038            | \$4,353 | (7 %)                  | \$7,991          | \$8,392 | (5 %)                  |      |

Our mobile handheld computer and related product and service revenues in the three and six months ended June 30, 2012 were \$2.2 million and \$4.5 million, a decrease of 23% and 15% compared to revenues of \$2.9 million and \$5.3 million in the corresponding periods one year ago. Mobile handheld computer revenues (excluding revenues from the related plug-in products and services) in the second quarter of 2012 declined by \$0.3 million compared to the same period one year ago reflecting lower sales volumes and price discounts in effect during the second quarter 2012 to incentivize sales of our older SoMo 650 models ahead of initial shipments of our next generation SoMo 655 mobile computers into our distribution channel which commenced in late June 2012. Mobile handheld computer revenues in the first half of 2012 were flat compared to the same period one year ago reflecting a recovery from shortages in the supply of our mobile handheld computer from our contract manufacturer which adversely affected our mobile handheld revenues in the first half of 2011. Beginning in late 2010, a major tablet and smartphone manufacturer secured a majority of the LCD touch screen manufacturing capacity of our screen manufacturer causing short term supply disruptions as our LCD touch screen manufacturer reprioritized capacity commitments. Consequently, beginning in the fourth quarter 2010, sales of our mobile handheld computer products were reduced as a result of the shortages in the availability of LCD touch screens used in the manufacture of our mobile handheld computer. The shortages continued but to progressively lesser extents through the first three quarters of 2011, resulting in an inability to fully ship our quarterly mobile handheld computer backlog within each quarter until resolution of the supply issue in the fourth quarter 2011. Additional declines in the three and six month periods ended June 30, 2012 of \$0.4 million and \$0.8 million, respectively, were primarily from declines in sales of our companion plug-in data collection products due primarily to lower sales volumes of customized versions of our CompactFlash plug-in barcode scanners compared to the corresponding periods one year ago.

Our cordless handheld barcode scanning product revenues in the three and six months ended June 30, 2012 were \$1.6 million and \$3.1 million, an increase of 86% and 84% compared to revenues of \$0.8 million and \$1.7 million in the comparable periods one year ago. Revenue increases in the three and six month periods were primarily from increased sales volumes of our imager based cordless handheld scanners including our Apple certified cordless handheld

scanner, and our new entry level cordless handheld scanning product which began shipping in the fourth quarter of 2011.

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Service revenues were \$0.2 million or 5% of our revenues in the second quarter 2012 compared to \$0.3 million or 6% of our revenue in same quarter one year ago. Service revenues were \$0.4 million or 5% of our revenues in the first half of 2012 compared to \$0.5 million or 6% of our revenue in same period one year ago. Decreases in service revenues in the comparable three and six month periods were due to decreases in out-of-warranty related services. Service revenues related to our SocketCare service program were flat in the comparable three and six month periods. Service revenues have been allocated to the respective products serviced in the table above.

Other revenues in the second quarter of 2012 were \$0.2 million, a decrease of 61% compared to revenues of \$0.6 million in the same quarter one year ago. Other revenues in the first half of 2012 were \$0.4 million, a decrease of 73% compared to revenues of \$1.4 million in the same period one year ago. Revenue declines of \$0.2 million and \$0.6 million in the comparable three and six month periods were from reduced sales volumes of our Cordless Ring Scanner. Remaining declines were from reduced sales volumes in our legacy connectivity products, and reduced sales volumes of our Bluetooth and wireless LAN plug-in cards used primarily by OEM customers. Sales of these products vary from quarter to quarter based on the timing of customer purchases.

## Gross Margins

Our gross margins in the three and six months ended June 30, 2012 were 37% and 38%, compared to margins of 42% and 40%, in the corresponding periods one year ago. We generally price our products as a markup from our cost, and we offer discount pricing for higher volume purchases. Declines in overall margins in the three and six months ended June 30, 2012 were due primarily to lower margins on our mobile handheld computer products as a result of pricing discounts in effect during the second quarter 2012 to incentivize sales of our older SoMo 650 models ahead of initial unit shipments of our next generation SoMo 655 mobile computers into our distribution channel which commenced in latter June 2012. Additional margin declines were due to the reduction of inventory in our distribution channel, primarily in the stocking levels of our SoMo 650 models which resulted in the absorption of a greater portion of fixed overhead costs in the current periods compared to the corresponding periods one year ago.

## Research and Development Expense

Research and development expense in the three months ended June 30, 2012 was \$0.7 million, an increase of 14% compared to \$0.6 million in the corresponding period one year ago. Research and development expense for the six months ended June 30, 2012 was \$1.5 million, an increase of 16% compared to research and development expense of \$1.3 million in the corresponding period one year ago. Increased research and development expense in the comparable three and six month periods was primarily from increased development activities related to the development of our next generation SoMo series of mobile handheld computers, which we began shipping in June 2012. Research and development expense in the third quarter of 2012 is expected to decline from second quarter levels as a result of concluding the majority of our next generation mobile handheld development activities.

## Sales and Marketing Expense



Sales and marketing expense for the three months ended June 30, 2012 was \$1.0 million, an increase of 15% compared to sales and marketing expense of \$0.9 million in the corresponding period one year ago. Sales and marketing expense for the six month period ended June 30, 2012 was \$1.9 million, an increase of 15% compared to sales and marketing expense of \$1.7 million in the corresponding period one year ago. Increased sales and marketing expense in the comparable three and six month periods was due primarily to increases in personnel costs reflecting personnel additions in the latter half of 2011. Additional increases in sales and marketing expense were from increases in advertising and travel costs in the comparable periods. Sales and marketing expense in the third quarter of 2012 is expected to continue at levels comparable to the preceding second quarter.

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**General and Administrative Expense**

General and administrative expense for the three months ended June 30, 2012 was \$497,000, a decrease of 7% compared to general and administrative expense of \$532,000 in the corresponding period one year ago. General and administrative expense for the six month period ended June 30, 2012 was \$1,110,000, a decrease of 2% compared to general and administrative expense of \$1,128,000 in the corresponding period one year ago. Declines in the comparable three and six month periods were primarily from reductions in outside services expense, partially offset by increases in legal expense in each of the comparable periods.

**Interest Income and Expense**

Interest income reflects interest earned on cash balances. Interest income in the three and six months ended June 30, 2012 and 2011 was nominal in each of the periods, reflecting low average rates of return on cash balances.

Interest expense in the three and six months ended June 30, 2012 was \$27,000 and \$56,000, compared to interest expense of \$173,000 and \$513,000 in the same periods one year ago. Interest expense in the three and six months ended June 30, 2012 was related primarily to interest on amounts drawn on our bank lines of credit. Interest expense in the three and six months ended June 30, 2011 was related primarily to our convertible note including the amortization of the related debt discount and interest on the principal outstanding during the three and six month periods. Amortization of debt discount in 2011 was a non-cash expense. Additionally, interest expense in each of the quarters presented includes interest on equipment lease financing obligations.

**Income Taxes**

Deferred tax expense in the first half of 2012 and 2011 and the corresponding deferred tax liability shown on our balance sheet, is related entirely to the deferred tax liability on the portion of our goodwill amortized for tax purposes. Due to the indefinite characteristic of this deferred tax liability, it cannot be offset against deferred tax assets. We maintain a full valuation allowance for all other components of deferred tax assets. There can be no assurance that the deferred tax assets subject to the valuation allowance will be realized. We have not generated taxable income in any periods in any jurisdiction, foreign or domestic.

**Cash Flows and Contractual Obligations**

As reflected in our Statements of Cash Flows, net cash provided from operating activities was \$36,000 in the first six months 2012, compared to cash used in operating activities of \$124,000 in the comparable period a year ago. We calculate net cash provided by or used in operating activities by reducing our net loss (\$1.6 million and \$1.3 million in the first six months of 2012 and 2011, respectively) by those expenses that did not require the use of cash, and reversing gains or losses that did not generate or use cash. These items consist of stock based compensation expense,

depreciation, amortization of intangible assets, deferred tax expense, and in 2011, the amortization of debt discount. These amounts totaled \$0.6 million in the first half of 2012 and \$1.1 million in the first half of 2011. In addition, we report increases in assets and reductions in liabilities as uses of cash and decreases in assets and increases in liabilities as sources of cash, together referred to as changes in operating assets and liabilities. In the first half of 2012 changes in operating assets and liabilities resulted in a net source of cash of \$1.1 million and were primarily from reductions in accounts receivables due to lower overall shipments to our distributors in the second quarter of 2012 compared to the fourth quarter of last year, increases in accounts payables due to increased inventory purchases of our mobile handheld computers and the timing of vendor payments, partially offset by the increases in inventory due to the purchases just mentioned. In the first half of 2011 changes in operating assets and liabilities resulted in a net source of cash of \$140,000 and were primarily from reductions in inventory as a result of increased shipments, increased stocking levels in our distribution channel as a result of the overall increased shipments, and increases in accounts payable due to deferred payments, partially offset by increases in accounts receivable due to the increase in overall shipments in the second quarter 2011 compared to the fourth quarter of the prior year, increases in prepaid expenses, and declines in deferred service revenues.

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Cash used in investing activities was \$206,000 in the first half of 2012 compared to \$40,000 in the first half of 2011. Increases in investing activities in the first half of 2012 is related primarily to expenditures on tooling for our next generation mobile handheld computer which we began shipping into our distribution channel in June 2012.

Cash used in financing activities was \$0.2 million in the first half of 2012 compared to cash provided of \$0.7 million in the first half of 2011. Financing activities in the first half of 2012 consisted primarily of net amounts paid on our bank lines of credit partially offset by stock option and warrant exercises. Financing activities in the first half of 2011 consisted primarily of a reduction in the amount of cash required to collateralize our senior convertible note payable. Increases in qualified accounts receivable in the first half of 2011 were sufficient to fully collateralize the note thereby eliminating the requirement to restrict cash at June 30, 2011. The reduction in restricted cash was partially offset by payments on capital leases.

Our contractual cash obligations at June 30, 2012 are outlined in the table below:

| Contractual Obligations  | Total       | Payments Due by Period |                 |                 |                         |
|--|-------------|------------------------|-----------------|-----------------|-------------------------|
|  |             | Less than<br>1 year    | 1 to 3<br>years | 4 to 5<br>years | More<br>than<br>5 years |
| Capital leases   | \$74,000    | \$17,000               | \$37,000        | \$20,000        | \$—                     |
| Operating leases   | 2,364,000   | 356,000                | 756,000         | 818,000         | 434,000                 |
| Unconditional purchase obligations with contract manufacturers | 4,898,000   | 4,898,000              | —               | —               | —                       |
| Total contractual obligations                                  | \$7,336,000 | \$5,271,000            | \$793,000       | \$838,000       | \$434,000               |

**Off-Balance Sheet Arrangements**

As of June 30, 2012, we have no off-balance sheet arrangements as defined in Item 303 of Regulation S-K.



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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 and our bank credit line facilities. Our cash is invested in short-term money market investments backed by U.S. Treasury notes and other investments that mature within one year and whose principal is not subject to market rate fluctuations. Accordingly, interest rate declines would adversely affect our interest income but would not affect the carrying value of our cash investments. Based on a sensitivity analysis of our cash investments during the quarter ended June 30, 2012, a decline of 1% in interest rates would not have had a material effect on our quarterly interest income.

**Foreign Currency Risk**

A substantial majority of our revenue, expense and purchasing activities are transacted in U.S. dollars. However, we require our European distributors to purchase our products in Euros and we pay the expenses of our European employees in Euros and British pounds. Our distributor in Japan began purchases our products in Yen. 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 and our Yen denominated receivables, to reduce the foreign currency risk associated with these assets, and we have not been subject to significant losses from material foreign currency fluctuations. Based on a sensitivity analysis of our net foreign currency denominated assets and expenses at the beginning, during and at the end of the quarter ended June 30, 2012, an adverse change of 10% in exchange rates would have resulted in an increase in our net loss for the second quarter 2012 of approximately \$63,000 if left unprotected. For the second quarter of 2012 the total net adjustment for the effects of changes in foreign currency on cash balances, collections, payables, and derivatives used to hedge foreign currency risks, was a net loss of \$1,600. We will continue to monitor, assess, and mitigate through hedging activities, our risks related to foreign currency fluctuations.

**Item 4. Controls and Procedures**

*Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures*

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and

reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control Over Financial Reporting*

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

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**PART II**

**Item 1A. Risk Factors**

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

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

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

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

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



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

We may incur operating losses in future quarters and would need to raise capital to fund such losses. Our forecasts are highly dependent on factors beyond our control, including market acceptance of our products, deployments by businesses of applications that use our handheld computers and our data collection products, and supply delays in key components such as we experienced in the fourth quarter of 2010 and to progressively lesser extents in the first three quarters of 2011. 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.

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

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

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

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

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

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

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

We review our goodwill for impairment at least annually as of September 30th, and more often if factors suggest potential impairment. Many factors are considered in evaluating goodwill including our market capitalization, comparable companies within our industry, our estimates of our future performance, and discounted cash flow analysis. Many of these factors are highly subjective and may be negatively impacted by our financial results and market conditions in the future. We recorded goodwill impairment charges in 2009 of \$5.4 million and none in 2010 and 2011. We may incur goodwill impairment charges in the future and any future write-downs of our goodwill would increase our net losses, make it more difficult to achieve profitability, and as a result the market price of our common stock could be adversely affected.

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

Several of our component parts, including our serial interface chip, our Ethernet chip, our barcode scanning modules, and our line of mobile handheld computers, are produced by one or a limited number of suppliers. Shortages could occur in these essential components due to an interruption of supply or increased demand in the industry. In particular, shipments of our mobile handheld computers in the fourth quarter 2010, and to progressively lesser extent in the first, second, and third quarters of 2011, were adversely affected by a worldwide supply chain LCD screen shortage, due to increased demand for LCD screens by tablet and smart phone manufacturers. If we are unable to procure certain component parts such as we experienced in the fourth quarter of 2010 and the first nine months of 2011, we could be required to reduce our operations while we seek alternative sources for these components, which could have a material adverse effect on our financial results. To the extent that we acquire extra inventory stocks to protect against possible shortages, we would be exposed to additional risks associated with holding inventory, such as obsolescence, excess quantities, or loss.

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

Our success has been dependent upon the ability of third-parties in the mobile computer industry to successfully develop products that include or are compatible with our technology and then to sell these products into the marketplace. Even if we are successful in marketing and selling our new line of mobile handheld computers, our ability to generate increased revenue depends significantly on the commercial success of other parties' Windows mobile products, particularly vertical market software applications for use with our handheld computer and peripheral

products, and standard Pocket PC handhelds, phone-integrated devices, tablet computers, and other phone-integrated devices, including those from Blackberry, Google, and Apple, with which our plug-in and wireless peripherals can be used, and the adoption of these mobile computer devices for business use. A number of manufacturers of handheld computers have reduced the number of handheld products they offer, or curtailed development of future handheld computer products. If manufacturers are unable or choose not to ship new products such as Windows Mobile devices, or experience difficulties with new product transitions that cause delays in the market, or if these products fail to achieve or maintain market acceptance, the number of our potential new customers could be reduced and we may not be able to meet our sales expectations.

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

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

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

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

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

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

A significant portion of our revenue comes from a limited number of distributors. Ingram Micro Inc. and ScanSource, Inc. together represented approximately 37% and 29% of our worldwide revenues in the first half of 2012 and fiscal year 2011, respectively. We expect that a significant portion of our revenue will continue to depend on sales to a limited number of distributors. Additionally, 11% of our revenue in the fiscal year 2011 came from Epocal, Inc., an OEM customer. We do not have long-term commitments from our distributors to carry our products, and any of our

distributors may from quarter to quarter comprise a significant concentration of our revenues. Any could choose to stop selling some or all of our products at any time, and each of these companies also carries our competitors' products. If we lose our relationship with Ingram Micro Corporation or ScanSource, Inc., or any of our other significant distributors, we would experience disruption and delays in marketing our products.

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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. The current global financial crisis may have an impact on our customers' ability to pay us in a timely manner, and consequently, we may experience increased difficulty in collecting our accounts receivable, and we may have to increase our reserves in anticipation of increased uncollectible accounts.

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

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

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

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

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

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



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

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

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

The demand for our products depends on many factors and is difficult to forecast. We expect that it will become more difficult to forecast demand given current economic conditions, as we introduce and support more products, and as competition in the market for our products intensifies. In particular, we expect to transition our mobile handheld computer product line from the SoMo 650 series to the SoMo 655 series in the second half of 2012. If demand is lower than forecasted levels, such as demand for our SoMo series products, we could have excess production resulting in higher inventories of finished products and components, which could lead to write-downs or write-offs of some or all of the excess inventories, and reductions in our cash balances. Lower than forecasted demand could also result in excess manufacturing capacity at our third-party manufacturers and in our failure to meet minimum purchase commitments, each of which may lower our operating results.

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

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

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

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

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

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

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

We have devoted significant research and development resources to design products to work with a number of operating systems used in mobile devices including Windows Mobile, Windows CE, Windows 7/Vista/XP, Windows Embedded Handheld, RIM Blackberry, Apple, Google's Android, and to develop our own family of mobile handheld computers. Such design activities have diverted financial and personnel resources from other development projects. These design activities are not undertaken pursuant to any agreement under which Microsoft, Research In Motion, Apple, or Google 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.



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

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

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.

**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.

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

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

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

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

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

Historically, we have used stock options as a key component of our employee compensation packages. We believe that stock options provide an incentive to our employees to maximize long-term stockholder value and, through the use of vesting, encourage valued employees to remain with us. The expensing of employee stock options adversely affects our net income and earnings per share, will continue to adversely affect future quarters, and will make profitability harder to achieve. In addition, we may decide in response to the effects of expensing stock options on our operating results to reduce the number of stock options granted to employees or to grant options to fewer employees. This could adversely affect our ability to retain existing employees and attract qualified candidates, and also could increase the cash compensation we would have to pay to them.



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

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

**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 44% and 34% of our revenue in the first half of 2012 and fiscal 2011, respectively. Accordingly, our operating results are subject to the risks inherent in export sales, including:

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

Our export sales are primarily denominated in United States dollars, in Euros for our sales to European distributors and in Yen for our sales to Japanese 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 or Yen relative to the United States dollar may result in foreign currency losses relating to collection of Euro or Yen denominated receivables if left unhedged. Furthermore, the recent economic instability of the Eurozone could have a material adverse affect on our business, including the ability of our distributors to sell our products and our ability the collect the related Euro receivables.

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

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

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

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

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 August 10, 2012, we had 4,861,063 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 August 10, 2012, we had 1,619,490 shares of common stock subject to outstanding options under our stock option plans, and 67,136 shares of common stock were available for future issuance under the plans. We have registered the shares of common stock subject to outstanding options and reserved for issuance under our stock option plans. Accordingly, the shares of common stock underlying vested options will be eligible for resale in the public market as soon as the options are exercised.

As of August 10, 2012, we had 57,776 shares of common stock subject to outstanding warrants issued in our 2009 private placement. We have registered the resale of all shares of common stock subject to the warrants. Accordingly, the shares of common stock underlying these warrants will be eligible for resale in the public market as soon as the warrants are exercised, subject to S-3 prospectus delivery requirements.

As of August 10, 2012, we had 550,000 shares of common stock subject to outstanding warrants issued in connection with the convertible note financing in November 2010. We have registered the resale of all shares of common stock subject to the note conversion and warrants. Accordingly, the shares of common stock underlying the note and warrants will be eligible for resale in the public market as soon as the note is converted and the warrants are eligible and exercised, subject to S-3 prospectus delivery requirements.

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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, 2011 through August 10, 2012, our common stock price fluctuated between a high of \$3.90 and a low of \$0.99. On July 30, 2012, our common stock was delisted from the Nasdaq market and began trading on the Over-the-Counter Marketplace. We have experienced low trading volumes in our stock, and thus relatively small purchases and sales can have a significant effect on our stock price. The trading price of our common stock could be subject to wide fluctuations in response to many factors, some of which are beyond our control, including general economic conditions and the outlook of securities analysts and investors on our industry. In addition, the stock markets in general, and the markets for high technology stocks in particular, have experienced high volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

**Item 6. Exhibits**

Exhibits

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

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

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

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**SIGNATURES**

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

SOCKET MOBILE, INC.

Registrant

Date: August 13, 2012 /s/ Kevin J. Mills  
Kevin J. Mills  
President and Chief Executive Officer  
(Duly Authorized Officer and Principal Executive Officer)

Date: August 13, 2012 /s/ David W. Dunlap  
David W. Dunlap  
Vice President of Finance and Administration and Chief Financial Officer (Duly Authorized Officer and Principal Financial and Accounting Officer)



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**Index to Exhibits**

Exhibit

Number Description

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