

PHOENIX TECHNOLOGIES LTD

Form 10-Q

July 31, 2008

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

**Form 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended June 30, 2008**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period to .**

**Commission file number 0-17111**

**PHOENIX TECHNOLOGIES LTD.**

*(Exact name of Registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of incorporation or organization)*

**04-2685985**

*(I.R.S. Employer Identification Number)*

**915 Murphy Ranch Road, Milpitas, CA 95035**

*(Address of principal executive offices, including zip code)*

**(408) 570-1000**

*(Registrant's telephone number, including area code)*

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
 (Do not check if a smaller reporting company)

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

As of July 30, 2008, the number of outstanding shares of the registrant's common stock, \$0.001 par value, was 28,032,691.

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**FORWARD-LOOKING STATEMENTS**

This report on Form 10-Q includes 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 may include, but are not limited to, statements concerning: future liquidity and financing requirements; expectations of sales volumes to customers and future revenue growth; new business and technology partnerships; our acquisition activities; plans to improve and enhance existing products; plans to develop and market new products; recruiting efforts; trends we anticipate in the industries and economies in which we operate; the outcome of pending disputes and litigation; our tax and other reserves; and other information that is not historical information. Words such as could, expects, may, anticipates, believes, projects, estimates, intends, plans, and other similar expressions are intended to indicate forward-looking statements. All forward-looking statements included in this report reflect our current expectations and various assumptions, and are based upon information available to us as of the date hereof. Our expectations, beliefs and projections are expressed in good faith, and we believe there is a reasonable basis for them, but we cannot assure you that our expectations, beliefs and projections will be realized.

Some of the factors that could cause actual results to differ materially from the forward-looking statements in this Form 10-Q include, but are not limited to: our dependence on key customers; our ability to successfully enhance existing products and develop and market new products and technologies; our ability to maintain profitability; our ability to meet our capital requirements in the long-term and maintain positive cash flow from operations; our ability to attract and retain key personnel; product and price competition in our industry and the markets in which we operate; our ability to successfully compete in new markets where we do not have significant prior experience; end-user demand for products incorporating our products; the ability of our customers to introduce and market new products that incorporate our products; risks associated with any acquisition strategy that we might employ; results of litigation; failure to protect our intellectual property rights; changes in our relationship with leading software and semiconductor companies; the rate of adoption of new operating system and microprocessor design technology; the volatility of our stock price; risks associated with our international sales and operating internationally, including currency fluctuations, acts of war or terrorism, and changes in laws and regulations relating to our employees in international locations; whether future restructurings become necessary; our ability to complete the transition from our historical reliance on paid-up licenses to volume purchase license agreements (VPAs) and pay-as-you-go arrangements; any material weakness in our internal controls over financial reporting; changes in financial accounting standards and our cost of compliance; the effects of any software viruses or other breaches of our network security, power shortages and unexpected natural disasters; trends regarding the use of the x86 microprocessor architecture for personal computers and other digital devices; and changes in our effective tax rates. If any of these risks or uncertainties materialize, or if any of our underlying assumptions are incorrect, our actual results may differ significantly from the results that we express in or imply by any of our forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect future events or circumstances.

For a more detailed discussion of these and other risks associated with our business, see Item 1A Risk Factors in Part II of this Form 10-Q and Item 1A Risk Factors in our Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****PHOENIX TECHNOLOGIES LTD.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2008</b>	<b>September 30, 2007</b>
	<b>(In thousands) (Unaudited)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 46,101	\$ 62,705
Accounts receivable, net of allowances	3,508	6,383
Other assets current	23,139	3,496
Total current assets	72,748	72,584
Property and equipment, net	3,258	2,791
Purchased technology and intangible assets, net	14,324	3,571
Goodwill	25,759	14,497
Other assets noncurrent	3,003	1,037
Total assets	\$ 119,092	\$ 94,480
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,041	\$ 1,186
Accrued compensation and related liabilities	4,193	3,922
Deferred revenue	14,042	11,805
Income taxes payable current	3,401	11,733
Accrued restructuring charges current	706	1,905
Other liabilities current	5,700	1,744
Total current liabilities	30,083	32,295
Accrued restructuring charges noncurrent	10	358
Income taxes payable noncurrent	13,065	
Other liabilities noncurrent	2,505	2,055
Total liabilities	45,663	34,708
Stockholders equity:		
Preferred stock		
Common stock	28	28

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Additional paid-in capital	222,804	206,800
Accumulated deficit	(57,216)	(55,311)
Accumulated other comprehensive loss	(509)	(67)
Less: Cost of treasury stock	(91,678)	(91,678)
Total stockholders' equity	73,429	59,772
Total liabilities and stockholders' equity	\$ 119,092	\$ 94,480

See notes to unaudited condensed consolidated financial statements

Table of Contents**PHOENIX TECHNOLOGIES LTD.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<b>(In thousands, except per share amounts)</b>			
	<b>(Unaudited)</b>			
Revenues:				
License fees	\$ 16,883	\$ 10,678	\$ 47,110	\$ 26,077
Subscription fees	20		20	
Service fees	2,373	1,902	6,570	5,275
Total revenues	19,276	12,580	53,700	31,352
Cost of revenues:				
License fees	179	201	421	693
Subscription fees	20		20	
Service fees	2,161	1,811	5,678	5,768
Amortization of purchased intangible assets	373	333	444	916
Total cost of revenues	2,733	2,345	6,563	7,377
Gross margin	16,543	10,235	47,137	23,975
Operating expenses:				
Research and development	8,397	5,204	20,069	14,056
Sales and marketing	3,245	2,554	8,885	9,399
General and administrative	6,708	3,615	16,221	12,254
Restructuring	67	(14)	180	3,082
Total operating expenses	18,417	11,359	45,355	38,791
Income (loss) from operations	(1,874)	(1,124)	1,782	(14,816)
Interest and other income, net	328	479	602	1,514
Income (loss) before income taxes	(1,546)	(645)	2,384	(13,302)
Income tax expense	1,234	1,129	4,037	2,439
Net loss	\$ (2,780)	\$ (1,774)	\$ (1,653)	\$ (15,741)
Loss per share:				
Basic and diluted	\$ (0.10)	\$ (0.07)	\$ (0.06)	\$ (0.61)
Shares used in loss per share calculation:				
Basic and diluted	27,574	26,001	27,385	25,719

See notes to unaudited condensed consolidated financial statements





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	<b>Nine Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In thousands) (Unaudited)</b>	
Cash flows from operating activities:		
Net loss	\$ (1,653)	\$ (15,741)
Reconciliation to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,919	2,644
Stock-based compensation	8,292	3,924
Loss from disposal of fixed assets	16	51
Change in operating assets and liabilities:		
Accounts receivable	2,785	3,232
Prepaid royalties and maintenance	38	86
Other assets	113	1,835
Accounts payable	649	(2,177)
Accrued compensation and related liabilities	34	(874)
Deferred revenue	2,077	4,148
Income taxes	4,311	1,281
Accrued restructuring charges	(1,608)	(3,186)
Other accrued liabilities	(10)	(1,618)
Net cash provided by (used in) operating activities	16,963	(6,395)
Cash flows from investing activities:		
Proceeds from sales of marketable securities		113,714
Proceeds from maturities of marketable securities		1,000
Purchases of marketable securities		(89,125)
Purchases of property and equipment	(1,958)	(373)
Escrow deposit	(18,706)	
Acquisition of business, net of cash acquired	(17,715)	
Net cash provided by (used in) investing activities	(38,379)	25,216
Cash flows from financing activities:		
Proceeds from stock purchases under stock option and stock purchase plans	4,723	5,154
Net cash provided by financing activities	4,723	5,154
Effect of changes in exchange rates	89	36
Net increase in cash and cash equivalents	(16,604)	24,011
Cash and cash equivalents at beginning of period	62,705	34,743

Cash and cash equivalents at end of period	\$ 46,101	\$ 58,754
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Supplemental disclosure of cash flow information:

Non-cash investing activity:

Fair value of stock issued in connection with acquisition	2,985
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See notes to unaudited condensed consolidated financial statements

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**PHOENIX TECHNOLOGIES LTD.**

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

**Note 1. Summary of Significant Accounting Policies**

*Basis of Presentation.* The condensed consolidated financial statements as of June 30, 2008 and for the three and nine months ended June 30, 2008 and 2007 have been prepared by Phoenix Technologies Ltd. (the Company or Phoenix ), without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ) and in accordance with the Company s accounting policies as described in its latest Annual Report on Form 10-K filed with the SEC and in this Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The condensed consolidated balance sheet as of September 30, 2007 was derived from the audited financial statements but does not include all disclosures required by generally accepted accounting principles. These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (which include normal recurring adjustments in each of the periods presented) necessary for a fair presentation of the Company s results of operations and cash flows for the interim periods presented and financial condition of the Company as of June 30, 2008. The results of operations for interim periods are not necessarily indicative of results to be expected for the full fiscal year.

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

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

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

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

arrangement fee is recognized as revenue. If VSOE of fair value of one or more undelivered elements does not exist, revenue is deferred and recognized when delivery of those elements occurs or when fair value can be established.

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

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

**Pay-As-You-Go Arrangements**

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

**Volume Purchase Arrangements**

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

For periods ended on or before December 31, 2006, the Company recognized revenues from VPAs for units estimated to be consumed by the end of the following quarter, provided the customer had been invoiced for such consumption prior to the end of the current quarter and provided all other revenue recognition criteria had been met. These estimates had historically been recorded based on customer forecasts. Actual consumption that was subsequently reported by these same customers was regularly compared to the previous estimates to confirm the reliability of this method of determining projected consumption. The Company's examination of reports received from its customers during April 2007 regarding actual consumption of the Company's products during the three month period ended March 31, 2007 and a comparison of those consumption reports to forecasts previously provided by these customers, led the Company to the view that customer forecasts were no longer a reliable indicator of future consumption. Since the Company no longer considered customer forecasts to be a reliable estimate of future consumption, it became no longer appropriate to include future period consumption in current period revenues beginning with the quarter ended March 31, 2007.

**Fully Paid-up License Arrangements**

During fiscal years 2005 and 2006, the Company had increasingly relied on the use of software license agreements with its customers in which they paid a fixed upfront fee for an unlimited number of units, subject to certain Phoenix product or design restrictions ( paid-up licenses ). Revenues from such paid-up license arrangements were generally recognized upfront, provided all other revenues recognition criteria had been met. Effective September 2006, the Company decided to eliminate the practice of entering into paid-up licenses.

**Services Arrangements**

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

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

**Subscription Fees**

Subscription fees are revenues arising from agreements that provide for the ongoing delivery over a period of time of services, generally delivered over the web. Primary subscription fee sources include fees charged for back-up, recovery and device management services.

*Cost of Revenues.* Cost of revenues consists of third party license costs, service costs, subscription costs and amortization of purchased intangibles. License costs are primarily third party royalty fees, electronic product fulfillment costs, and the costs of product labels for customer use. Service costs include personnel-related expenses such as salaries and other related costs associated with work performed under professional service contracts, non-recurring engineering agreements and post-sales customer support costs. Subscription costs are primarily hosting fees associated with customer data, product fulfillment costs and personnel-related expenses such as salaries associated with post-sales customer support costs.

*Amortization of Acquired Intangible Assets.* The Company accounts for purchased computer software, or purchased technology, including that which is acquired through business combinations, in accordance with Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* ( SFAS No. 86 ). SFAS No. 86 states that capitalized software costs are to be amortized on a product by product basis. The annual amortization shall be the greater of the amount computed using (a) the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product or (b) the straight-line method over the remaining estimated economic life of the product including the period being reported on. Furthermore, at each balance sheet date, the unamortized capitalized costs of a computer software product shall be compared to the net realizable value of that product. The amount by which the unamortized capitalized costs of a computer software product exceed the net realizable value of that asset shall be written off. The net realizable value is the estimated future gross revenues from that product reduced by the estimated future costs of completing and disposing of that product, including the costs of performing maintenance and customer support required to satisfy the enterprise's responsibility set forth at the time of sale.

In fiscal year 2007 and in the nine months ended June 30, 2008, purchases of technology consisted of a) the acquisition in August 2007 of certain intangible assets from XTool Mobile Security, Inc., for \$3.5 million, and b) the acquisition in April 2008 of certain intangible assets valued at \$6.0 million as part of the acquisition of BeInSync Ltd.

The technology purchased from XTool Mobile Security, Inc. has not yet begun to be amortized. This technology is being further developed to become a product, Phoenix FailSafe, to be sold by the Company. When Phoenix FailSafe reaches a state of general release, then amortization will begin for the technology purchased from XTool Mobile Security in accordance with SFAS No. 86. See Note 7 for further information.

The technology purchased as part of the acquisition of BeInSync Ltd. is used in a product which was formerly sold by BeInSync Ltd. and is now being sold by Phoenix. Since the technology is for a product which has achieved the state of general release, the Company began amortizing the value of the technology upon its acquisition. See Notes 7 and 11 for further information.

In addition to the technology purchased as part of the acquisition of BeInSync, the Company also acquired customer relationships valued at \$4.8 million and trade names valued at \$0.4 million. The amount of intangible assets subject to



amortization acquired with the acquisition of BeInSync totaled \$11.2 million.

*Income Taxes.* Income taxes are accounted for in accordance with Statement of Financial Accounting Standards No. 109 *Accounting for Income Taxes* ( SFAS No. 109 ). Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable

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income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period of enactment.

On October 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken in an income tax return. FIN 48 requires that we determine whether the benefits of tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, we recognize the largest amount of the benefit that is more likely than not of being sustained in the financial statements. For tax positions that are not more likely than not of being sustained upon audit, we do not recognize any portion of the benefit in the financial statements.

*Stock-Based Compensation.* On October 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment ( SFAS No. 123(R) ) using the modified prospective method. Under this method, compensation cost recognized during the three months ended June 30, 2008 and 2007, includes:

(a) compensation cost for all share-based payments granted prior to, but not yet vested as of, October 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and amortized on a graded vesting basis over the options' vesting period, and (b) compensation cost for all share-based payments granted subsequent to October 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R) and amortized on a straight-line basis over the options' vesting period. The Company has elected to use the alternative transition provisions described in FASB Staff Position FAS No. 123(R)-3 for the calculation of its pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R). Pro forma results for prior periods have not been restated.

The following table shows total stock-based compensation expense included in the condensed consolidated statement of operations for the three and nine months ended June 30, 2008 and 2007 (*in thousands*):

	<b>Three Months Ended</b>		<b>Nine Months</b>	
	<b>June 30,</b>		<b>Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Costs and Expenses				
Cost of goods sold	\$ 162	\$ 52	\$ 369	\$ 146
Research and development	984	394	2,140	970
Sales and marketing	399	218	966	707
General and administrative	2,060	505	4,817	2,049
Total stock-based compensation expense	\$ 3,605	\$ 1,169	\$ 8,292	\$ 3,872

There was no capitalized stock-based employee compensation cost as of June 30, 2008. There was no recognized tax benefit relating to stock-based employee compensation during the three and nine months ended June 30, 2008.

The Company uses Monte Carlo option pricing models to value stock option grants that contain a market condition such as the options that were granted to the Company's four most senior executives and approved by the Company's stockholders on January 2, 2008. The Company uses Black-Scholes option pricing models to value all other options granted since no other options granted contain a market condition. The models require inputs such as expected term, expected volatility, expected dividend yield and the risk-free interest rate. Further, the forfeiture rate of options also affects the amount of aggregate compensation. These inputs are subjective and generally require significant analysis and judgment to develop. While estimates of expected term, volatility and forfeiture rate are derived primarily from the Company's historical data, the risk-free interest rate is based on the yield available on U.S. Treasury zero-coupon issues. Under SFAS No. 123(R), the Company has divided option recipients into three groups (outside directors, officers and non-officer employees) and determined the expected term and anticipated

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forfeiture rate for each group based on the historical activity of that group. The expected term is then used in determining the applicable volatility and risk-free interest rate.

The fair value of the options granted in the three and nine months ended June 30, 2008 and 2007 reported above has been estimated as of the date of the grant using either a Monte Carlo option pricing model or a Black-Scholes single option pricing model with the following assumptions:

	<b>Employee Stock Options</b>			
	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Expected life from grant date (in years)	3.4 - 10.0	3.2 - 10.0	3.4 - 10.0	3.2 - 10.0
Risk-free interest rate	2.8 - 3.9%	4.8 - 4.9%	2.2 - 4.4%	4.7 - 5.0%
Volatility	0.5 - 0.7	0.5 - 0.7	0.5 - 0.7	0.5 - 0.7
Dividend yield	None	None	None	None

	<b>Employee Stock Purchase Plan</b>			
	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Expected life from grant date (in years)	0.5 - 1.0	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0
Risk-free interest rate	1.9 - 2.1%	4.9 - 5.0%	1.9 - 3.7%	4.8 - 5.1%
Volatility	0.5	0.4 - 0.6	0.4 - 0.6	0.4 - 0.7
Dividend yield	None	None	None	None

*Computation of Earnings (Loss) per Share.* Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the weighted-average number of common and dilutive potential common shares outstanding during the period. Dilutive common-equivalent shares primarily consist of employee stock options computed using the treasury stock method. The treasury stock method assumes that proceeds from exercise are used to purchase common stock at the average market price during the period, which has the impact of reducing the dilution from options. Stock options will have a dilutive effect under the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options. Also, for periods in which the Company reports a net loss, diluted net loss per share is computed using the same number of shares as is used in the calculation of basic net loss per share because adding potential common shares outstanding would have an anti-dilutive effect. See Note 6 for further information.

*New Accounting Pronouncements.* In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands fair value measurement disclosures. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, which

for the Company will be the fiscal year beginning on October 1, 2008. The Company does not expect the adoption of SFAS No. 157 to have a material impact on its consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115. SFAS No. 159 allows companies to choose to measure eligible financial instruments and certain other items at fair value that are not required to be measured at fair value. SFAS No. 159 requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings at each reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and will be adopted by the Company for our fiscal year beginning October 1, 2009. We are currently evaluating the impact of the adoption of SFAS No. 159 on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 141 (revised 2007), Business Combinations ( SFAS No. 141R ). SFAS No. 141R retains the fundamental requirements of the

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original pronouncement requiring that the acquisition method of accounting, or purchase method, be used for all business combinations. SFAS No. 141R defines the acquirer as the entity that obtains control of one or more businesses in the business combination, establishes the acquisition date as the date that the acquirer achieves control and requires the acquirer to recognize the assets acquired, liabilities assumed and any noncontrolling interest at their fair values as of the acquisition date. SFAS No. 141R requires, among other things, expensing of acquisition-related and restructuring-related costs, measurement of pre-acquisition contingencies at fair value, measurement of equity securities issued for purchase at the date of close of the transaction and capitalization of in-process research and development, all of which represent modifications to current accounting for business combinations. In addition, under SFAS No. 141R, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact the income tax provision. SFAS No. 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning after December 15, 2008. Adoption is prospective and early adoption is prohibited. Adoption of SFAS No. 141R will not impact the Company's accounting for business combinations closed prior to its adoption. The Company will adopt this standard in fiscal year beginning on October 1, 2009. We are currently evaluating the impact of the adoption of SFAS No. 141R on our consolidated financial statements.

In December 2007 the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, which establishes accounting and reporting standards for the noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for business arrangements entered into in fiscal years beginning on or after December 15, 2008, which means that it will be effective for our fiscal year beginning October 1, 2009. Early adoption is prohibited. We are currently evaluating the impact of the adoption of SFAS No. 160 on our consolidated financial statements.

**Note 2. Comprehensive Loss**

The following are the components of comprehensive loss (*in thousands*):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net loss	\$ (2,780)	\$ (1,774)	\$ (1,653)	\$ (15,741)
Other comprehensive loss				
Net change in defined benefit obligation	(5)		(13)	
Net change in unrealized gain (loss) on investments				(19)
Net change in cumulative translation adjustment	(166)	(82)	(429)	63
Comprehensive loss	\$ (2,951)	\$ (1,856)	\$ (2,095)	\$ (15,697)

Table of Contents**PHOENIX TECHNOLOGIES LTD.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 3. Restructuring Charges**

The following table summarizes the activity related to the asset/liability for restructuring charges through June 30, 2008 (in thousands):

	<b>Facilities Exit Costs Fiscal Year 2003 Plan</b>	<b>Severance and Benefits Fiscal Year 2006 Plans</b>	<b>Facilities Exit Costs Fiscal Year 2006 Plans</b>	<b>Severance and Benefits Fiscal Year 2007 Plans</b>	<b>Facilities Exit Costs Fiscal Year 2007 Plans</b>	<b>Total</b>
<b>Balance of accrual at September 30, 2004</b>	\$ 2,184					\$ 2,184
Cash payments	(546)					(546)
True up adjustments	41					41
<b>Balance of accrual at September 30, 2005</b>	1,679					1,679
Provision in fiscal year 2006 plans		\$ 4,028	\$ 166			4,194
Cash payments	(414)	(1,328)	(120)			(1,862)
True up adjustments	475	(32)	(1)			442
<b>Balance of accrual at September 30, 2006</b>	1,740	2,668	45			4,453
Provision in fiscal year 2007 plans				\$ 2,252	\$ 1,492	3,744
Cash payments	(400)	(2,707)	(410)	(1,864)	(948)	(6,329)
True up adjustments	(12)	39	365	7	(4)	395
<b>Balance of accrual at September 30, 2007</b>	1,328			395	540	2,263
Cash payments	(356)			(434)	(493)	(1,283)
True up adjustments	(98)			82	85	69
<b>Balance of accrual at December 31, 2007</b>	874			43	132	1,049
Cash payments	(184)			(38)	(136)	(358)
True up adjustments				(3)	47	44
<b>Balance of accrual/(other assets) at March 31, 2008</b>	690			2	43	735
Cash payments	(178)				(48)	(226)

True up adjustments				(2)	101	99
<b>Balance of accrual/(other assets) at June 30, 2008</b>	\$	512	\$	\$	\$	96 \$ 608

**Fiscal Year 2007 Restructuring Plans**

In the fourth quarter of fiscal year 2007, management approved a restructuring plan for the purpose of reducing future operating expenses by eliminating 12 positions and closing the office in Norwood, Massachusetts. The Company recorded a restructuring charge of approximately \$0.6 million, which consisted of the following: (i) \$0.4 million related to severance costs and (ii) \$0.2 million related to on-going lease obligations for the Norwood facility, net of estimated sublease income. Since the amount of restructuring charge is net of estimated sublease income, if the Company is unable to arrange a sublease with timing and terms as previously anticipated, then there may be additional restructuring charges in future quarters. These restructuring costs were accounted for in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ( SFAS No. 146 ) and are included in the Company's results of operations. During the three months ended June 30, 2008, the Company paid approximately \$55,000 of the restructuring liability and recorded an additional restructuring cost of approximately \$0.1 million related to a change in estimate regarding the expected time to



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**PHOENIX TECHNOLOGIES LTD.**

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

obtain a subtenant, leaving a total estimated unpaid amount of approximately \$0.2 million related to on-going lease obligations and no remaining outstanding liabilities related to severance costs as of June 30, 2008.

In the first quarter of fiscal year 2007, management approved a restructuring plan designed to reduce operating expenses by eliminating 58 positions and closing or consolidating offices in Beijing, China; Taipei, Taiwan; Tokyo, Japan; and Milpitas, California. The Company recorded a restructuring charge of approximately \$1.9 million in the first quarter of fiscal year 2007 related to the reduction in staff. In addition, the Company recorded a charge of \$0.9 million in the second quarter of fiscal year 2007 and a charge of \$0.3 million in the fourth quarter of fiscal year 2007 related to office consolidations. These restructuring costs were accounted for under SFAS No. 146 and are included in the Company's results of operations. During the three months ended June 30, 2008, the Company paid approximately \$6,000 of this restructuring plan's liability.

As of June 30, 2008, the first quarter 2007 restructuring plan has an asset balance of \$0.1 million which is classified under the captions "Other assets - current" and "Other assets - noncurrent" in the Condensed Consolidated Balance Sheets. This balance is related solely to the restructuring activity which was recorded in the fourth quarter of fiscal 2007 as noted above. All other restructuring liabilities associated with the first quarter 2007 plan have been fully paid. When the reserve was first established in the fourth quarter of fiscal 2007, it had a liability balance of \$0.3 million which was comprised of a projected cash outflow of approximately \$3.0 million less a projected cash inflow of approximately \$2.7 million, though the reserve was later increased by \$0.1 million as the result of a change in estimated expenses. The source of the cash inflow is a sublease of the facility that the Company had vacated, and the sublease was executed as anticipated. Since the projected cash inflows exceed the projected cash outflows, the net balance is classified as an asset rather than a liability.

**Fiscal Year 2006 Restructuring Plans**

In fiscal year 2006, the Company implemented a number of cost reduction plans aimed at reducing costs which were not integral to its overall strategy and at better aligning its expense levels with its revenues expectations.

In the fourth quarter of fiscal year 2006, management approved a restructuring plan designed to reduce operating expenses by eliminating 68 positions. The Company recorded \$2.2 million of employee severance costs under the plan. In the third quarter of fiscal year 2006, management approved a restructuring plan designed to reduce operating expenses by eliminating 35 positions and closing facilities in Munich, Germany and Osaka, Japan. The Company recorded \$1.8 million of employee severance costs and \$0.2 million of facility closure costs. These restructuring costs were accounted for in accordance with SFAS No. 146 and are included in the Company's results of operations. As of June 30, 2008, there are no remaining outstanding liabilities pertaining to the fiscal year 2006 restructuring plans.

**Fiscal Year 2003 Restructuring Plan**

In the first quarter of fiscal year 2003, the Company announced a restructuring plan that affected approximately 100 positions across all business functions and closed its facilities in Irvine, California and Louisville, Colorado. This restructuring resulted in expenses relating to employee termination benefits of \$2.9 million, estimated facilities exit expenses of \$2.5 million, and asset write-downs in the amount of \$0.1 million. All then appropriate charges were recorded in the three months ended December 31, 2002 in accordance with Emerging Issues Task Force 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity" (EITF 94-3). As of

September 30, 2003, payments relating to the employee termination benefits were completed. During fiscal years 2003 and 2004 combined, the Company's financial statements reflected a net increase of \$1.8 million in the restructuring liability related to the Irvine, California facility as a result of the Company's revised estimates of sublease income. While there were no changes in estimates for the restructuring liability in fiscal year 2005, in fiscal years 2006 and 2007, the restructuring liability was impacted by changes in the estimated building operating expenses as follows: \$0.5 million increase in the fourth quarter of fiscal year 2006, \$0.1 million decrease in the first quarter of fiscal year 2007, and \$0.1 million increase in the fourth quarter of fiscal

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year 2007. During the first quarter of fiscal year 2008, the Company decreased the fiscal year 2003 restructuring reserve by \$0.1 million due to a projected increase in income due to a new sublease which extends over the remaining term of the lease. During the three months ended June 30, 2008, the Company paid approximately \$0.2 million of the costs associated with this restructuring program. The total estimated unpaid portion of this restructuring, which relates to facilities exit expenses, is \$0.5 million as of June 30, 2008.

**Note 4. Other Assets Current and Noncurrent; Other Liabilities Current and Noncurrent**

The following table provides details of other assets current (*in thousands*):

	<b>June 30, 2008</b>	<b>September 30, 2007</b>
Other assets current:		
Prepaid taxes	\$ 43	\$ 1,868
Prepaid other	835	849
Deferred acquisition costs	240	
Escrow deposit	18,706	
Shares held in escrow	2,989	
Other	326	779
Total other assets current	\$ 23,139	\$ 3,496

The cash consideration for the acquisition of Touchstone was paid by the Company on June 30, 2008 into escrow so that the exchange agent for the transaction would have the consideration available for distribution upon the closing of the acquisition on July 1, 2008. As such, the cash, though not in the possession of the Company, was still considered an asset of the Company as of June 30, 2008 and is classified under the caption Escrow deposit, which is included in Other assets current in the Condensed Consolidated Balance Sheets.

Shares held in escrow represents the value of the stock consideration paid by the Company for the acquisition in April 2008 of BeInSync Ltd. amounting to \$3.0 million and, per the terms of the purchase agreement, the shares are to be held in escrow to cover indemnification obligations BeInSync or the former shareholders of BeInSync may have to the Company for breaches of any of the representations, warranties or covenants set forth in the purchase agreement. These shares are issued and outstanding as of June 30, 2008 and are held by a third party in escrow. While they will not be released until the one year anniversary of the acquisition closing date, up to 50% of the escrowed shares may be sold on each of the 6 month and 9 month anniversaries of the acquisition closing date, with the proceeds from any such sales remaining in escrow. Since these shares are held in escrow and have not yet been distributed to the former shareholders and option holders of BeInSync Ltd., the Company must maintain a liability amounting to \$3.0 million representing the purchase consideration payable in shares which is classified under the captions Purchase consideration payable which is included in Other liabilities current in the Condensed Consolidated Balance Sheets. See Note 11 for further information regarding the acquisition of BeInSync Ltd.

As of June 30, 2008, \$1.9 million, which represents tax payments made relating to the income tax returns for the years 2000 through 2005 filed in Taiwan for which the final tax liability is yet to be settled with the local tax authority, was reclassified from prepaid taxes in other current assets to long-term prepaid taxes in other assets as a result of a change in the estimate of how long it will take to resolve the related tax issue.

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The following table provides details of other assets noncurrent (*in thousands*):

	<b>June 30, 2008</b>	<b>September 30, 2007</b>
Other assets noncurrent:		
Deposits and other	\$ 822	\$ 807
Long-term prepaid taxes	1,998	
Deferred tax	183	230
Total other assets noncurrent	\$ 3,003	\$ 1,037

The following table provides details of other liabilities current (*in thousands*):

	<b>June 30, 2008</b>	<b>September 30, 2007</b>
Other liabilities current:		
Royalties and commissions	\$ 173	\$