PHOENIX TECHNOLOGIES LTD
Form 10-K
November 19, 2008

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

# Form 10-K

**ANNUAL REPORT**
**PURSUANT TO SECTIONS 13 OR 15(d)**
**OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**for the fiscal year ended September 30, 2008**

**OR**

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

**Commission file number 0-17111**

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

| | |
|---|---|
| **Delaware** | **04-2685985** |
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |

**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)*

**Securities registered pursuant to Section 12(b) of the Act:**
**Common Stock, par value $.001**
**Preferred Stock Purchase Rights**
*(Title of each Class)*

**Securities registered pursuant to Section 12(g) of the Act:**
**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES o NO þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o NO þ

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 o | Accelerated filer þ | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

The aggregate market value of the registrant s Common Stock held by non-affiliates of the registrant as of March 31, 2008 was $281,411,766 based upon the last reported sales price of the registrant s Common Stock on the NASDAQ Global Market on such date. For purpose of this disclosure, shares of Common Stock held by directors and officers of the registrant and by stockholders who own more than 5% of the registrant s outstanding Common Stock have been excluded because such persons may be deemed affiliates of the registrant. This determination is not necessarily a conclusive determination for other purposes.

The number of shares of the registrant s Common Stock outstanding as of November 17, 2008 was 28,807,400.

**Documents Incorporated by Reference**

Portions of the registrant s definitive proxy statement to be filed pursuant to Regulation 14A in connection with the 2008 annual meeting of its stockholders are incorporated by reference into Part III of this Form 10-K.

**PHOENIX TECHNOLOGIES LTD.**

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## FORWARD-LOOKING STATEMENTS

This report on Form 10-K 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; our relationships with key industry leaders; 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 , inter 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-K include the factors described in the section of this Form 10-K entitled Item 1A-Risk Factors. These factors include, but are not limited to: demand for our products and services in adverse economic conditions; our dependence on key customers; our ability to successfully enhance existing products and develop and market new products and technologies; our ability to achieve profitability and maintain positive cash flow from operations; our ability to meet our capital requirements in the long-term; 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; our ability to maintain the average selling price of our Core System Software for Netbooks; end-user demand for products incorporating our products; the ability of our customers to introduce and market new products that incorporate our products; our ability to generate additional capital on terms acceptable to us; 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; fluctuations in our operating results; the effects of any software viruses or other breaches of our network security; our ability to convert free users to paid customers and retain customers for our subscription services; storage of confidential customer information; our ability to effectively manage our rapid growth; defects or errors in our products and services; consolidation in the industry we operate in; internet infrastructure; risk associated with usage of open source software; our dependence on third party service providers; any material weakness in our internal controls over financial reporting; changes in financial accounting standards and our cost of compliance; business disruptions due to acts of war, 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.

# PART I

## ITEM 1. *BUSINESS*

### Description of Business

Phoenix Technologies Ltd. ( Phoenix or the Company ) designs, develops and supports core system software for personal computers and other computing devices. Our products, which are commonly referred to as firmware, support and enable the compatibility, connectivity, security and manageability of the various components and technologies used in such devices. We sell these products primarily to computer and component device manufacturers. We also provide training, consulting, maintenance and engineering services to our customers.

The majority of our revenues come from Core System Software ( CSS ), the modern form of BIOS ( Basic Input-Output System ) for personal computers ( PCs ), servers and embedded devices. Our CSS customers are primarily original equipment manufacturers ( OEMs ) and original design manufacturers ( ODMs ), who incorporate CSS products during the manufacturing process. The CSS is typically stored in non-volatile memory on a chip that resides on the motherboard built into the device manufactured by our customer. The CSS is executed during the power-up process in order to test, initialize and manage the functionality of the device s hardware. We believe that our products are incorporated into over 125 million computing devices each year, making us the global market share leader in the CSS sector.

We also design, develop and support software products and services that provide the users of personal computers with enhanced device utility, reliability and security. Included among these products and services are offerings which assist users to locate and manage portable devices that have been lost or stolen, offerings which provide backup, sharing, and synchronization of files and data, and offerings which enable certain applications to operate on the device independently of the device s primary operating system. Although the true consumers of these products and services are enterprises, governments, service providers and individuals, we typically license these products to OEMs and ODMs to assist them in making their products attractive to those end-users.

In addition to licensing our products to OEM and ODM customers, we also sell certain of our products directly or indirectly to computer end users, generally delivering such products as subscription based services utilizing web-based delivery capabilities.

We derive additional revenues from providing development tools and support services such as customization, training, maintenance and technical support to our software customers and to various development partners.

We were incorporated in the Commonwealth of Massachusetts in September 1979, and was reincorporated in the State of Delaware in December 1986. Our headquarters are in Milpitas, California. The mailing address of our headquarters is 915 Murphy Ranch Road, Milpitas, CA 95035, the telephone number at that location is +1 (408) 570-1000 and our website is www.phoenix.com.

### Products

Described below are certain selected products and services we offer.

***Phoenix Core Systems Software***

Phoenix s CSS products include:

*Phoenix SecureCore*

Phoenix SecureCore™ is our primary CSS product, and consists of the firmware that, together with its predecessor TrustedCore, runs many of today s most modern computers. SecureCore supports and enables the compatibility, connectivity, security and manageability of the various components of modern desktop and notebook PCs, PC-based servers and embedded computing systems. The SecureCore product group was released during fiscal year 2007 and includes support for a wide variety of new features developed by semiconductor manufacturers who provide products to the PC industry.

*Phoenix TrustedCore*

Phoenix TrustedCore™ is the predecessor to SecureCore and was the leading product from our CSS product group until the launch of SecureCore during fiscal year 2007. Customers can continue to purchase TrustedCore object licenses and source code to support older versions of processors in their new and existing products.

*Phoenix Award*

The Phoenix Award CSS product group supports fast time to market for high-volume PC and digital device electronics design and manufacturing companies. Typically these manufacturers operate on short design and product life cycles. We believe the Phoenix Award product group delivers the standards-based features, simplicity and small code size necessary for this dynamic market segment. Our Phoenix Award CSS product group consists of both our AwardCore™ CSS product group and our legacy Award BIOS™ product group. Our customers can continue to purchase Award BIOS object licenses and source code to support older versions of processors in their new and existing products.

*Developments in Core System Software*

In recent years, the personal computing industry has been migrating to a new overall design concept for the standardization of Core System Software. This standardization concept was initially pioneered by Intel Corporation ( Intel ) with its Extensible Firmware Interface ( EFI ), created for CSS support of the Itanium processor, and the Platform Innovation Framework. Intel s initial implementation of EFI has continued to evolve in recent years and this overall design concept is now supported by a wide industry consortium called the Unified EFI Forum, Inc., which includes Microsoft Corporation, Intel, Advance Micro Devices, Inc. ( AMD ), Phoenix and others. Under this design concept, firmware has become more modular and standardized than it had been in the past. As a result, computer processor providers are now able to deliver hardware drivers that can be easily integrated into the CSS by both independent BIOS vendors and computer OEMs and ODMs. In addition, due to the standardization of the interfaces, individual developers can also build add-ons or plug-ins to standard interface specifications and deliver products that may be incorporated with firmware platforms from a variety of vendors. Vendor support of these new design concepts and industry standards eases the burden of continually porting features and customizations to new hardware and personal computer designs.

The current Phoenix SecureCore architecture incorporates these philosophies, and hence supports various device drivers and value-added service offerings known as add-ons and plug-ins that we and others may sell in the future.

*Phoenix EmbeddedBIOS*

Phoenix EmbeddedBIOS™ consists of a specialized version of our CSS product line specifically tailored for the embedded market. The solution includes the firmware and tools necessary for solution providers in key embedded vertical markets to quickly bring up their platforms and bring their products to market. We believe it uniquely addresses their needs which include support for a wide variety of target devices and extreme flexibility within a powerful software development environment.

***Services and Solutions***

Phoenix s service and solution products include:

*Phoenix BeInSync*

The Phoenix BeInSync™ service offering is an all-in-one solution that allows users to backup, synchronize, share and access their data online. The solution consists of a software agent that resides on the PC, and an online storage repository. The agent enables users to set backup and synchronization policies that determine which data to backup online, and which data to synchronize with another agent-enabled PC. Once the data is online, users can access it remotely, or share it with others.

*Phoenix eSupport*

eSupport™ consists of a collection of Web sites and PC diagnostic software products designed to detect and fix the typical problems encountered by users during normal use of their computers. The software products include DriverAgent™ which detects out of date device drivers, RegistryWizard™ which detects and corrects problems

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with the Windows Registry, and BIOS Agent Plus™ which identifies and updates the BIOS software. The solutions consist of a software component and an online database. The software is accessed and downloaded from one of the eSupport Web sites. It scans the information on the computer, and then compares the results of the scan with its database and provides the user with recommendations on how to repair any issues it finds.

***Phoenix New Products***

*Phoenix FailSafe*

The Phoenix FailSafe™ service is an advanced theft-loss protection and prevention solution for mobile PCs. The FailSafe solution consists of an embedded tamper-resistant agent that resides in the mobile device and a network connected secure communications center ( SCC ). The SCC enables users to set policies for their mobile devices and then monitors those devices to detect and prevent violations of those policies. Optional features of this service include the ability for users to encrypt data on the mobile device as well as to retrieve or remove information from the device remotely.

*Phoenix HyperSpace*

The Phoenix HyperSpace™ family of products provides an environment that enables various Phoenix and third party applications to be installed on a device and to operate independently from the user s primary operating system. A primary component of this family is a lightweight virtualization engine called Phoenix HyperCore™, which allows multiple purpose-built applications to operate autonomously alongside the primary operating system. With HyperCore these applications can run at any time, before the primary operating system has been loaded, while it is running or after it has shut down, and users can instantaneously switch between their primary operating system and the HyperSpace environment with a single button or mouse click.

Substantially all of our revenues in fiscal years 2008, 2007 and 2006 were derived from sales of CSS products and related services.

**Sales and Marketing**

The Company sells its products and services through a global direct sales force with sales offices in North America, Japan and the Asia Pacific region, as well as through a network of regional distributors and sales representatives. We market to OEMs, ODMs, resellers, system integrators, and system builders as well as to independent software vendors.

Our products and services are sold directly to larger OEMs and ODMs of PCs and of embedded systems, many of which are global technology leaders. These include:

**Original Equipment Manufacturers**

| | | |
|---|---|---|
| Dell Inc. | International Business Machines Corporation | Samsung Electronics Co. Ltd. |
| Foxconn Electronics Inc. | LG Electronics Inc. | Sharp Corporation |
| Fujitsu Ltd. | Lenovo (Singapore) Pte. Ltd. | Sony Corporation |
| Fujitsu Siemens Computers GmbH | Matsushita Electric Industrial Co., Ltd. | Toshiba Corporation |
| Hewlett-Packard Company | NEC Corporation | |

| Original Design Manufacturers | Motherboard Manufacturers | Non-PC Systems |
|---|---|---|
| Arima Computer Corporation | ASUSTeK Computer Inc. | Motorola, Inc. |
| Compal Electronics Inc. | Elitegroup Computer Systems Co., Inc. | NEC Corporation |
| Inventec Corporation | Giga-byte Technology Co., Ltd. | Taito Corporation |
| Quanta Computer, Inc. | Micro-Star International Co., Ltd. | Cisco Systems, Inc. |
| Wistron Corporation | | |

**Significant Customers**

Quanta Computer, Inc. and Lenovo (Singapore) Pte. Ltd. accounted for 18% and 14%, respectively, of the Company s total revenues in fiscal year 2008. Quanta Computer, Inc. accounted for 18% of the Company s total revenues in fiscal year 2007. Fujitsu Ltd. accounted for 12% of the Company s total revenues in fiscal year 2006. No other customer accounted for more than 10% of total revenues in fiscal years 2008, 2007 or 2006.

## International Sales and Activities

Revenues derived from international sales comprise a majority of total revenues. During fiscal years 2008, 2007 and 2006, $60.6 million, or 82%, $39.4 million, or 84%, and $54.1 million, or 89%, of total revenues for each of the respective years were derived from sales outside of the U.S. See Note 8 Segment Reporting to the Consolidated Financial Statements for information relating to revenues by geographic area. We have international sales and engineering offices in Japan, Korea, Taiwan, China and India. Almost all of our license fees and royalty contracts are U.S. dollar denominated; however, we do enter into non-recurring engineering ( NRE ) service contracts in Japan in the local currency.

In addition, an increasing percentage of our labor force, particularly in engineering, is located in China, Taiwan and India. Approximately 63%, or 320, of our employees are located outside of the U.S. as of September 30, 2008.

## Competition

The Company competes for sales primarily with in-house research and development ( R&D ) departments of PC and component manufacturers such as Dell Inc. ( Dell ), Hewlett-Packard Company ( Hewlett-Packard ), Toshiba Corporation ( Toshiba ), Apple Inc. ( Apple ) and Intel. These manufacturers may have significantly greater financial and technical resources, as well as closer engineering ties and experience with specific hardware platforms, than we do. We believe that OEM and ODM customers often license our CSS products rather than develop these products internally in order to: (1) differentiate their system offerings with advanced features; (2) easily leverage the additional value of our other software solutions; (3) improve time to market; (4) reduce product development risks; (5) minimize product development and support costs; and/or (6) enhance compatibility with the latest industry standards.

The Company also competes for sales with other independent suppliers, including American Megatrends Inc., a privately held U.S. company, and Insyde Software Corp., a public company based and listed in Taiwan.

## Product Development

The Company constantly seeks to develop new products and services, maintain and enhance our current product lines and service offerings, maintain technological competitiveness and meet continually changing customer and market requirements. Our research and development expenditures in fiscal years 2008, 2007 and 2006 were $29.7 million, $19.2 million and $22.9 million, respectively. All of our expenditures for research and development have been expensed as incurred. As of September 30, 2008, the Company s research and development and customer engineering group included 370 full-time employees, or 73% of our total workforce.

## Intellectual Property and Other Proprietary Rights

The Company relies primarily on U.S. and foreign patents, trade secrets, trademarks, copyrights and contractual agreements to establish and maintain proprietary rights in our technology. We have an active program to file applications for and obtain patents in the U.S. and in selected foreign countries where there is a potential market for our products. As of September 30, 2008, we have been issued 79 patents in the United States and have 41 patent applications in process in the U.S. Patent and Trademark Office. On a worldwide basis, we have been issued 159 patents with respect to our product offerings and have 136 patent applications pending with respect to certain products we market. We also hold certain licenses and other rights granted to us by the owners of other patents. There can be no assurance that any of these patents would be upheld as valid if challenged. Of the key patents and copyrights that are most closely tied to our product offerings, none are set to expire within the next eight years.

The Company s general policy has been to seek patent protection for those inventions and improvements likely to be incorporated in our products or otherwise expected to be of long-term value. We protect the source code of our products as trade secrets and as unpublished copyrighted works. We may also initiate litigation where appropriate to protect our rights in that intellectual property. We license the source code for our products to our customers for limited uses. Wide dissemination of our software products makes protection of our proprietary rights difficult, particularly outside the United States. Although it is possible for competitors or users to make illegal copies of our products, we believe the rate of technology change and the continual addition of new product features lessen the impact of illegal copying.

In recent years, there has been a marked increase in the number of patents applied for and issued with respect to software products. Although we believe that our products and services do not infringe on any patents, copyright or other proprietary rights of third parties, we have no assurance that third parties will not obtain, or do not have, intellectual property rights covering features of our products or services, in which event we or our customers might be required to obtain licenses to use such features. If an intellectual property rights holder refuses to grant a license on reasonable terms or at all, we may be required to alter certain of our products or services or stop marketing them.

**Employees**

As of September 30, 2008, we employed 510 full-time employees worldwide, of whom 370 were in research and development and customer engineering, 64 were in sales and marketing, and 76 were in general administration. Other than in Nanjing, China, where our employees have formed a trade union in accordance with local laws and regulations, our employees are not represented by any labor organizations. We have never experienced a work stoppage and we consider our employee relations to be satisfactory.

**Executive Officers of the Company**

The executive officers of the Company serve at the discretion of the Board of Directors of the Company. As of the filing date of this Form 10-K, the executive officers of the Company are as follows:

| Name | Age | Position |
|---|---|---|
| Woodson Hobbs | 61 | President and Chief Executive Officer |
| Richard Arnold | 60 | Chief Operating Officer and Chief Financial Officer |
| Dr. Gaurav Banga | 36 | Senior Vice President, Engineering and Chief Technology Officer |
| David Gibbs | 51 | Senior Vice President and General Manager, Worldwide Field Operations |
| Timothy Chu | 35 | Vice President, General Counsel and Secretary |

**BIOGRAPHIES**

Mr. Hobbs joined the Company as President and Chief Executive Officer and as a member of the Board of Directors of the Company in September 2006. Prior to joining the Company, Mr. Hobbs served as president, chief executive officer and a member of the board of Intellisync Corporation, a provider of platform-independent wireless messaging and mobile software, from 2002 to 2006. Between 1995 and 2002, Mr. Hobbs was a consulting executive for the venture capital community and a strategic systems consultant to large corporations. During this timeframe, he held the position of interim chief executive officer for various periods at the following companies: FaceTime Communications, a provider of instant messaging network-independent business solutions; Tradenable, Inc., an online escrow service company; BigBook, Inc., a provider in the online yellow pages industry; and I/PRO Corporation, a provider of quantitative measurement of Web site usage. From 1993 to 1994, Mr. Hobbs served as chief executive officer of Tesseract Corporation, a human resources outsourcing and software company. Mr. Hobbs spent the early part of his career with Charles Schwab Corporation, a securities brokerage and financial services company, as chief information officer; with Service Bureau, a division of IBM, as a developer; and with Online Focus, an online credit union system, as the director of operations.

Mr. Arnold joined the Company as Executive Vice President, Strategy and Corporate Development in September 2006 and was also appointed Chief Financial Officer in November 2006. In October 2007, Mr. Arnold was named Chief Operating Officer and Chief Financial Officer. Prior to joining the Company, Mr. Arnold served as a member of the board of the Intellisync Corporation from 2004 to 2006. From 2001 to 2006, Mr. Arnold served as a founding partner of Committed Capital Proprietary Limited, a private equity investment company based in Sydney, Australia. From 1999 to 2001, Mr. Arnold served as executive director of Consolidated Press Holdings Limited, also a private investment company based in Sydney. Mr. Arnold has also previously served as managing director of TD

Waterhouse Australia, a securities dealer; as chief executive officer of Integrated Decisions and Systems, Inc., an application software company; as managing director of Eagleroo Proprietary Limited, a corporate advisory company; and in various capacities with Charles Schwab Corporation, a securities brokerage and financial services company, including serving as chief financial officer and as executive vice president strategy and corporate development. Mr. Arnold holds a B.S. degree in psychology from Stanford University.

Dr. Banga joined the Company as Chief Technology Officer in October 2006 and was appointed Senior Vice President, Engineering in November 2006. Prior to joining the Company, he was vice president of product management at Intellisync (and at Nokia Corp., after its acquisition of Intellisync), responsible for all client-side products. Before Intellisync, Dr. Banga was co-founder and chief executive officer of PDAapps, the creator of VeriChat, a mobile instant messaging solution. PDAapps was acquired by Intellisync in 2005. From 1998 to 2003, Dr. Banga was a senior engineer at Network Appliance. Dr. Banga holds a B.Tech. in computer science and engineering from the Indian Institute of Technology, Delhi, as well as M.S. and Ph.D. degrees in computer science from Rice University.

Mr. Gibbs joined the Company as Vice President of Business Development in March 2001, was promoted to Senior Vice President and General Manager of the Information Appliance Division in May 2001, became Senior Vice President and General Manager of the Global Sales and Support Division in October 2001, and then became Senior Vice President and General Manager, Worldwide Field Operations in October 2005. From 1998 to 2001, Mr. Gibbs served as vice president, sales and Asia Pacific strategic accounts manager at FlashPoint Technologies, a company that provides embedded software solutions. From 1997 to 1998, Mr. Gibbs was vice president of sales at DocuMagix, Inc. Mr. Gibbs held a number of executive sales and business development positions with Insignia Solutions from 1993 to 1997. Mr. Gibbs holds a bachelor s degree in economics from the University of California at Los Angeles.

Mr. Chu joined the Company in April 2007 as Vice President, General Counsel and Secretary. Prior to Phoenix, Mr. Chu served as Director of Corporate Legal Affairs at Solectron Corporation, a leading global provider of supply chain and electronics manufacturing solutions, where he was responsible for corporate governance and securities matters and all acquisition, divestiture and other corporate transactions. Prior to Solectron, he was a Senior Attorney at Venture Law Group, where he represented numerous Silicon Valley technology companies and was a member of the firm s mergers and acquisitions group. Mr. Chu began his legal career as an associate in the New York and Helsinki offices of White & Case LLP, where he focused on banking, public offering and private placement transactions. He received his B.A. in Economics and Chinese Language and Literature from the University of Michigan and his J.D. from the University of Michigan Law School.

**Available Information**

The Company s website is located at www.phoenix.com. Through a link on the Investor Relations section of our website, we make available the following and other filings as soon as reasonably practicable after they are electronically filed with or furnished to the SEC: the Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. All such filings are available free of charge. Also available on our website are printable versions of our Corporate Governance Guidelines, Audit Committee charter, Compensation Committee charter, Nominating and Corporate Governance Committee charter, Insider Trading Policy and Code of Ethics. Information accessible through our website does not constitute a part of, and is not incorporated into, this annual report or into any of our other filings with the SEC. Copies of the Company s fiscal year 2008 Annual Report on Form 10-K may also be obtained without charge by contacting Investor Relations, Phoenix Technologies Ltd., 915 Murphy Ranch Road, Milpitas, California, 95035 or by calling 408-570-1319.

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## ITEM 1A. *RISK FACTORS*

The following factors should be considered carefully when evaluating our business.

### Adverse Economic Conditions

Our business depends on the overall demand for information technology ( IT ) and on the economic health of our current and prospective customers. The use of some of our products and services is often discretionary and may involve a significant commitment of capital and other resources. The recent deterioration of worldwide economic conditions will likely result in a reduction of IT spending by businesses as well reduced levels of consumer spending and such spending may remain depressed for the foreseeable future. These and other economic factors could have a material adverse effect on our business, operating results and financial condition in a number of ways, including reduced sales to our OEM and ODM customers, resellers and system integrators in light of reduced end user demand for products, reduced direct sales to end users of certain of our products and services, lengthening sales cycles, the postponement by customers of more capital intensive projects and services, reluctance of customers to purchase new products and services, and increased pressure to reduce the prices for our products and services.

### Dependence on Key Customers

Most of our revenues come from a relatively small number of customers, comprised of larger OEMs, ODMs and computer equipment manufacturers. Our ten largest customers accounted for approximately 74%, 65% and 57% of net revenue in fiscal years 2008, 2007 and 2006, respectively. The loss of any key customer and our inability to replace revenues provided by a key customer may have a material adverse effect on our business and financial condition. If these customers fail to meet guaranteed minimum royalty payments and other payment obligations under existing agreements, our operating results and financial condition could be adversely affected.

Our key customers and other potential larger customers enter into agreements for the purchase of large quantities of our licensed products. As such they may be able to negotiate terms in such agreements which are favorable to them and may impose risks and burdens on us that are greater than those we have historically been exposed to, including those related to indemnification and warranty provisions. These risks may become more pronounced if a larger portion of our revenue is generated from agreements directly with larger computer equipment manufacturers rather than through indirect channels.

### Product Development

The market in which we operate is characterized by rapid technological change, frequent new products and service introductions and evolving industry standards. Our ability to attract new customers and increase revenue from existing customers will depend in large part on our ability to enhance and improve our existing product offerings, introduce new products and services, such as our Phoenix FailSafe solution and our Phoenix HyperSpace product family, in a timely and cost-effective manner that meets the needs of our existing customers, and sell into new markets. To achieve market acceptance for our products and services, we must effectively anticipate and offer services that meet changing customer demands in a timely manner. Customers may require features and capabilities that our current products and services do not have. If we fail to develop or enhance products and services that satisfy customer preferences in a timely and cost-effective manner, it can adversely impact our ability to market and sell such products and services to potential customers, thereby adversely affecting the acceptance of and the revenue we may generate from such products and services. We have, from time to time, experienced such delays.

We may experience difficulties with software development, industry standards, design or marketing that could delay or prevent our development, introduction or implementation of new products, services and enhancements. The introduction of new products and services by competitors, the emergence of new industry standards or the development of entirely new technologies to replace existing offerings could render our existing or future products and services obsolete. If our products and services become obsolete due to widespread adoption of alternative connectivity technologies such as other Web-based computing solutions, our ability to generate revenue may be impaired. In addition, any new markets into which we attempt to sell our products and services, including new countries or regions, may not be receptive.

If we are unable to successfully develop new products and services and enhance our existing offerings to anticipate and meet customer preferences or sell our products into new markets, our revenue and results of operations would be adversely affected.

**Net Losses; Liquidity**

In fiscal year 2008, we reported a net loss of $6.2 million, although we achieved positive net cash flow from operations. There can be no assurance that we will achieve profitability or be able to maintain positive cash flow in any future periods. If we do not become profitable within the timeframe expected by securities analysts or investors, the market price of our stock may decline.

We believe that we currently have sufficient liquidity to operate our business over the short term; however, our ability to meet our capital requirements over the long term depends upon the return of our operations to profitability and upon maintaining positive cash flow.

**Attraction and Retention of Key Personnel**

The success of our business will continue to depend upon certain key senior management and technical personnel. Competition for such personnel is intense, and there can be no assurance that we will be able to retain our existing key managerial, technical or sales and marketing personnel. The loss of key executives and employees in the future might adversely affect our business and impede the achievement of our business objectives.

In addition, 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 engineering, sales, marketing and managerial personnel. As we expand into new products and new markets, we increasingly need to hire people with backgrounds different from those required for our traditional CSS business. We believe that there is significant competition for qualified personnel with the skills and technical knowledge that we require. New hires require significant training and, in most cases, take significant time before they achieve full productivity. Our recent hires and planned hires may not become as productive as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals. A failure to attract and retain employees with the necessary skill sets could adversely affect our business and operating results.

**Competition**

The markets for our products are intensely competitive and we expect both product and pricing competition to increase. Increased competition could result in pricing pressures, reduced margins, or the failure of one or more of our products to achieve or maintain market acceptance, any of which could adversely affect our business.

We compete for sales primarily with in-house R&D departments of PC and component manufacturers that may have significantly greater financial and technical resources, as well as closer engineering ties and experience with specific hardware platforms, than us. Major companies that use their own internal BIOS R&D personnel include Dell, Hewlett-Packard, Toshiba, Apple and Intel. In addition, some of these competitors are also our customers, suppliers and development partners. Any inability to effectively manage these complex relationships with customers, suppliers and development partners could have a material adverse effect on our business, operating results and financial condition and accordingly could affect our chances of success.

We also compete for business with other independent suppliers, including American Megatrends Inc., a privately held U.S. company, and Insyde Software Corp., a public company based and listed in Taiwan. Such privately held or foreign competitors may have significantly less onerous compliance obligations and therefore are likely to have lower cost structures than those of a U.S. public company. Any resulting cost disadvantage to us could have an adverse impact on our competitiveness, margins or profitability. The principal competitive factors in the markets in which we presently compete and may compete in the future include:

The ability to provide products and services that meet the needs of our target customers;

The functionality and performance of these products;

Price;

The ability to timely introduce new products; and

Overall company size and perceived stability.

There can be no assurance that we will be successful in our efforts to compete in any markets in which we operate.

**Entrance into New or Developing Markets**

As we continue to seek new market opportunities, we will likely increasingly encounter and compete with large, established suppliers as well as start-up companies. Some of our current and potential competitors may have greater resources, including technical and engineering resources, than we have. Additionally, as customers in these markets mature and expand, they may require greater levels of service and support than we have provided in the past. Our efforts to sell new firmware and CSS products for PCs as well as non-PC devices may require us to sell into markets, or to players in those markets, where we do not have significant prior experience and may require us to increase our spending levels for marketing and sales as well as research and development activities. Certain of our competitors may have an advantage over us because of their larger presence and deeper experience in these markets. There can be no assurance that we will be able to develop and market products, services, and support to effectively compete for these market opportunities. Further, provision of greater levels of services may result in a delay in the timing of revenue recognition.

**Impact of Netbooks on Product Mix**

Spurred by the introduction of Intel s Atom processer, an emerging category of low cost portable computers, also called Netbooks , has received considerable attention by both small and large PC manufacturers. It is believed that these low cost portables, which are priced at less than one third the price of regular notebooks, will significantly expand the PC market. While we expect to gain from the expansion of the PC market as a result of this new category, there is an associated risk that netbooks may cannibalize sales of conventional higher priced notebooks and we would consequently experience downward pressure on the average selling price of our Core System Software products as a result of the changed product mix.

**End-User Demand for Device Security and Availability**

Many of our products and product features, such as the security-related features in SecureCore and TrustedCore, and our new FailSafe solution, are focused on helping to ensure that PCs and other digital devices are secure and available to users, with a minimum of skill required for end-users to use these products and solutions. The success of our strategy depends on continued growth in end-user demand for these capabilities. Although factors such as global terrorism, the growing threat of identity theft, increased instances of malware and increased end-user reliance on digital devices have all contributed to significant growth in demand for security-related products over the last several years, it is difficult to predict whether these trends will continue, accelerate or decelerate. Variations in demand for secure and available digital devices below our expectations could have a significant adverse impact on our operating results.

**Dependence on New Product Releases by Our Customers**

Successful introduction of new products is key to our success in both our CSS and new applications businesses. Frequently, our new products are incorporated or used in our customers new products, making each party dependent on the other for product introduction schedules. In some instances, a customer may not be able to introduce one of its new products for reasons unrelated to our new product. In these cases, we would not be able to ship our new product until the customer has resolved its other difficulties. In addition, our customers may delay their product introductions due to market uncertainties in certain geographic regions. If our customers delay their product introductions, our ability to generate revenue from our own new products would be adversely affected.

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### Additional Capital

We may need to raise additional funds to execute on our strategic plans, and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests, and the price of our common stock could decline. The recent volatility in global capital and credit markets has made it much harder for smaller public companies like Phoenix to obtain debt financing and therefore, if we are able to obtain debt financing, we may be required to accept more onerous terms including requirements to maintain specified asset, liquidity or other ratios and restrictions on our ability to incur additional indebtedness. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- develop new products and services or enhance our current products and services;
- continue to expand our development, sales and marketing organizations;
- acquire complementary technologies, products or businesses;
- expand our operations in the United States or internationally;
- hire, train and retain additional employees; or
- respond to competitive pressures or unanticipated working capital requirements.

### Risks in Acquisitions

As part of our strategy, we intend to continue to make investments in complementary companies, products or technologies. We recently acquired BeInSync Ltd. (in April 2008), TouchStone Software Corporation (in July 2008) and General Software, Inc. (in August 2008). We may not realize future benefits from any of these acquisitions, or from any acquisition we may make in the future. If we fail to integrate successfully our past and future acquisitions, or the technologies associated with such acquisitions, the revenue and operating results of the combined company could be adversely affected. Any integration process will require significant time and resources, and we may not be able to manage the process successfully. If our customers are uncertain about our ability to operate on a combined basis, they could delay or cancel orders for our products. We may not successfully evaluate or utilize the acquired technology and accurately forecast the financial impact of an acquisition transaction, including accounting charges. The areas where we may face risks include:

- Difficulties in integrating the operations, technologies, products and personnel of the companies we acquire into our operations;
- Potential disruption of our on-going business and diversion of management s attention from normal daily operations of the business;
- Insufficient revenues to offset increased expenses associated with acquisitions;
- Potential for third party intellectual property infringement claims against the companies we acquire;
- Failure to successfully further develop acquired technology, resulting in the impairment of amounts capitalized as intangible assets;

Impairment of relationships with customers and partners of the companies we acquire or in which we invest, or with our customers and partners, as a result of the integration of acquired operations;

Impairment of relationships with employees of the acquired companies or our existing employees as a result of integration of new management personnel;

Impact of known potential liabilities or unknown liabilities associated with the companies we acquire; and

In the case of foreign acquisitions, uncertainty regarding foreign laws and regulations and difficulty integrating operations and systems as a result of cultural, systems and operational differences.

We are likely to experience similar risks in connection with our future acquisitions. Our failure to be successful in addressing these risks or other problems encountered in connection with our past or future acquisitions could cause us to fail to realize the anticipated benefits of such acquisitions, incur unanticipated liabilities and adversely affect our business, operating results or financial condition, or result in significant or material control weaknesses with respect to Sarbanes-Oxley compliance.

Future acquisitions or dispositions could also result in dilutive issuances of our equity securities, the incurrence of additional expense related to Sarbanes-Oxley compliance, contingent liabilities or amortization expenses, or write-offs of goodwill, any of which could harm our financial condition. We have not recently made any acquisition that resulted in material in-process research and development expenses being charged in an individual quarter. These charges may occur in future acquisitions in any particular quarter, resulting in variability in our quarterly earnings.

**Litigation**

From time to time, we become involved in litigation claims and disputes in the ordinary course of business. See Item 3 Legal Proceedings below. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit or proceeding could have a material adverse effect on our business, operating results or financial condition.

**Protection of Intellectual Property**

We rely on a combination of patent, trade secret, copyright, trademark and contractual provisions to protect our proprietary rights in our software products. There can be no assurance that these protections will be adequate or that competitors will not independently develop technologies that are substantially equivalent or superior to our technology. In addition, copyright and trade secret protection for our products may be unavailable or unreliable in certain foreign countries. As of September 30, 2008, we have been issued 79 patents in the United States and have 41 patent applications in process in the United States Patent and Trademark Office. On a worldwide basis, we have been issued 159 patents with respect to our product offerings and have 136 patent applications pending with respect to certain products we market. We also hold certain licenses and other rights granted to us by the owners of other patents. There can be no assurance that any of these patents would be upheld as valid if challenged. We maintain an active internal program designed to identify employee inventions we deem worthwhile to patent. There can be no assurance that any of the pending applications will be approved, and patents issued, or that our engineers will be able to develop technologies capable of being patented. Also, as the overall number of software patents increases, we believe that companies that develop software products may become increasingly subject to infringement claims.

There can be no assurance that a third party will not assert that their patents or other proprietary rights are violated by products offered by us. Any such claims, whether or not meritorious, may be time consuming and expensive to defend, may trigger indemnity obligations owed by us to third parties and may have an adverse effect on our business, results of operations and financial condition. Alleged infringement of valid patents or copyrights or misappropriation of valid trade secrets, whether alleged against us or our customers, and regardless of whether such claims have merit, could also have an adverse effect on our business, results of operations and financial condition.

**Importance of Microsoft and Intel**

For a number of years, we have worked closely with leading software and semiconductor companies, including Microsoft and Intel, in developing standards for the PC industry. Although we remain optimistic regarding relationships with these industry leaders, there can be no assurance that they or other software or semiconductor companies will not develop alternative product strategies that could conflict with our product plans and marketing strategies. Action by such companies may adversely impact our business and results of operations.

Intel is the leading semiconductor supplier to the customers of our CSS products. Intel is developing and promoting software under the product name Tiano that competes with our CSS products and offers this software at no charge through both custom and open source licenses. Some of our CSS competitors provide services and additional features for this Intel software, and we believe that in return Intel provides them with compensation and promotional benefits. We must continuously create new features and functions to sustain, as well as increase, our software s added value to our customers, particularly in light of Intel s initiative. There can be no assurances that we will be successful in these efforts.

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**Demand for Microsoft s Vista Operating System and for Newer Microprocessor Designs**

The adoption of new primary PC technology related to operating systems and to microprocessor designs may have a significant impact on the relative demand for our different CSS products. In particular, Microsoft s new Vista operating system is designed to support security capabilities that will operate more effectively on PCs running SecureCore than on those running our older CSS versions. Similarly, some newer microprocessor designs offered by the silicon chip vendors may require the functionality provided by SecureCore to take full advantage of the new designs enhancements. For example, SecureCore is designed to be easily adaptable for the newer generation of multiple-core microprocessors offered by Intel and AMD, while our older CSS versions will require more customization effort by our customers. As a result, the demand for SecureCore could vary in proportion to the rate at which Vista and these newer microprocessor designs are adopted. Such variations would not necessarily lead to changes in our market share for CSS; however, because we have entered into a significantly larger number of paid-up license agreements for our older CSS products than for SecureCore, our future reported revenues could be affected to the extent that revenues related to our older CSS products may already have been recognized.

**Volatile Market for Phoenix Stock**

The market for our stock is highly volatile. The trading price of our common stock has been, and will continue to be, subject to fluctuations in response to operating and financial results, changes in demand for our products and services, announcements of technological innovations, the introduction and market acceptance of new technologies by us, our competitors, or other industry participants, changes in our product mix or product direction or the product mix or direction of our competitors, pricing pressure from our customers and competitors, changes in our revenue mix and revenue growth rates, changes in expectations of growth for the PC industry or the x86 based non-PC digital device industry, the overall trend toward industry consolidation both among our competitors and customers, the timing and size of orders from customers, our ability to maintain control over our costs, as well as other events or factors which we may not be able to influence or control. Statements or changes in opinions, ratings or earnings estimates made by brokerage firms and industry analysts relating to the markets in which we do business, companies with which we compete or relating to us specifically could have an immediate and adverse effect on the market price of our stock.

In addition, the stock market has from time to time experienced extreme price and volume fluctuations that have particularly affected the market price for many small capitalization, high technology companies and have often been triggered by factors other than the operating performance of these companies. If the market value of our stock decreases below our net book value, we may have to record a charge for impairment of goodwill.

**International Sales and Risks Associated with Operating Internationally**

Revenues derived from international sales comprise a majority of our total revenues. There can be no assurances that we will not experience significant fluctuations in international revenues. Our operations and financial results may be adversely affected by factors associated with international operations, such as changes in foreign currency exchange rates; restrictions on the transfer of funds; uncertainties related to regional economic circumstances; unexpected changes in local laws or regulations, or new or existing laws and regulations that we are not initially made aware of; reduced or varied protection for intellectual property rights in some countries, political instability in emerging markets; terrorism and conflict; inflexible employee contracts in the event of business downturns; difficulties in attracting qualified employees and managing international operations; and language, cultural and other difficulties in managing foreign operations.

**Restructurings to Reduce Operating Expenses**

We incurred approximately $0.2 million, $4.1 million and $4.6 million of restructuring costs in fiscal years 2008, 2007 and 2006, respectively, in order to reduce operating expenses and rationalize our cost structure. Due to the uncertainties of predicting our future revenues as well as potential changes in industry, market conditions and our business needs, we may need to consider further strategic realignment of our resources from time to time through additional restructuring or by disposing of, or otherwise exiting, one or more of our current businesses.

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Any decision to limit investment in or dispose of or otherwise exit a business or businesses may result in the recording of special charges, such as technology related write-offs, workforce reduction costs or charges relating to consolidation of excess facilities. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such decisions. Further, our estimates relating to the liabilities for excess facilities are affected by changes in real estate market conditions. Additionally, we are required to perform goodwill impairment tests on an annual basis and periodically between annual tests in certain circumstances. There can be no assurance that future goodwill impairment tests will not result in charges to earnings.

**Transitioning from Paid-Up Licenses**

Over a three year period ended in fiscal year 2006, we entered into a number of paid-up license agreements with our customers. Under paid-up license agreements, customers paid a fixed up-front fee to install the applicable product on an unlimited number of devices. Generally, we recognized all license revenues under these paid-up license agreements upon execution of the agreement, provided all revenue recognition criteria had been met. Paid-up license agreements may have had the effect of accelerating revenue into the quarter in which the agreement was executed and thereby decreasing recurring revenues in later quarters. Beginning in the third quarter of fiscal year 2006, we elected to significantly decrease the use of paid-up license agreements and, prior to the beginning of fiscal year 2007, to eliminate their use entirely in favor of volume purchase agreements and pay-as-you-go or consumption-based licensing agreements. Decreasing the number of paid-up license agreements contributed to, along with other factors, a substantial drop in license revenues in the last two quarters of fiscal year 2006.

During fiscal years 2007 and 2008, we had no revenues derived from paid-up licenses, as compared to approximately 50% of net revenues in fiscal year 2006. There can be no assurance that we will continue to be successful in increasing the number of volume purchase agreements and pay-as-you-go arrangements or in terminating our customers rights under existing paid-up license agreements, in which case, our license revenue may weaken in future quarters.

**Fluctuations in Operating Results**

Our future operating results may vary from period to period. The timing and amount of our license fees are subject to a number of factors that make estimating revenues and operating results prior to the end of a quarter uncertain. Generally, we have in the past experienced a pattern of recording a substantial portion of our quarterly revenues in the final weeks of each quarter. We have historically monitored our revenue bookings through regular, periodic worldwide forecast reviews within the quarter. There can be no assurances that this process will result in our meeting revenue expectations. Our planned operating expenses for any year are normally based on the attainment of planned revenue levels for that year and are generally incurred ratably throughout the year. As a result, if revenues were less than planned in any period while expense levels remain relatively fixed, our operating results would be adversely affected for that period. In addition, unplanned expenses could adversely affect operating results for the period in which such expenses were incurred.

**Viruses and Breach of Network Security**

While we have not been the target of software viruses specifically designed to impede the performance of our products and services, such viruses could be created and deployed against our products and services in the future. Similarly, experienced computer programmers or hackers may attempt to penetrate our network security or the security of our websites from time to time. A hacker who penetrates our network or websites could misappropriate proprietary information or cause interruptions of our services. We might be required to expend significant capital and resources to protect against, or to alleviate, problems caused by virus creators and/or hackers.

**Customer Retention**

We sell some of our services pursuant to subscriptions that are generally one to three years in duration. These end-user customers have no obligation to renew their subscriptions after their subscription period expires, and these subscriptions may not be renewed on the same or on more profitable terms. As a result, our ability to grow depends

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in part on subscription renewals. In addition, a portion of our end-user base utilizes some of our services free of charge through our free services or free trials. We seek to convert these free and trial users to paying customers of our services. We may not be able to accurately predict future trends in customer renewals, and our customers renewal rates may decline or fluctuate because of several factors, including their satisfaction or dissatisfaction with our services, the prices of our services, the prices of services offered by our competitors, or reductions in our end-user customers spending levels. If our end-user customers do not renew their subscriptions for our services, renew on less favorable terms, do not purchase additional functionality or subscriptions, or if our conversion rate from free users to paid customers suffers for any reason, our revenue may grow more slowly than expected or even decline, which could adversely impact our profitability and gross margins.

**Customer Information**

Our systems store certain of our end-user customers confidential information, including personal identifiable information. Any security breaches or other unauthorized access of our systems could expose us to liability and penalties for the loss of such information, time-consuming and expensive litigation and other possible liabilities, as well as negative publicity. Techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are difficult to recognize and react to. We may be unable to anticipate these techniques or to implement adequate preventative or reactionary measures. In addition, many jurisdictions have enacted laws requiring companies to notify individuals of data security breaches involving their personal data. These mandatory disclosures regarding a security breach often lead to widespread negative publicity, which may cause our customers to lose confidence in the effectiveness of our data security measures. Any security breach, whether successful or not, would harm our reputation and could cause the loss of customers.

**Managing Growth**

In the recent past we have experienced, and continue to experience, rapid growth in our headcount and operations, which has placed, and will continue to place, significant demands on our management and operational and financial infrastructure. If we do not effectively manage our growth, the quality of our products and services could suffer, which could negatively affect our brand and operating results. Our expansion and growth in international markets heightens these risks as a result of the particular challenges of supporting a rapidly growing business in an environment of multiple languages, cultures, customs, legal systems, alternative dispute systems, regulatory systems and commercial infrastructures. To effectively manage this growth, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. These systems enhancements and improvements will require significant capital expenditures and management resources. Failure to implement these improvements could hurt our ability to manage our growth and our financial position.

**Defects or Errors in Our Software Products and Services**

The applications underlying our software products and services inherently contain complex code and may contain material undetected errors and/or bugs, particularly when first introduced or when new versions or enhancements are released. Any defects that cause interruptions to the availability of our products, services and enhancements could result in:

- a reduction in sales or delay in market acceptance of our products and services;
- sales credits or refunds to our customers;
- loss of existing customers and difficulty in attracting new customers;

- diversion of development resources;
- harm to our reputation; and
- increased insurance costs.

After the release of our products and services, defects or errors may also be identified from time to time by our internal team and by our customers. The costs incurred in correcting any material defects or errors may be substantial and could harm our operating results.

### Industry Consolidation

Some of our competitors have made or may make acquisitions or may enter into partnerships or other strategic relationships to offer a more comprehensive service than they individually had offered. In addition, new entrants not currently considered to be competitors may enter the market through acquisitions, partnerships or strategic relationships. We expect these trends to continue as companies attempt to strengthen or maintain their market positions. Many of the companies driving this trend have significantly greater financial, technical and other resources than we do and may be better positioned to acquire and offer complementary services and technologies. The companies resulting from such combinations may create more compelling service offerings and may offer greater pricing flexibility than we can or may engage in business practices that make it more difficult for us to compete effectively, including on the basis of price, sales and marketing programs, technology or service functionality. These pressures could result in a substantial loss of customers or a reduction in our revenues.

Additionally, consolidation among our customers could lead to increased purchasing power by the companies resulting from such combinations which could reduce the average selling prices we are able to achieve for our products and services.

### Internet Infrastructure

Some of our services are designed to work over the Internet and therefore, our revenue growth partially depends on our end-user customers high-speed access to the Internet, as well as the continued maintenance and development of the Internet infrastructure. The future delivery of our services will depend on third-party Internet service providers to expand high-speed Internet access, to maintain a reliable network with the necessary speed, data capacity and security, and to develop complementary products and services, including high-speed modems, for providing reliable and timely Internet access and services. The success of our business depends partially on the continued accessibility, maintenance and improvement of the Internet as a convenient means of customer interaction, as well as an efficient medium for the delivery and distribution of information by businesses to their employees. All of these factors are out of our control.

To the extent that the Internet continues to experience increased numbers of users, frequency of use or bandwidth requirements, the Internet may become congested and be unable to support the demands placed on it, and its performance or reliability may decline. Any future Internet outages or delays could adversely affect our ability to provide services to our customers.

### Use of Open Source Software in Some of Our Products

Certain of our products are distributed with software licensed by its authors or other third parties under so-called open source licenses. Certain open source licenses contain provisions that would require us to make available the source code for modifications or derivative works we create based upon the open source software, and would require us to license such modifications or derivative works under the terms of a particular open source license or other license granting third parties certain rights of further use. If we combine our proprietary software with open source software in a certain manner, we could, under certain open source licenses, be required to release the source code of our proprietary software. We have processes in place to avoid the use of software subject to restrictive open source licenses and to ensure that we use open source software in a manner that prevents any disclosure of our proprietary source code. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third party commercial software, as open source licensors generally do not provide warranties or controls on origin of the software. We have established processes to help mitigate these risks; however, some of the risks associated with usage of open source software cannot be completely eliminated and could, if not properly addressed, negatively affect our business.

**Dependence on Third Party Service Providers**

Failure of our third-party providers to provide adequate Internet, telecommunications and power services could result in significant losses of revenue. Our operations depend upon third parties for Internet access and telecommunications service. Frequent or prolonged interruptions of these services could result in significant losses of revenues. We have experienced outages in the past and could experience outages, delays and other difficulties due to system failures unrelated to our internal activities in the future. These types of occurrences could also cause users to perceive our services as not functioning properly and therefore cause them to use other methods to deliver and receive information. We have limited control over these third parties and cannot assure that we will be able to maintain satisfactory relationships with any of them on acceptable commercial terms or that the quality of services that they provide will remain at the levels needed to enable us to conduct our business effectively.

We rely on third party vendors and resellers to process and fulfill on-line purchases of our services and products that are delivered or provided over the Internet. These third parties collect important customer information, including credit card data. While we do not view, collect or have access to any credit card or other similar financial information of our customers, any loss of this type of information by our third party vendors (including due to willful or accidental security breaches of our third party vendors information systems) could reflect negatively on Phoenix s business and harm our reputation, and may result in the loss of customers as well as adversely impact our ability to gain new customers for our Internet-based services and products. In addition, any need for us to change a third party vendor as a result of the vendor losing customer data or not maintaining adequate security and data protection standards may cause delays and disruptions in our business.

**Internal Controls over Financial Reporting**

Our internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with accounting principles generally accepted in the United States ( GAAP ). One or more material weaknesses in our internal controls over financial reporting could occur or be identified in the future. In addition, because of inherent limitations, our internal controls over financial reporting may not prevent or detect misstatements, and any projections of any evaluation of effectiveness of internal controls to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with our policies or procedures may deteriorate. If we fail to maintain the adequacy of our internal controls, including any failure to implement or difficulty in implementing required new or improved controls, (i) our business and results of operations could be harmed, (ii) we could fail in our ability to provide reasonable assurance as to our financial results or meet our reporting obligations, which could materially and adversely affect the price of our securities, and (iii) we may encounter greater difficultly in effectively marketing and selling our products and services to new and existing customers.

**Changes in Financial Accounting Standards and Increased Cost of Compliance**

We prepare our financial statements in conformity with GAAP. GAAP principles are subject to interpretation by the Financial Accounting Standard Board, the American Institute of Certified Public Accountants, the SEC and various bodies appointed by these organizations to interpret existing rules and create new accounting policies. Accounting policies affecting software revenue recognition, in particular, have been the subject of frequent interpretations, which have had a profound effect on the way we license our products. As a result of the enactment of the Sarbanes-Oxley Act in 2002 and the related scrutiny of accounting policies by the SEC and the various national and international accounting industry bodies, we expect the frequency of accounting policy changes as well as the cost of compliance, to increase. Future changes in financial accounting standards, including pronouncements relating to revenue recognition, may have a significant effect on our reported results.

**Business Disruptions**

Acts of war, power shortages, natural disasters, acts of terror, and regional and global health risks could impact our ability to conduct business in certain regions. Any of these events could have an adverse effect on our business, results of operations, and financial condition, as well as disrupt the supply chains and business operations of our customers, thereby adversely impacting or delaying customer demand for our products.

**Market for Device Designs Based on the x86 Microprocessor Architecture**

Our current CSS products are designed for systems built with digital microprocessors based on derivatives of the Intel product used in the original IBM PC/XT/AT. This microprocessor design is commonly called x86 and current suppliers include Intel and AMD. The largest market for x86 microprocessors is personal computer systems, including desktop PCs, mobile PCs and volume servers. Competing microprocessor designs dominate numerous other significant markets, including mobile phones, consumer electronics, PDAs, telematics, digital photography and telecommunications. There can be no assurance that x86 microprocessors will continue to hold a large market share of personal computer system designs. There can also be no assurance that corporations and consumers will continue to purchase traditional desktop and mobile PC designs instead of substitute products such as digital wireless handsets and other consumer digital electronic devices which may utilize other microprocessor designs.

**Certain Anti-Takeover Effects**

Our Amended and Restated Certificate of Incorporation, Bylaws, as amended, and the Delaware General Corporation Law include provisions that may be deemed to have anti-takeover effects and may delay, defer or prevent a takeover attempt that stockholders might consider in their best interests but is deemed undesirable by our board of directors. For example, in November 1999, and in accordance with our Preferred Shares Rights Agreement (as amended), we issued as a dividend on our common stock certain rights to purchase our Series B Participating Preferred Stock. These rights are exercisable upon triggering events related to a change of control of the Company on terms not approved by our board of directors and, upon exercise, would cause immediate substantial dilution of our outstanding common stock. The existence of these rights (also known as a poison pill ) could have a deterrent effect on any person or group that is considering acquiring us on terms not approved by our board of directors.

**Income and Other Taxes**

Our future income taxes could be adversely affected by earnings being lower than anticipated in jurisdictions where we have lower statutory rates and higher than anticipated in jurisdictions where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, accounting principles or interpretations thereof.

We are subject to income taxes and other taxes in both the United States and the foreign jurisdictions in which we currently operate or have historically operated. The determination of our worldwide provision for income taxes and current and deferred tax assets and liabilities requires judgment and estimation which is subject to review by applicable tax authorities. Any adverse outcome of such a review could have a negative effect on our operating results and financial condition. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our consolidated financial statements and may materially affect our financial results in the period or periods for which such determination is made.

**ITEM 1B.** ***UNRESOLVED STAFF COMMENTS***

None.

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## ITEM 2. *PROPERTIES*

The Company leases approximately 86,000 square feet of office space for our headquarters in Milpitas, California under a facility lease that expires in October 2013. This facility has been partially vacated and in November 2007, the Company entered into a sublease agreement with a third party for the remainder of the lease term for approximately 28,000 square feet of the Milpitas, California office space. The Company leases an approximately 49,000 square foot facility in Irvine, California under a lease agreement that expires in 2009. The Company has subleased approximately 35,800 square feet of the Irvine facility for the remainder of the lease term and is currently marketing the remaining 13,200 square feet for sublease. The Company also leases office facilities in other locations including: Beaverton, Oregon; Bellevue, Washington; North Andover and Norwood, Massachusetts; Tel Aviv, Israel; Taipei, Taiwan; Shanghai and Nanjing, China; Tokyo, Japan; Hyderabad and Bangalore, India; and Seoul, South Korea. These offices range from small sales offices that are several hundred square feet to large office spaces of up to approximately 40,000 square feet, and generally provide engineering, sales, and technical support to customers as well as serve as research and development centers. The lease terms for these facilities expire between 2009 and 2013. The Company opened a new office in Bangalore, India in October 2008. In fiscal year 2006, the Company closed offices in Shenzhen, China; Munich, Germany; Zaltbommel, the Netherlands; Osaka, Japan; and Rockville, Maryland pursuant to our announced restructuring plans. In fiscal year 2007, the Company closed its offices in Wanchai, Hong Kong; Beijing, China; and Norwood, Massachusetts. In October 2008, the Company subleased the Norwood facility for the remainder of its term.

The Company considers its leased properties to be in good condition, well maintained, and generally suitable for their present and foreseeable future needs. The Company believes its facilities are adequate for its current needs and that suitable additional or substitute space will be available as needed to accommodate any expansion of its operations.

## ITEM 3. *LEGAL PROCEEDINGS*

The Company is subject to certain legal proceedings that arise in the normal course of our business. We believe that the ultimate amount of liability, if any, for pending claims of any type (either alone or combined), including the legal proceeding described below, will not materially affect the Company s results of operations, liquidity, or financial position taken as a whole. However, the ultimate outcome of any litigation is uncertain, and unfavorable outcomes could have a material adverse impact on the results of operations and financial condition of the Company. Regardless of the outcome, litigation can have an adverse impact on the Company due to defense costs, diversion of management resources and other factors.

*Jablon v. Phoenix Technologies Ltd.* On November 7, 2006, David P. Jablon filed a Demand for Arbitration with the American Arbitration Association (under its Commercial Arbitration Rules) pursuant to the arbitration provisions of a certain Stock Purchase Agreement dated February 16, 2001, by and among Phoenix Technologies Ltd., Integrity Sciences, Incorporated ( ISI ) and David P. Jablon (the ISI Agreement ). The Company acquired ISI from Mr. Jablon (the sole shareholder) pursuant to the ISI Agreement. Mr. Jablon has alleged breach of the earn-out provisions of the ISI Agreement, which provide that Mr. Jablon will be entitled to receive 50,000 shares of the Company s common stock in the event certain revenue milestones are achieved from the sale of certain security-related products by the Company. The dispute relates to the calculation of the achievement of such milestones and whether Mr. Jablon is entitled to receive the 50,000 shares. On November 21, 2006, the Company was formally served with a demand for arbitration in this case. On June 3, 2008, the parties entered into a binding settlement agreement which fully and finally resolved all disputes with Mr. Jablon. Pursuant to that agreement, the Company made a cash payment to Mr. Jablon in an amount that was immaterial to the Company, in exchange for a stipulated permanent injunction which prohibits Mr. Jablon s possession, use or disclosure of certain Company information, as well as a full mutual release of all known and unknown claims.

**ITEM 4.** ***SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS***

None.

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## PART II

### ITEM 5. *MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES*

The Company s common stock is traded on the NASDAQ Global Market under the symbol PTEC. The following table sets forth, for the periods indicated, the highest and lowest closing sale prices for the Company s common stock, as reported by the NASDAQ Global Market. The closing price of the Company s common stock on November 17, 2008 was $3.46.

| | High | Low |
|---|---|---|
| Year ended September 30, 2008 | | |
| Fourth quarter | $ 12.38 | $ 7.80 |
| Third quarter | 15.98 | 10.15 |
| Second quarter | 17.40 | 11.40 |
| First quarter | 13.81 | 8.52 |
| Year ended September 30, 2007 | | |
| Fourth quarter | $ 11.53 | $ 8.60 |
| Third quarter | 8.49 | 6.06 |
| Second quarter | 6.89 | 4.50 |
| First quarter | 4.90 | 4.13 |

The Company had 170 shareholders of record as of November 17, 2008. To date, the Company has paid no cash dividends on its common stock. The Company currently intends to retain all earnings for use in its business and does not anticipate paying any dividends in the foreseeable future.

The remaining information required by this item will be contained in the Company s definitive proxy statement that the Company will file pursuant to Regulation 14A in connection with the annual meeting of its stockholders to be held in January 2009 (the Proxy Statement ) in the section captioned Equity Compensation Plan Information and is incorporated herein by this reference.

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## Company Stock Price Performance

The graph below compares the cumulative total stockholder return on the Common Stock of the Company from September 30, 2003 to September 30, 2008 with the cumulative total return on the Standard and Poor s 500, the Standard and Poor s Application Software, and the Standard and Poor s System Software market indices over the same period, assuming the investment of $100 in the Company s Common Stock and in each of the indices on September 30, 2003 and the reinvestment of all dividends.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN***
**Among Phoenix Technologies Ltd., The S&P 500 Index,**
**The S&P Application Software Index And The S&P Systems Software Index**

* $100 invested on 9/30/03 in stock & index-including reinvestment of dividends. Fiscal year ending September 30.

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## ITEM 6. *SELECTED CONSOLIDATED FINANCIAL DATA*

The financial data set forth below should be read in conjunction with our consolidated financial statements and related notes thereto in Item 8 Financial Statements and Supplementary Data and Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations. The results of operations for any period are not necessarily indicative of the results to be expected for any future period and may vary because of a number of factors, including those set forth under Item 1A Risk Factors and elsewhere in this Form 10-K *(in thousands, except per share data)*.

### Consolidated Statements of Operations Data

| | For the Years Ended September 30, | | | | |
|---|---|---|---|---|---|
| | **2008** | **2007** | **2006** | **2005** | **2004** |
| Revenues | $ 73,702 | $ 47,017 | $ 60,495 | $ 99,536 | $ 86,750 |
| Gross margin | 63,883 | 37,326 | 42,585 | 82,083 | 71,558 |
| Operating income (loss) | (1,795) | (14,588) | (42,182) | 9,541 | 3,064 |
| Net income (loss) | (6,223) | (16,409) | (43,969) | 277 | 449 |
| Earnings (loss) per share: | | | | | |
| Basic | $ (0.23) | $ (0.63) | $ (1.74) | $ 0.01 | $ 0.02 |
| Diluted | $ (0.23) | $ (0.63) | $ (1.74) | $ 0.01 | $ 0.02 |

### Consolidated Balance Sheet Data

| | September 30, | | | | |
|---|---|---|---|---|---|
| | **2008** | **2007** | **2006** | **2005** | **2004** |
| Cash, cash equivalents, and marketable securities | $ 37,721 | $ 62,705 | $ 60,331 | $ 74,827 | $ 59,823 |
| Working capital | 13,167 | 40,289 | 42,495 | 72,348 | 65,696 |
| Total assets | 136,542 | 94,480 | 95,160 | 131,036 | 120,885 |
| Long-term obligations | 16,145 | 2,413 | 4,551 | 4,205 | 3,590 |
| Stockholders equity | 81,407 | 59,772 | 60,176 | 96,964 | 93,029 |

## ITEM 7. *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

The following discussion should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this Form 10-K.

### Overview

We design, develop and support core system software for personal computers and other computing devices. Our products, which are commonly referred to as firmware, support and enable the compatibility, connectivity, security and manageability of the various components and technologies used in such devices. We sell these products primarily to computer and component device manufacturers. We also provide training, consulting, maintenance and engineering services to our customers.

The majority of our revenues come from Core System Software ( CSS ), the modern form of BIOS ( Basic Input-Output System ) for personal computers, servers and embedded devices. Our CSS customers are primarily original equipment manufacturers ( OEMs ) and original design manufacturers ( ODMs ), who incorporate CSS products during the manufacturing process. The CSS is typically stored in non-volatile memory on a chip that resides on the motherboard built into the device manufactured by our customer. The CSS is executed during the power-up process in order to test, initialize and manage the functionality of the device s hardware. We believe that our products are incorporated into over 125 million computing devices each year, making us the global market share leader in the CSS sector.

We also design, develop and support software products and services that provide the users of personal computers with enhanced device utility, reliability and security. Included among these products and services are offerings which assist users to locate and manage portable devices that have been lost or stolen, offerings which provide backup, sharing, and synchronization of files and data, and offerings which enable certain applications to operate on the device independently of the device s primary operating system. Although the true consumers of these products and services are enterprises, governments, service providers and individuals, we typically license these products to OEMs and ODMs to assist them in making their products attractive to those end-users.

In addition to licensing our products to OEM and ODM customers, we also sell certain of our products directly or indirectly to computer end users, generally delivering such products as subscription-based services utilizing web-based delivery capabilities.

We derive additional revenues from providing development tools and support services such as customization, training, maintenance and technical support to our software customers and to various development partners.

Our revenues arise from three sources:

1. License fees: revenues arising from agreements that license Phoenix intellectual property rights to a third party. Primary license fee sources include: (1) Core System Software, system firmware development platforms, firmware agents and firmware run-time licenses, (2) software development kits and software development tools, (3) device driver software, (4) embedded operating system software, and (5) embedded application software.

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

3. Service fees: revenues arising from agreements that provide for the delivery of professional engineering services. Primary service fee sources include software deployment, software support, software development and technical training.

***Fiscal Year 2008 Overview***

The fiscal year ended September 30, 2008 represents the second full fiscal year of the Company s execution of new strategic and operational plans developed by the Company s new management team, led by President and Chief Executive Officer Woody Hobbs. These plans, as discussed regularly by us in various public statements, called for restoring the Company to positive cash flow within the first year and announcing major new products early in the second year. Having achieved these objectives, we informed investors in various public statements that we would now focus on building out industry partnerships to integrate our new products with the offerings of other hardware and software vendors and on expanding our research and development efforts to assist in these integration initiatives.

Our results for fiscal year 2008 reflect the success of initiatives taken by us and hence reflect a substantial improvement over the prior fiscal year, with revenues increasing by approximately 57%. Similarly, total expenditures (including operating expenses and costs of goods sold) increased by approximately 23%, reflecting our support for new product initiatives and certain expenses associated with our strategic initiatives.

During the fiscal year ended September 30, 2008, we recorded stock compensation expense under SFAS No. 123(R) which included stock options granted to the Company s four most senior executives as approved by the Company s stockholders on January 2, 2008 (the Performance Options ). Amortization of expense associated with the Performance Options began during the quarter ended March 31, 2008 and there were no similar charges in prior periods. Total expense recognized in the fiscal year ended September 30, 2008 from the Performance Options was $5.8 million. (Of this total, $4.1 million is classified as general and administrative expense, $1.1 million is classified as research and development expense and $0.6 million is classified as sales and marketing expense.)

We achieved positive net cash flow from operations of $20.5 million during fiscal year 2008, a substantial improvement from the prior fiscal year, when we had negative net cash flow from operations of $2.4 million. This

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improvement is the combined effect of our improved operating results and improved terms of trade with customers, which resulted from the Company s new pricing policies and sales practices.

During the first quarter of fiscal year 2007, we had made significant changes in our pricing policies and sales practices and our revenues for the fiscal year ended September 30, 2008 reflect the continuing success of these initiatives. During fiscal year 2008, we executed additional significant long term volume purchase agreements ( VPAs ) with several of our major customers. Combined with the effect of other similar agreements executed since fiscal year 2007, we have achieved both a 27% increase in our deferred revenue balances and a 215% increase in our unbilled backlog of VPA agreements. We consider these unbilled VPA commitments, along with deferred revenues, as order backlog. Our total order backlog increased by 99% from $19.1 million at September 30, 2007 to $38.0 million at September 30, 2008.

During the fiscal year ended September 30, 2008 we recruited a significant number of additional personnel, particularly into our research and development department. As a result of this effort, and of the acquisitions we completed during the fiscal year, we increased our total workforce from 334 employees at September 30, 2007 to 510 at September 30, 2008.

Total revenues for the fiscal year ended September 30, 2008 increased by 57%, or $26.7 million, to $73.7 million, from $47.0 million for fiscal year 2007. The increase in revenues was principally attributable to recurring quarterly revenues associated with VPA and similar licenses, including revenues from customers who had generated little or no revenues in earlier periods as a result of having previously purchased fully paid-up licenses.

Fully paid-up licenses gave customers unlimited distribution rights of the applicable product over a specific time period or with respect to a specific customer device. In connection with paid-up licenses, we recognized all license fees upon execution of the agreement, provided that all other revenue recognition criteria had been met. Paid-up license agreements may have had the effect of accelerating revenues into the quarter in which the agreement was executed and thereby decreasing recurring revenues in subsequent periods. During the third quarter of fiscal year 2006, we began changing our licensing practices away from heavy reliance on paid-up licenses to: (i) VPAs for most large customers and (ii) pay-as-you-go consumption-based license arrangements for other customers. In the fourth quarter of fiscal year 2006, we completely ceased entering into paid-up licenses with our customers, and converted to the use of only VPAs and pay-as-you-go consumption-based license arrangements.

Our revenues for the fiscal year ended September 30, 2008 include revenues from certain customers who had entered into fully paid-up licenses in prior periods but who, as a result of the specific terms of those contracts or amendments thereto, were no longer authorized to continue to deploy the products covered by those licenses.

Gross margin for fiscal year 2008 was $63.9 million, a 71% increase from the gross margin of $37.3 million during fiscal year 2007. This increase resulted from the increase in revenues described above, combined with a lower rate of growth in the total cost of goods and services, which was principally the result of cost management initiatives in our customer service activities.

Operating expenses for fiscal year 2008 were $65.7 million, an increase of 27%, from $51.9 million for fiscal year 2007. Of the $13.8 million increase, $5.8 million was due to stock based compensation expense resulting from the grant of the Performance Options approved by the Company s stockholders on January 2, 2008, $3.4 million was due to increased use of consultants, and $5.7 million was due to higher salary and benefits principally as a result of increased headcount. These increases were partly offset by lower facilities and other expenses of $1.1 million.

During fiscal year 2008, we experienced lower interest and other income and higher tax expense as compared to fiscal year 2007. The $0.4 million lower interest and other income was primarily driven by lower interest rates. The increase in tax expense was principally associated with higher revenue and related taxes in Taiwan.

We experienced a net loss of $6.2 million for fiscal year 2008, compared to a net loss of $16.4 million for fiscal year 2007. As described above, this $10.2 million decrease in net loss was principally the result of the $26.7 million increase in reported revenues offset by a $0.1 million increase in costs of revenues, a $13.8 million increase in operating expenses, a $0.4 million reduction in interest and other income and a $2.2 million increase in tax expense.

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**Results of Operations**

The following table includes Consolidated Statements of Operations data for the fiscal years ended September 30, 2008, 2007 and 2006 as a percentage of total revenues:

| | Fiscal Years Ended September 30, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| Revenues: | | | |
| License fees | 87% | 84% | 92% |
| Subscription fees | | | |
| Service fees | 13% | 16% | 8% |
| Total revenues | 100% | 100% | 100% |
| Cost of revenues: | | | |
| License fees | | 2% | 8% |
| Subscription fees | | | |
| Service fees | 11% | 16% | 17% |
| Amortization of purchased intangible assets | 2% | 3% | 5% |
| Total cost of revenues | 13% | 21% | 30% |
| Gross margin | 87% | 79% | 70% |
| Operating expenses: | | | |
| Research and development | 40% | 41% | 38% |
| Sales and marketing | 18% | 25% | 58% |
| General and administrative | 31% | 35% | 35% |
| Amortization of acquired intangible assets | | | 1% |
| Restructuring and related charges | | 9% | 8% |
| Total operating expenses | 89% | 110% | 140% |
| Operating loss | (2)% | (31)% | (70)% |
| Interest and other income, net | 2% | 4% | 3% |
| Loss before income taxes | | (27)% | (67)% |
| Income tax expense | 8% | 8% | 6% |
| Net loss | (8)% | (35)% | (73)% |

***Revenues***

Revenues by geographic region based on country of sale for fiscal years 2008, 2007 and 2006 were as follows *(in thousands, except percentages)*:

| | Amount of Revenues | | | % Change from Previous Year | | % of Consolidated Revenues | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | 2007 | 2006 | 2008 | 2007 | 2008 | 2007 | 2006 |
| North America | $ 13,136 | $ 7,616 | $ 6,384 | 72% | 19% | 18% | 16% | 11% |
| Japan | 15,326 | 7,651 | 18,302 | 100% | (58)% | 21% | 16% | 30% |
| Taiwan | 39,959 | 26,882 | 28,556 | 49% | (6)% | 54% | 57% | 47% |
| Other Asian countries | 4,132 | 3,670 | 5,089 | 13% | (28)% | 6% | 8% | 8% |
| Europe | 1,149 | 1,198 | 2,164 | (4)% | (45)% | 1% | 3% | 4% |
| Total revenues | $ 73,702 | $ 47,017 | $ 60,495 | 57% | (22)% | 100% | 100% | 100% |

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Total revenues in fiscal year 2008 increased by $26.7 million, or 57%, compared with fiscal year 2007. Revenues for fiscal year 2008 for most regions increased over fiscal year 2007. Significant increases for most regions were attributable to recurring revenues associated with VPA and similar licenses, including revenues from customers who had generated little or no revenues in the prior period as a result of having previously purchased fully paid-up licenses.

Total revenues in fiscal year 2007 decreased by $13.5 million, or 22%, compared with fiscal year 2006. Revenues for fiscal year 2007 decreased in all geographic areas with the exception of North America. Revenues for North America increased by 19% in fiscal year 2007 compared to fiscal year 2006. The increase was attributable to higher VPA and service revenues. The decreases in other regions were primarily due to sales of paid-up licenses in fiscal year 2006, a practice that was discontinued prior to the beginning of fiscal year 2007. The declines for fiscal year 2007 were greatest in Japan, Europe and other Asian countries, with declines of 58%, 45%, and 28%, respectively, primarily due to a number of large paid-up license arrangements which were entered into in fiscal year 2006. Revenues for Taiwan declined by only 6% due to our success in restoring revenue from certain major customers who previously had the benefit of fully paid-up licenses.

Revenues for fiscal years 2008, 2007 and 2006 were as follows *(in thousands, except percentages):*

| | **Amount of Revenues** | | | **% of Consolidated Revenues** | | |
|---|---|---|---|---|---|---|
| | **2008** | **2007** | **2006** | **2008** | **2007** | **2006** |
| License fees | | | | | | |
| Fully paid-up | $ | $ | $ 30,477 | | | 50% |
| Other | 64,359 | 39,655 | 25,465 | 87% | 84% | 42% |
| | 64,359 | 39,655 | 55,942 | 87% | 84% | 92% |
| Subscription fees | 132 | | | | | |
| Service fees | 9,211 | 7,362 | 4,553 | 13% | 16% | 8% |
| Total revenues | $ 73,702 | $ 47,017 | $ 60,495 | 100% | 100% | 100% |

License fees for fiscal year 2008 were $64.4 million, an increase of $24.7 million, or 62%, from revenues of $39.7 million in fiscal year 2007. The increase in license fees is primarily due to recurring quarterly revenues associated with VPA licenses that were signed in previous years and the success of our initiatives to re-monetize customers who had previously had the benefit of fully paid-up license arrangements.

In fiscal year 2008, the Company executed additional VPA transactions with certain of its customers with payment terms spread over periods of up to 24 months. Consistent with our policy, only fees due within 90 days are invoiced and recorded as revenues or deferred revenues. VPA fees due beyond 90 days are not invoiced or recorded by the Company. The Company considers these unbilled VPA commitments, along with deferred revenues, as order backlog. As of the end of fiscal year 2008, total order backlog was approximately $38.0 million, an increase of 99%, or $18.9 million, from the $19.1 million balance at September 30, 2007. The Company expects to recognize this $38.0 million as revenues over future periods; however, uncertainties such as the timing of customer utilization of our products may impact the timing of recognition of these revenues.

The $38.0 million order backlog as of September 30, 2008 is composed of $23.0 million of unbilled VPA commitments and $15.0 million of deferred revenue. Unbilled VPA commitments increased 215%, or $15.7 million, from the $7.3 million balance at September 30, 2007 while deferred revenue increased 27%, or $3.2 million, from the $11.8 million balance at September 30, 2007. The increases in unbilled VPA commitments and deferred revenue reflect the combined effect of overall business growth and the Company s decision at the beginning of fiscal year 2008 to enter into certain agreements with major customers that extend for periods greater than one year.

As a percentage of total revenue, license fees were 87% for fiscal year 2008 versus 84% in fiscal year 2007. This increase is principally attributable to the sale of VPA and similar licenses in fiscal year 2008.

During the third and fourth quarters of fiscal year 2008, we recognized our first subscription fee revenues, which principally resulted from the completion of our acquisitions of BeInSync Ltd. and TouchStone Software

Corporation, which provide subscriptions-based services to customers. Subscription fees for fiscal year 2008 were $0.1 million. We did not have similar revenues in prior years.

Service fees for fiscal year 2008 were $9.2 million, an increase of $1.8 million, or 25%, from $7.4 million for fiscal year 2007. As a percentage of total revenues, service fees were 13% in fiscal year 2008 versus 16% for fiscal year 2007. The increase in service fees is principally a result of the sale of support service days with new VPAs, while the decrease in service fees as a percentage of total revenues is principally a result of greater revenues attributable to VPA and pay-as-you-go licenses.

License fees for fiscal year 2007 were $39.7 million, a decrease of 29% from license fees of $55.9 million in fiscal year 2006. This decrease in license fees was primarily due to the sale of fully paid-up licenses in the earlier period. There were no paid-up license fees for fiscal year 2007 as compared to $30.5 million of revenue from paid-up licenses for fiscal year 2006. Revenues from all other licenses (*i.e.*, other than paid-up licenses) were $39.7 million in fiscal year 2007, an increase of $14.2 million, or 56%, from $25.5 million of such revenues in the same period of the previous fiscal year. The increase in other license fees was attributable to higher revenues from VPAs and pay-as-you-go licenses, which typically included higher per unit prices than what we had achieved during the earlier periods.

As a percentage of total revenue, license fees were 84% for fiscal year 2007 versus 92% in fiscal year 2006. This decrease was principally attributable to the sale of fully paid-up licenses in fiscal year 2006 and the growth in service fees discussed below.

Service fees for fiscal year 2007 were $7.4 million, an increase of $2.8 million, or 62%, from $4.6 million for fiscal year 2006. As a percentage of total revenue, service fees were 16% in fiscal year 2007 versus 8% for fiscal year 2006. The increase in service fees was principally a result of a large engineering contract signed with a single customer as well as overall price increases for engineering and support services, while the increase in service fees as a percentage of total revenue was principally a result of the increased service fee revenues and the sale of fully paid-up licenses in the earlier period.

***Cost of Revenues and Gross Margin***

Cost of revenues consists of third party license fees, expenses related to the provision of subscription services, service fees, and amortization of purchased intangible assets. License fees are primarily third party royalty fees, electronic product fulfillment costs, and the costs of product labels for customer use. Expenses related to subscription services are primarily hosting fees associated with customer data, product fulfillment costs, credit card transaction fees and personnel-related expenses such as salaries associated with post-sales customer support costs. Service fees 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.

Cost of revenues increased by 1% from $9.7 million in fiscal year 2007 to $9.8 million in fiscal year 2008. Cost of revenues associated with license fees declined by 44%, from $0.9 million in fiscal year 2007 to $0.5 million in fiscal year 2008. This decline in costs associated with license fees is principally due to a strategic shift away from the sale of products which had included licensed intellectual property. Cost of revenues associated with service fees increased by 7%, principally as a result of increase in payroll and related benefit expenses. Amortization of purchased intangible assets marginally declined by 8% from $1.4 million in fiscal year 2007 to $1.3 million in fiscal year 2008, principally as a result of write-downs of certain intangible assets during fiscal year 2007 offset by the commencement of amortization of new intangible assets acquired during fiscal year 2008.

As a percentage of revenue, cost of revenues declined from 21% in fiscal year 2007 to 13% in fiscal year 2008, principally as a result of the increase in revenues and the cost management initiatives described above.

Cost of revenues decreased by 46%, or $8.2 million, in fiscal year 2007 compared to fiscal year 2006. Costs related to license fees decreased by $3.8 million, primarily due to a change in product strategy which reduced costs associated with enterprise software product revenue. Cost of service revenues decreased by $2.7 million primarily as a result of staffing reductions associated with the new product strategy. Amortization of purchased technology was lower by $1.7 million in fiscal year 2007 as compared to fiscal year 2006, primarily as a result of accelerated

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intellectual property amortization in fiscal year 2006 as well as certain intellectual property assets becoming fully amortized.

As a percentage of revenue, cost of revenues declined from 30% in fiscal year 2006 to 21% in fiscal year 2007, principally as a result of the cost reductions described above offset by growth in service revenues, which have higher costs than license revenues.

Gross margin as a percentage of revenues was 87%, 79%, and 70% for fiscal years 2008, 2007 and 2006, respectively. Gross margin was $63.9 million for fiscal year 2008 as compared to $37.3 million in fiscal year 2007 and $42.6 million in fiscal year 2006. These variations in gross margin and gross margin as a percentage of revenues are a result of the changes in the cost of revenues and in the cost of revenues as a percentage of revenues described above. The increased margin percentage and dollar amount of gross margin in fiscal year 2008 as compared to fiscal year 2007 is principally due to the increase in overall revenues and the relatively fixed nature of the associated costs. The increased margin percentage and decreased dollar amount of gross margin in fiscal year 2007 as compared to fiscal year 2006 was the result of the cost of revenues having being reduced by a greater proportion than the reduction in revenue.

***Research and Development Expenses***

Research and development expenses consist primarily of salaries and other related costs for research and development personnel, quality assurance personnel, product localization expense, fees to outside contractors, facilities and IT support costs, as well as depreciation of capital equipment. Research and development expenses were $29.7 million, $19.2 million and $22.9 million in fiscal years 2008, 2007 and 2006, respectively, and as a percentage of revenues, these expenses represented 40%, 41%, and 38%, respectively.

The $10.5 million, or 55%, increase in research and development expense for fiscal year 2008 versus fiscal year 2007 is principally due to increased spending related to the development of our new product groups, the FailSafe solution and the HyperSpace platform and of the new technologies acquired during the year. These increased expenses included: increased payroll and related benefit expenses of $4.0 million associated with an increase in the number of engineering and engineering management personnel from 246 to 370; increased stock-based compensation expense of $1.8 million due in part to the grant of the Performance Options; increased consulting costs of $2.9 million due to the use of additional consultants for recruiting and new product development; higher corporate bonuses of $0.8 million; and higher net cost of facilities and other expenses of $1.0 million.

The one percentage point reduction in research and development expense as a percentage of revenues was principally the result of our revenues having increased at a faster rate than the increase in R&D costs described above.

The $3.7 million, or 16%, decrease in research and development expense in fiscal year 2007 compared to fiscal year 2006 was due to decreases of $2.4 million in payroll and related benefit expenses and $1.2 million in outside support costs, both relating to the discontinuation of development efforts on certain enterprise application software products. The reductions in payroll and benefit spending on research and development were smaller in percentage terms than the reductions in payroll costs in sales and marketing due to our continuation of research and development efforts on our CSS products and our initiation of new development efforts related to our two new product groups, the FailSafe solution and the HyperSpace platform. Other research and development related expenses for fiscal year 2007 were $0.6 million lower than fiscal year 2006 resulting from various other cost management initiatives. These reductions were offset by increased stock-based compensation expenses of $0.5 million pursuant to SFAS No. 123(R).

***Sales and Marketing Expenses***

Sales and marketing expenses consist primarily of salaries, commissions, travel and entertainment, facilities and IT support costs, promotional expenses (marketing and sales literature) and marketing programs, including advertising, trade shows and channel development. Sales and marketing expenses also include costs relating to technical support personnel associated with pre-sales activities such as performing product and technical presentations and answering customers product and service inquiries.

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Sales and marketing expenses were $13.3 million, $12.0 million and $35.4 million in fiscal years 2008, 2007 and 2006, respectively, and as a percentage of revenues, these expenses represented 18%, 25%, and 58% in fiscal years 2008, 2007 and 2006, respectively.

The $1.3 million increase in sales and marketing expenses for fiscal year 2008 versus fiscal year 2007 was principally due to: increased payroll and related benefit expenses of $1.3 million, which includes an increased stock-based compensation expense of $0.5 million due in part to the grant of the Performance Options, higher corporate bonuses of $0.6 million and $0.2 million of other payroll and related benefit expenses; and increased consulting costs of $1.0 million due to the use of additional consultants for recruiting. These increases were partly offset by lower facilities and other expenses of $1.0 million.

The seven percentage point reduction in sales and marketing expenses as a percentage of revenues is the result of our revenues having increased significantly by 57% over fiscal year 2007 as compared to a corresponding increase of only 11% in sales and marketing expenses.

The $23.4 million net decrease in sales and marketing expenses in fiscal year 2007 from fiscal year 2006 and the reduction from 58% to 25% of these expenses as a percentage of revenues were primarily due to management s decision to withdraw from the sale of enterprise application software products. In connection with this decision, we ceased all spending on marketing programs and sales initiatives aimed at enterprise customers and intermediaries. Payroll and related benefit expenses for sales and marketing personnel were reduced by $12.6 million partly as a result of these decisions and partly as a result of reductions in middle management among the remaining sales teams. Other savings included (i) lower marketing expenses of $4.6 million; (ii) lower spending on travel and entertainment of $2.5 million; (iii) lower outside support expense of $1.9 million; (iv) lower stock-based compensation expense of $0.9 million due to lower staffing levels; and (v) a net decrease in other expense items of approximately $0.9 million due to various other cost management initiatives.

***General and Administrative Expenses***

General and administrative expenses consist primarily of salaries and other costs relating to administrative, executive and financial personnel and outside professional fees, including those associated with audit and legal services.

General and administrative expenses were $22.5 million, $16.6 million and $21.5 million in fiscal years 2008, 2007 and 2006, respectively, and as a percentage of revenues, these expenses represented 31%, 35%, and 35% of total revenue for each such year, respectively.

The $5.9 million, or 36%, increase in general and administrative expenses in fiscal year 2008 as compared with fiscal year 2007 was due principally to a $3.4 million increase in stock-based compensation which included the effect of the Performance Options; a $0.3 million increase in corporate bonus expense; and increased costs of $1.0 million due to increased recruiting costs and the use of additional consultants and professional advisors. In addition to these increases, facilities and other expenses were higher by $1.2 million.

The four percentage point reduction in general and administrative expenses as a percentage of revenues is the result of our revenues having increased at a faster rate than the increase in general and administrative expenses described above.

General and administrative expense decreased by $4.9 million, or 23%, in fiscal year 2007 as compared to fiscal year 2006 due principally to: a $2.9 million decrease in payroll and related benefit expenses associated with staff reductions; a $3.4 million decrease in professional services and other advisory costs primarily associated with reduced audit and compliance services and reduced costs of the Board of Director s investigation of strategic alternatives for the Company which began in fiscal year 2006, and other net reductions of $0.5 million. These reductions were offset by increased stock-based compensation expenses of $1.9 million pursuant to SFAS No. 123(R).

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### *Restructuring Costs*

Restructuring charges were $0.2 million, $4.1 million and $4.6 million in fiscal years 2008, 2007 and 2006, respectively, and as a percentage of revenues, these expenses represented 0%, 9%, and 8% of total revenue for each such year, respectively.

*Fiscal Year 2007 Restructuring Plans*

In the fourth quarter of fiscal year 2007, a restructuring plan was approved for the purpose of reducing future operating expenses by eliminating 12 positions and closing the office in Norwood, Massachusetts. We recorded a restructuring charge of approximately $0.6 million in fiscal year 2007, 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. 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 our results of operations. During the fiscal year ended September 30, 2008, approximately $0.2 million of the restructuring liability was amortized and an additional restructuring cost of approximately $0.2 million was recorded related to a change in estimate regarding the expected time to obtain a subtenant, leaving a total estimated unamortized amount of approximately $0.1 million as of September 30, 2008 for the on-going lease obligations and no remaining outstanding liabilities related to severance costs. There may be additional restructuring charges in future quarters if a sublease agreement is not entered into within the previously anticipated timing and/or terms and conditions.

In the first quarter of fiscal year 2007, a restructuring plan was approved that was designed to reduce operating expenses by eliminating 58 positions and closing or consolidating offices in Beijing, China; Taipei, Taiwan; Tokyo, Japan; and Milpitas, California. We 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, restructuring charges of $0.9 million and $0.3 million were recorded in the second and fourth quarter, respectively, of fiscal year 2007 in connection with office consolidations. These restructuring costs were accounted for under SFAS No. 146 and are included in our results of operations. During the fiscal year ended September 30, 2008, approximately $13,000 of this restructuring plan s liability was amortized.

As of September 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 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, we implemented a number of cost reduction plans aimed at reducing costs which were not integral to our overall strategy and at better aligning our expense levels with our revenue expectations.

In the fourth quarter of fiscal year 2006, a restructuring plan was approved that was designed to reduce operating expenses by eliminating 68 positions. A charge of $2.2 million related to employee severance costs was recorded under the plan. In the third quarter of fiscal year 2006, a restructuring plan designed to reduce operating expenses by eliminating 35 positions and closing facilities in Munich, Germany and Osaka, Japan was approved. A charge of $1.8 million of employee severance costs and $0.2 million of facility closure costs was recorded under this plan in fiscal years 2006 and 2007. These restructuring costs were accounted for in accordance with SFAS No. 146 and are included in our results of operations. As of September 30, 2008, there are no remaining outstanding liabilities pertaining to fiscal year 2006 restructuring plans.

*Fiscal Year 2003 Restructuring Plan*

In the first quarter of fiscal year 2003, we announced a restructuring plan that affected approximately 100 positions across all business functions and closed our 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 the 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, our financial statements reflected a net increase of $1.8 million in the restructuring liability related to the Irvine, California facility as a result of our 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 year 2007. During the fiscal year 2008, the restructuring liability was impacted by changes in the estimated building operating expenses as follows: $0.1 million decrease in the first quarter of fiscal year 2008 and approximately $50,000 increase in the fourth quarter of fiscal year 2008. During the fiscal year ended September 30, 2008, we amortized approximately $0.8 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 September 30, 2008.

***Interest and Other Income, Net***

Net interest and other income were $1.6 million, $2.0 million and $1.9 million in fiscal years 2008, 2007 and 2006, respectively. Net interest and other income consists mostly of interest income, which is primarily derived from cash, cash equivalents and marketable securities, realized and unrealized foreign exchange transaction gains and losses, losses/gains on disposal of assets and other miscellaneous expenses/income. Net interest and other income decreased by $0.4 million in fiscal year 2008 compared to fiscal year 2007, principally due to lower interest rates earned during the year.

The interest income generated each period is highly dependent on available cash and fluctuations in interest rates. The average interest rate earned was approximately 3.6%, 5.3%, and 4.7% for fiscal years 2008, 2007 and 2006, respectively. All cash equivalents and marketable securities are U.S. dollar denominated. To reduce administrative costs and liquidity risks, we sold all of our marketable securities in fiscal year 2007 and invested the proceeds in money market funds. In fiscal year 2006, we invested mostly in highly liquid short-term marketable securities such as U.S. government and municipal bonds, taxable auction rate preferred instruments and corporate notes. Interest income was $1.9 million, $2.5 million and $2.8 million in fiscal years 2008, 2007 and 2006, respectively.

Net losses on currency translations were approximately $0.2 million, $0.3 million and $0.8 million, in fiscal years 2008, 2007 and 2006, respectively, while net losses on disposal of assets and other miscellaneous expenses were $0.1 million, $0.2 million and $0.1 million in fiscal years 2008, 2007 and 2006, respectively.

***Income Tax Expense***

We recorded income tax provisions of $6.0 million, $3.8 million and $3.7 million reflecting effective tax rates of (3124.4%), (30.2%), and (9.1%) in fiscal years 2008, 2007 and 2006, respectively, and representing primarily foreign withholding taxes in Taiwan, state franchise taxes and estimated taxes related to operations of foreign subsidiaries.

The effective tax rate in fiscal year 2008 was significantly different from the expected tax benefit derived by applying the U.S. federal statutory rate to income before taxes, primarily due to foreign income taxes and withholding taxes assessed by foreign jurisdictions. During the fiscal year ended September 30, 2008, the Company recorded a tax expense of $6.0 million of which $5.0 million related to the combination of Taiwan withholding tax and an increase in the tax accrual for a potential Taiwanese transfer pricing adjustment.

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We received notification in 2005 that the Taiwan taxing authority disagrees with the transfer pricing used by us. While we are in the process of contesting the assessment notices, we have received from the Taiwan taxing authorities, there is no reasonable assurance as to the ultimate outcome. We have therefore accrued but not paid the amount of the potential Taiwanese tax liability related to the transfer pricing adjustment, should the Taiwan taxing authority prevail. As of the September 30, 2008, the balance of this reserve was $13.1 million, of which $3.5 million, $1.3 million and $0.4 million were added in fiscal years 2008, 2007 and 2006, respectively.

Deferred tax assets, which relate to both U.S. and foreign taxes and tax credits, amounted to $46.0 million at September 30, 2008. However, due to a history of losses, the deferred tax asset has been offset by a valuation allowance of $45.8 million.

The effective tax rate in fiscal year 2007 was significantly different from the expected tax benefit derived by applying the U.S. federal statutory rate to income before taxes, primarily due to foreign income taxes and withholding taxes assessed by foreign jurisdictions. During fiscal year ended September 30, 2007, the Company recorded a tax expense of $3.8 million of which $2.6 million related to the combination of Taiwan withholding tax and the increase described above in the tax accrual for the potential Taiwanese transfer pricing adjustment.

The effective tax rate in fiscal year 2006 was significantly different from the expected tax benefit derived by applying the U.S. federal statutory rate to the income before taxes primarily due to foreign income taxes, foreign withholding taxes, and an addition of $0.4 million to the reserve established for the Taiwanese transfer-pricing adjustment exposure.

***Acquisitions***

On April 30, 2008, we acquired BeInSync Ltd., a company incorporated under the laws of the State of Israel ( BeInSync ). We believe that the acquisition will further strengthen our leadership in the PC industry by enabling us to include new products in our offerings to OEMs and ODMs and will enhance our ability to respond to consumer and business needs for secure and always available web access to their digital assets as well as automatic protection of PC programs and data. We paid approximately $20.8 million in connection with the acquisition, comprised of $17.3 million in cash consideration, $3.0 million in equity consideration and $0.5 million of direct transaction costs.

On July 1, 2008, we acquired TouchStone Software Corporation, a company incorporated under the laws of the State of Delaware ( TouchStone ). We believe that the acquisition of TouchStone will enable us to develop a strong online presence and infrastructure for web-based automated service delivery. We paid approximately $19.1 million in connection with the acquisition, comprised of $18.7 million in cash consideration and $0.4 million of direct transaction costs.

On August 31, 2008, we acquired General Software, Inc, a company incorporated under the laws of the State of Washington ( General Software ). We believe that the acquisition will further strengthen our position as the global market and innovation leader in system firmware for today s computing environments, and will extend the reach of our products to devices that use embedded processors. We paid approximately $20.0 million in connection with the acquisition, comprised of $11.7 million in cash consideration, $7.9 million in equity consideration and $0.4 million of direct transaction costs.

All the above acquisitions were accounted for in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 141, Business Combinations ( SFAS 141 ). See Note 12 Business Combinations in the Consolidated Financial Statements for more information relating to these acquisitions.

We expect to continue to evaluate possible acquisitions of, or strategic investments in, businesses, products and technologies that are complementary to our business, which may require the use of cash. Future acquisitions could cause amortization expenses to increase. In addition, if impairment events occur, they could also accelerate the timing of charges.

## Financial Condition

At September 30, 2008, our principal source of liquidity consisted of cash and cash equivalents totaling $37.7 million, compared to $62.7 million at September 30, 2007.

During fiscal year 2008, cash decreased by $25.0 million mainly as a result of investing activities totaling $50.7 million which were composed of a) $17.7 million that we paid in cash (net of cash acquired) associated with the acquisition of BeInSync Ltd., b) $17.8 million that we paid in cash (net of cash acquired) associated with the acquisition of TouchStone Software Corporation, c) $12.1 million that we paid in cash (net of cash acquired) associated with the acquisition of General Software, Inc., and d) $3.1 million for investment in property and equipment. Cash used in these investing activities was partly offset by $20.5 million of cash provided by operating activities and $5.3 million of cash provided by financing activities. Cash from operating activities resulted from a net loss of $6.2 million which was offset by non-cash charges of $12.3 million for stock-based compensation and $3.2 million for depreciation and amortization as well as a $5.6 million increase in taxes payable, a $1.5 million increase in accounts receivable and a net $4.1 million increase from other operating items. Cash from financing activities was due to the receipt of $5.5 million from stock issuances under stock option and stock purchase plans offset by $0.2 million paid for the repurchase of restricted common stock.

At September 30, 2007, our principal source of liquidity consisted of cash and cash equivalents totaling $62.7 million, compared to cash, cash equivalents and marketable securities of $60.3 million at September 30, 2006. During fiscal year 2007, to reduce administrative costs and liquidity risks, we implemented a change in our past practices regarding the investment of our cash which led to the elimination of our holdings of marketable securities and an increase in investments in money market funds, which are classified as cash equivalents on the Consolidated Balance Sheet. In connection with this change, we sold all of our marketable securities and invested the proceeds in money market funds. Our investment policy permits us to invest in securities with risks greater than those of money market funds and we may do so in the future.

Net cash used in operating activities in fiscal year 2007 was $2.4 million, which was primarily due to our net loss of $16.4 million, partly offset by a decrease in accounts receivable of $2.1 million, a decrease in other working capital items of approximately $2.1 million and non-cash items of depreciation and amortization and stock-based compensation expense of $3.6 million and $6.2 million, respectively.

Cash flows provided from investing activities for fiscal year 2007 were $21.3 million, which were primarily due to proceeds from the sale of marketable securities, net of purchases, of approximately $25.6 million, offset in part by equipment purchases of $0.8 million and a technology acquisition in the third quarter of fiscal year 2007 of $3.5 million.

Cash flows provided from financing activities during fiscal year 2007 were $9.0 million which related to the proceeds from the exercise of stock options and purchases under our Employee Stock Purchase Plan.

We believe that our current cash and cash equivalents and cash available from future operations will be sufficient to meet our operating and capital requirements for at least the next twelve months. We may incur a net loss in fiscal year 2009 and we may also incur negative net cash flow in fiscal year 2009, if we are unable to achieve the revenues we anticipate or to successfully control our cash expenditures.

### *Commitments*

As of September 30, 2008, we had commitments for $10.9 million under non-cancelable operating leases ranging from one to six years. The operating lease obligations include a net lease commitment for the Irvine, California location of $0.7 million, after sublease income of $0.2 million. The Irvine net lease commitment was included in our fiscal year 2003 first quarter restructuring plan. The operating lease obligations also include i) our facility in Norwood, Massachusetts which has been fully vacated and for which we have entered into a sublease agreement in October 2008 for the remainder of the term; and ii) our facility in Milpitas, California, which has been partially vacated and for which we entered into a sublease agreement in November 2007. See Note 6 Restructuring Charges to the Consolidated Financial Statements for more information on our restructuring plans.

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As of September 30, 2008, we had a non-current income-tax liability of $13.6 million which was associated primarily with the accrual of income taxes on our operations in Taiwan. We have not included this amount in the Contractual Obligations table below as we cannot make a reasonably reliable estimate regarding the timing of any settlement with the respective taxing authority, if any.

On September 30, 2008, our future commitments were as follows *(in thousands)*:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| **Contractual Obligations** | **Total** | **Less than 1 Year(1)** | **2-3 Years(2)** | **4-5 Years(3)** | **More than 5 Years(4)** |
| Operating lease obligations | $ 10,919 | $ 3,245 | $ 4,784 | $ 2,813 | $ 77 |

Note (1) fiscal year 2009
Note (2) fiscal years 2010-2011
Note (3) fiscal years 2012-2013
Note (4) fiscal year 2014

There were no material commitments for capital expenditures or non-cancelable purchase commitments as of September 30, 2008.

***Off-Balance Sheet Arrangements***

We have not entered into any off-balance sheet agreements.

***Recent Accounting Pronouncements***

For a description of recent accounting pronouncements, see Note 2 Summary of Significant Accounting Policies to Consolidated Financial Statements for more information.

## Critical Accounting Policies and Estimates

We believe that the following represent the more critical accounting policies used in the preparation of our consolidated financial statements, and are subject to the various estimates and assumptions used in the preparation of such financial statements. Critical accounting policies and estimates are reviewed by us on a regular basis and are also discussed by senior management with the Audit Committee of our Board of Directors.

*Revenue Recognition.* We license software under non-cancelable license agreements and provide 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. We use 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.

We recognize 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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***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 our software, provided that all other revenue recognition criteria have been met. We normally recognize revenues for all consumption prior to the end of the accounting period. Since we generally receive quarterly reports from OEMs and ODMs approximately 30 to 60 days following the end of a quarter, we have 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, we recognize 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, we recognize 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, we 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. Our examination of reports received from the customers during April 2007 regarding actual consumption of our 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 us to the view that customer forecasts were no longer a reliable indicator of future consumption. Since we 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 year 2006, we had increasingly relied on the use of software license agreements with our 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, we decided to eliminate the practice of entering into paid-up licenses.

***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 Internet. Primary subscription fee sources include fees charged for security, maintenance, back-up, recovery and device management services. Revenue derived from sale of our on-line subscription services are generally deferred and recognized ratably over the performance period, which typically ranges from one to three years.

***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

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performed. Amounts billed in advance for services that are in excess of revenues recognized are recorded as deferred revenues.

*Allowances for Accounts Receivable.* Provisions for doubtful accounts are recorded in general and administrative expenses. At September 30, 2008 and 2007, the allowance was approximately $26,000 and $84,000, respectively. These estimates are based on our assessment of the probable collection from specific customer accounts, the aging of the accounts receivable, historical revenue variances, analysis of credit memo data, bad debt write-offs, and other known factors. If economic or specific industry trends worsen beyond our estimates, or if there is a deterioration of our major customers credit worthiness, or actual defaults are higher than our estimates based on historical experience, we would increase the allowance which would impact our results of operations.