

# **AliphCom**

**Consolidated Financial Statements  
December 31, 2009 and 2008**

**AliphCom**  
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**December 31, 2009 and 2008**

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## Report of Independent Auditors

To the Board of Directors and Stockholders of  
AliphCom:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of AliphCom and its subsidiary at December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*PricewaterhouseCoopers LLP*

August 19, 2011

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**AliphCom**  
**Consolidated Balance Sheets**  
**December 31, 2009 and 2008**

(in thousands, except share and per share amounts)

	2009	2008
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 34,091	\$ 38,500
Accounts receivable	5,644	1,513
Inventories	5,396	5,275
Prepaid and other current assets	1,032	985
Total current assets	46,163	46,273
Property and equipment, net	2,357	3,980
Other long-term assets	6,259	11,139
Total Assets	\$ 54,779	\$ 61,392
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities		
Accounts payable	\$ 10,082	\$ 7,862
Accrued liabilities	17,359	10,342
Capital lease obligations, current portion	79	44
Income taxes payable	553	4,757
Total current liabilities	28,073	23,005
Preferred stock warrant liability	6,874	2,331
Capital lease obligations, less current portion	63	141
Total liabilities	35,010	25,477
Commitments and Contingencies (Note 5)		
Stockholders' Equity		
Redeemable convertible preferred stock: \$0.001 par value; 111,853,887 shares authorized at December 31, 2009 and 2008, 88,277,291 shares issued and outstanding at December 31, 2009 and 2008	43,725	43,725
Common Stock: \$0.001 par value; 215,000,000 shares authorized at December 31, 2009 and 2008, 40,724,308 and 38,383,508 shares issued and outstanding at December 31, 2009 and 2008, respectively	40	38
Additional paid-in capital	3,329	2,460
Stockholder's notes receivable	(180)	(180)
Accumulated deficit	(27,145)	(10,128)
Total stockholders' equity	19,769	35,915
Total liabilities and stockholders' equity	\$ 54,779	\$ 61,392

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

**AliphCom**  
**Consolidated Statements of Operations**  
**Years Ended December 31, 2009 and 2008**

<i>(in thousands)</i>	2009	2008
<b>Revenues</b>	\$ 66,789	\$ 145,455
Cost of revenues	42,706	100,644
Gross profit	<u>24,083</u>	<u>44,811</u>
<b>Operating expenses</b>		
Research and development	9,902	10,270
Selling, general and administrative	24,268	28,165
Litigation expense	5,410	-
Total operating expenses	<u>39,580</u>	<u>38,435</u>
(Loss) Income from operations	(15,497)	6,376
<b>Total other (expense) income, net</b>		
Warrant revaluation (expense) income	(4,543)	2,629
Interest expense	(60)	(549)
Interest and other (expense) income, net	(23)	629
Total other (expense) income, net	<u>(4,626)</u>	<u>2,709</u>
Net (loss) income before income taxes	(20,123)	9,085
(Benefit) provision for income tax	(3,106)	4,633
Net (loss) income	<u>\$ (17,017)</u>	<u>\$ 4,452</u>

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

**AliphCom**  
**Consolidated Statements of Stockholders' Equity**  
**Years Ended December 31, 2009 and 2008**

	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Stockholder's Notes Receivable	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
<i>(in thousands, except share and per share amounts)</i>								
<b>Balance at December 31, 2007</b>	87,151,799	\$ 43,527	36,775,091	\$ 36	1,680	(180)	\$ (14,580)	\$ 30,483
Issuance of Series 2 redeemable convertible preferred stock for cash, net of issuance costs of \$2	1,125,492	198	-	-	-	-	-	198
Exercise of common stock warrants	-	-	711,473	1	35	-	-	36
Issuance of common stock warrants	-	-	-	-	115	-	-	115
Exercises of common stock options	-	-	896,944	1	197	-	-	198
Stock-based compensation expense	-	-	-	-	433	-	-	433
Net income	-	-	-	-	-	-	4,452	4,452
<b>Balance at December 31, 2008</b>	88,277,291	43,725	38,383,508	38	2,460	(180)	(10,128)	35,915
Issuance of common stock warrants	-	-	-	-	7	-	-	7
Exercise of common stock warrants	-	-	1,686,238	2	298	-	-	300
Stock-based compensation expense	-	-	-	-	523	-	-	523
Exercises of common stock options	-	-	652,562	-	41	-	-	41
Net loss	-	-	-	-	-	-	(17,017)	(17,017)
<b>Balance at December 31, 2009</b>	88,277,291	\$ 43,725	40,724,308	\$ 40	3,329	(180)	\$ (27,145)	\$ 19,769

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

**AliphCom**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2009 and 2008**

<i>(in thousands)</i>	2009	2008
<b>Cash flows from operating activities</b>		
Net (loss) income	\$ (17,017)	\$ 4,452
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Inventory write-down	478	324
Depreciation and amortization	2,509	1,266
Issuance of warrants for services	7	103
Stock-based compensation	523	433
Remeasurement of preferred stock warrant liability	4,543	(2,629)
Changes in current assets and liabilities:		
Accounts receivable	(4,131)	4,911
Inventories	(600)	(3,072)
Prepaid and other current assets	(2,367)	(638)
Accounts payable	2,220	(3,888)
Accrued liabilities and other long-term liabilities	7,017	6,278
Deferred taxes	(4,203)	4,639
Net cash (used in) provided by operating activities	<u>(11,021)</u>	<u>12,179</u>
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(885)	(5,029)
Disposal of property and equipment	-	193
Changes in restricted cash	7,200	(7,118)
Net cash provided by (used in) investing activities	<u>6,315</u>	<u>(11,954)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of redeemable convertible preferred stock	-	198
Proceeds from exercises of stock options and warrants	341	234
Repayment of capital lease obligations	(44)	(8)
Net cash provided by financing activities	<u>297</u>	<u>424</u>
Net (decrease) increase in cash and cash equivalents	(4,409)	649
<b>Cash and cash equivalents</b>		
Beginning of year	<u>38,500</u>	<u>37,851</u>
End of year	<u>\$ 34,091</u>	<u>\$ 38,500</u>
<b>Supplemental cash flow information</b>		
Cash paid for income taxes	\$ 2,450	\$ 118
Cash paid for interest	34	389
<b>Supplemental noncash investing and financing activities</b>		
Assets purchased through capital lease obligations	-	193

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

# AliphCom

## Notes to Consolidated Financial Statements

### December 31, 2009 and 2008

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#### 1. The Company and Summary of Significant Accounting Policies

AliphCom ("Aliph" or the "Company") was incorporated in the State of California on March 12, 1998. Together with its wholly owned subsidiary the Company designs, develops and markets lightweight communications headset products under the Jawbone® brand. The Company sells its products primarily through a global sales channel network, which includes distributors and traditional retailers.

Through December 31, 2009, the Company has completed approximately \$46.0 million of equity financing since incorporation. In March 2011, the Company issued 7,131,940 shares of Series 4 preferred stock at \$3.926 per share for gross proceeds of approximately \$28.0 million. In March 2011, the Company also issued 2,025,300 shares of common stock at \$0.54 per share for proceeds of \$1.1 million to the purchaser of the Series 4 preferred stock. In June 2011, the Company issued 5,562,408 shares of Series 5 preferred stock at \$7.19113 per share for gross proceeds of approximately \$40.0 million. However, the Company has incurred significant losses and negative cash flows from operating activities. For the year ended December 31, 2009, the Company incurred a loss from operations of approximately \$15.5 million and negative cash flows from operating activities of approximately \$11.0 million. Operating losses and negative cash flows from operating activities may continue for the foreseeable future because of the additional costs and expenses related to product development, promotional activities, and continued expansion of operations and development of relationships with other businesses.

Management's plans include increasing the Company's revenues, focusing on the Company's fixed cost base and improving its working capital position to better align with operations, market demand and current sales levels. However, if projected sales do not materialize, management may reduce expenses.

#### Principles of Consolidation

The Company operates a wholly owned sales and customer support subsidiary in the United Kingdom. The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All intercompany accounts and transactions have been eliminated in consolidation.

The functional currency of the Company's subsidiary is the U.S. dollar. Accordingly, assets and liabilities denominated in foreign currency are remeasured into U.S. dollars at current exchange rates for monetary assets and liabilities and historical exchange rates for nonmonetary assets and liabilities. Expenses are remeasured at average exchange rates in effect during the period. Gains and losses from foreign currency remeasurement are included in interest and other (expense) income, net in the consolidated statements of operations and to date have not been material.

#### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions made by management involve: the assessment of collectability of accounts receivable, inventory valuations, the determination of accruals, the valuation and useful lives of long-lived assets, the fair value of the Company's equity instruments and the valuation of deferred tax asset balances. Actual results could differ from those estimates, and such differences may be material to the financial statements.

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**Revenue Recognition**

Revenue from product sales is recognized at the time the product is shipped provided that persuasive evidence of an arrangement exists, title and risk of loss has transferred to the customer, the selling price is fixed or determinable, and collection of the related receivable is reasonably assured. The Company assesses collectability based on a number of factors, including general economic and market conditions, past transaction history with the customer, and the creditworthiness of the customer.

The Company recognizes revenue net of estimated sales returns, price protection, and sales incentives. Upon shipment of the product, the Company reduces revenue for an estimate of potential future returns, price protection and sales incentives related to the current period revenue. Management analyzes historical returns, channel inventory levels, current economic trends, new product introduction timelines and changes in customer demand for the Company's products when evaluating the adequacy of the allowance for sales returns, price protection and sales incentives.

In late 2009, the Company released its ICON headset product. In connection with the ICON product, the Company provides firmware updates that may result in additional features and functionality, on an if-and-when available basis. The firmware updates represent an undelivered element in the revenue arrangement. In order for revenue to be recognized for the delivered elements in an arrangement, the Company must be able to establish vendor specific evidence of fair value ("VSOE") for the undelivered element. The Company had not established VSOE for the firmware updates as of December 31, 2009. Accordingly, the Company has deferred all revenue and associated cost of sales relating to sales of its ICON headsets and recognizes both on a straight-line basis over the estimated economic life of the product, with any loss recognized at the time of sale.

**Sales Incentives**

The Company accrues for sales incentives as a marketing expense if it receives an identifiable benefit in exchange and can reasonably estimate the fair value of the identifiable benefit received. Otherwise, the sales incentives are recorded as a reduction to revenues. The Company records its channel marketing costs as a reduction of revenues. The Company records estimated reductions to revenues for sales incentives upon the later of when the related revenue is recognized or when the program is offered to the customer or end consumer.

**Cash Equivalents**

All highly liquid investments with an original or remaining maturity of three months or less at the date of purchase are classified as cash equivalents. The Company maintains its cash and cash equivalents with major, high credit quality financial institutions. At December 31, 2009 and 2008, cash equivalents consisted primarily of money market funds and commercial paper.

**Deposits**

Certain deposits are required by the Company's landlords to guarantee the contractual obligations under its office lease agreements. As of December 31, 2009 and 2008, deposits totaled \$92,000 and \$73,000, respectively, and were recorded within other long-term assets in the accompanying consolidated balance sheets.

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**Restricted Cash**

At December 31, 2009 and 2008, the Company maintained \$3.8 million and \$11.0 million, respectively, of restricted cash in the form of institutional money market funds and certificates of deposit to support letters of credit required by the Company's primary inventory supplier. Restricted cash is recorded within other long-term assets in the accompanying consolidated balance sheets.

**Allowance for Doubtful Accounts**

The Company makes judgments as to its ability to collect outstanding accounts receivable and provides allowances for accounts receivable when and if collection becomes doubtful. To date, the Company has not recorded any allowance for doubtful accounts on customer accounts.

**Fair Value of Financial Instruments**

The Company's financial instruments consist principally of cash and cash equivalents, accounts receivable, accounts payable, and preferred stock warrant liability. The fair value of the Company's cash equivalents is determined based on quoted prices in active markets for identical assets. The recorded values of the Company's accounts receivable and accounts payable approximate their current fair values due to the relatively short-term nature of these accounts.

**Business Risk and Concentration of Credit Risk**

The Company's products are concentrated in an industry characterized by rapid technological advances, changes in customer requirements and evolving regulatory requirements and industry standards. Any significant delays in the development or introduction of products or services, or any failure by the Company to anticipate or to respond adequately to technological developments in its industry, changes in customer requirements or changes in regulatory requirements or industry standards, could have a material adverse effect on the Company's business and operating results.

The Company's products are manufactured, assembled and tested by a third-party contractor in Asia. There is no long-term agreement with the contractor. A significant disruption in the operations of the contractor would impact the production of the Company's products for a substantial period of time, which could have a material adverse effect on the Company's business, financial condition, and results of operations.

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, restricted cash, and trade accounts receivable. Cash and cash equivalents are deposited with major financial institutions in the United States. Deposits in the United States may exceed federally insured limits. Management believes that the financial institutions that hold the Company's deposits are financially credit worthy and, accordingly, minimal credit risk exists with respect to those balances. Generally, these deposits may be redeemed upon demand and, therefore, bear minimal interest rate risk.

The Company's accounts receivable are derived from customers located principally in the United States. The Company performs ongoing credit evaluations of its customers, does not require collateral, and maintains allowances for potential credit losses on customers' accounts when deemed necessary.

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As of and for the years ended December 31, 2009 and 2008, customers representing 10% or more of the accounts receivable balance and/or revenues were as follows:

	Percentage of Accounts Receivable		Percentage of Net Revenues	
	2009	2008	2009	2008
Customer A	52 %	38 %	59 %	82 %
Customer B	-	-	12	-
Customer C	-	28	-	-

**Inventories**

Inventories are stated at the lower of cost or market, cost being determined using the first-in, first out method. The Company reduces the value of its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value. Allowances, once established, are not reversed until the related inventory has been subsequently sold or scrapped.

**Property and Equipment, Net**

Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the related assets, as described in the table below. Maintenance and repairs are expensed as incurred. When assets are retired or otherwise disposed of, the cost and the related accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is reflected in the statement of operations.

Asset	Estimated Useful Lives
Computer equipment	3 years
Software	2 years
Office equipment, furniture and fixtures	5 years
Manufacturing equipment and tools	Based on the estimated life of the product
Leasehold improvements	The shorter of the lease term or the estimated useful lives of the improvements

**Capitalized Software Development Costs**

Software development costs are included in research and development and are expensed as incurred. After technological feasibility is established, software development costs are capitalized. To date, the period between achieving technological feasibility, which the Company has defined as the establishment of a working model which typically occurs when the beta testing commences, and the general availability of such software has been short and software development costs qualifying for capitalization have been insignificant. Accordingly, the Company has not capitalized any software development costs.

**Impairment of Long-Lived Assets**

The Company reviews the recoverability of its long-lived assets, such as property and equipment, when events or changes in circumstances occur that indicate that the carrying value of the asset or asset group may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows, undiscounted and without interest charges, of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized

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for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets. Through December 31, 2009, the Company has not identified any impairment on its long-lived assets.

**Research and Development Costs**

The Company expenses costs related to research, design and development of products to research and development as incurred. The costs included in research and development primarily consist of salaries, contractor fees and allocated overhead costs.

**Income Taxes**

The Company accounts for income taxes based on the asset and liability method whereby deferred tax asset and liability account balances are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

In evaluating the ability to recover its deferred income tax assets the Company considers all available positive and negative evidence, including its operating results, forecasts of future taxable income and ongoing tax planning on a jurisdiction-by-jurisdiction basis. In the event the Company was to determine that it would be able to realize its deferred tax assets in the future in excess of their net recorded amount, it would make an adjustment to the valuation allowance which would reduce the provision for income taxes. Conversely, in the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made.

The Company recognizes and measures benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions that are more likely than not to be sustained upon audit, the second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement. Significant judgment is required to evaluate uncertain tax positions. The Company evaluates its uncertain tax positions annually. Evaluations are based upon a number of factors, including changes in facts or circumstances, changes in tax law, correspondence with tax authorities during the course of audits and effective settlement of audit issues.

**Advertising Costs**

Costs related to advertising and promotions of products are expensed to sales and marketing as incurred. Advertising and promotion expense for the years ended December 31, 2009 and 2008 was \$507,000 and \$2.5 million, respectively.

**Product Warranty**

The Company offers a standard product warranty that the product will operate under normal use for a period of one year from date of original purchase. The Company shall, at its option, either repair or replace the defective product. If the Company determines that it is not reasonable to replace the defective product, the Company may refund the purchase price paid for the product.

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At the time revenue is recognized, an estimate of future warranty costs is recorded as a component of cost of revenues. Factors that affect the warranty obligation include product failure rates and service delivery costs incurred in correcting the product failures. Because the Company's products are manufactured by a third party manufacturer, in certain cases the Company has recourse to the third party manufacturer in determining its warranty liability. Product warranty accrual is included within accrued liabilities in the accompanying consolidated balance sheets, and its activity for the years ended December 31, 2009 and 2008 was as follows:

<i>(in thousands)</i>	<b>2009</b>	<b>2008</b>
<b>Balance at beginning of the year</b>	\$ 626	\$ 497
Provision for warranty liability made during the year	687	1,596
Settlements made during the year	<u>(1,037)</u>	<u>(1,467)</u>
<b>Balance at end of the year</b>	<u>\$ 276</u>	<u>\$ 626</u>

**Shipping and Handling Fees and Costs**

The Company accounts for shipping and handling fees billed to customers as revenues and the associated shipping and handling costs as cost of revenues. In addition, shipping and handling costs for inbound freight are included in cost of revenues.

**Preferred Stock Warrant Liability**

The freestanding warrant related to the Company's preferred stock is classified as a liability on its consolidated balance sheets. The warrant is subject to re-measurement at each balance sheet date and any change in fair value is recognized as a component of interest and other (expense) income, net. The Company will continue to adjust the liability for changes in fair value until the earlier of the exercise or expiration of the warrant or the completion of a liquidation event, including the completion of an initial public offering, at which time the preferred stock warrant will be converted into a warrant to purchase common stock and, accordingly, the liability would be reclassified to stockholders' equity.

**Stock-Based Compensation**

Stock-based compensation expense for the years ended December 31, 2009 and 2008, includes compensation expense for all stock-based compensation awards granted on or after January 1, 2006 and is based on the grant-date fair value estimated using the Black-Scholes option pricing model. Stock-based compensation expense recognized in the statements of operations is based on options ultimately expected to vest, reduced by the amount of estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. When estimating forfeitures, the Company considers historic voluntary termination behaviors as well as trends of actual option forfeitures.

The Company accounts for stock-based compensation arrangements with nonemployees, using the Black-Scholes option-pricing model, based on the fair value as these instruments vest. Accordingly, at each reporting date, the Company revalues the unearned portion of the stock-based compensation and the resulting change in fair value is recognized in the consolidated statements of operations over the period the related services are rendered.

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**Recently Issued Accounting Standards**

In January 2010, the Financial Accounting Standards Board (FASB) issued authoritative guidance related to additional requirements regarding disclosures of fair value measurements. The guidance requires the gross presentation of activity within the Level 3 fair value measurement roll forward and details of transfers in and out of Level 1 and 2 fair value measurements. It also clarifies two existing disclosure requirements on the level of disaggregation of fair value measurements and disclosures on inputs and valuation techniques. The new requirements and guidance are effective for interim and annual periods beginning after December 15, 2009, except for the Level 3 roll forward which is effective for fiscal years beginning after December 15, 2010 (including interim periods within those fiscal years). The Company is currently assessing the potential effect, if any, on its footnote disclosures.

In October 2009, the FASB issued authoritative guidance on revenue recognition that will become effective for the Company beginning January 1, 2011, with earlier adoption permitted. Under the new guidance, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, the FASB issued authoritative guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. The Company is currently assessing the potential effect of adoption, if any, on its financial statements.

In May 2009, the FASB issued new guidance which establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued. This new guidance is for annual periods ending after June 15, 2009, and: (i) sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition in the financial statements, (ii) identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (iii) the disclosures that should be made about events or transactions that occur after the balance sheet date. This new guidance provides largely the same framework for the evaluation of subsequent events which previously existed only in auditing literature. The Company has performed an evaluation of subsequent events through August 19, 2011, which is the day the financial statements were issued.

**2. Fair Value of Financial Instruments**

Effective January 1, 2008, the Company adopted the accounting guidance which defines fair value, establishes a framework for measuring fair value and expands required disclosures about fair value measurements. Under the standard, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. The standard clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. The impact of adopting this guidance as of January 1, 2008 was not material to the consolidated financial statements.

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The fair value hierarchy requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company primarily applies the market approach for recurring fair value measurements. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of December 31, 2009 and 2008, those assets and liabilities that are measured at fair value on a recurring basis consisted of the Company's short-term securities it classifies as cash equivalents and its preferred stock warrant liability. The Company believes that the carrying amounts of its other financial instruments, including accounts receivable, prepaid expenses and other current assets, accounts payable and accrued expenses, approximate fair value due to their short-term maturities.

The following table presents information about assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 and 2008, and indicates the fair value hierarchy utilized to determine such fair value.

(in thousands)	2009				2008			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets</b>								
Money market funds <sup>(1)</sup>	\$ 35,902	\$ -	\$ -	\$ 35,902	\$ 44,771	\$ -	\$ -	\$ 44,771
Certificates of deposit <sup>(2)</sup>	-	20	-	20	-	1,020	-	1,020
Commercial paper <sup>(2)</sup>	-	-	-	-	-	550	-	550
Total assets measured at fair value	\$ 35,902	\$ 20	\$ -	\$ 35,922	\$ 44,771	\$ 1,570	\$ -	\$ 46,341
<b>Liabilities</b>								
Preferred stock warrant liability	\$ -	\$ -	\$ 6,874	\$ 6,874	\$ -	\$ -	\$ 2,331	\$ 2,331
Total liabilities measured at fair value	\$ -	\$ -	\$ 6,874	\$ 6,874	\$ -	\$ -	\$ 2,331	\$ 2,331

<sup>(1)</sup> Included in cash and cash equivalents and other long-term assets on the Company's consolidated balance sheets.

<sup>(2)</sup> Included in other long-term assets on the Company's consolidated balance sheets.

The change in the fair value of the Level 3 preferred stock warrant liability is summarized below:

(in thousands)	2009	2008
Fair value at beginning of period	\$ 2,331	\$ 4,960
Issuances	-	-
Change in fair value recorded in warrant revaluation (expense) income	(4,543)	2,629
Fair value at end of period	\$ 6,874	\$ 2,331

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**3. Balance Sheet Components**

**Inventories**

<i>(in thousands)</i>	<u>December 31,</u>	
	2009	2008
Finished goods	\$ 5,396	\$ 5,275

**Property and Equipment, Net**

<i>(in thousands)</i>	<u>December 31,</u>	
	2009	2008
Computer equipment	\$ 619	\$ 582
Software	247	188
Office equipment, furniture and fixtures	870	838
Leasehold improvements	552	535
Manufacturing equipment and tools	<u>4,177</u>	<u>3,436</u>
	6,465	5,579
Accumulated depreciation and amortization	<u>(4,108)</u>	<u>(1,599)</u>
Property and equipment, net	<u>\$ 2,357</u>	<u>\$ 3,980</u>

Depreciation and amortization expense totaled \$2.5 million and \$1.3 million for the years ended December 31, 2009 and 2008, respectively. Property and equipment acquired through capital leases during 2008 totaled \$193,000 and was written off during the year ended December 31, 2008. As such, there was no property and equipment acquired through capital leases on the Company's consolidated balance sheets at December 31, 2009 and 2008 and no related accumulated depreciation and amortization at December 31, 2009 and 2008.

**Accrued Liabilities**

<i>(in thousands)</i>	<u>December 31,</u>	
	2009	2008
Accrued compensation	\$ 1,016	\$ 588
Purchase commitment	1,100	5,200
Accrued product returns	4,794	3,110
Litigation expense	5,410	-
Price protection and discounts	591	52
Product warranty reserve	276	626
Accrued royalties	203	148
Deferred Revenue	3,389	-
Other accrued liabilities	<u>580</u>	<u>618</u>
Accrued liabilities	<u>\$ 17,359</u>	<u>\$ 10,342</u>

In December 2008, the Company recorded a purchase commitment liability of \$5.2 million in connection with its key contract manufacturer. During the year ended December 31, 2009, the Company paid approximately, \$2.5 million and reversed \$1.6 million related to this liability and the remaining liability under the purchase commitment of \$1.1 million was paid in June 2010.

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**4. Income Taxes**

The components of the provision for income taxes for the years ended December 31, 2009 and 2008 were as follows:

<i>(in thousands)</i>	2009	2008
Current income tax (benefit) expense		
Federal	\$ (3,138)	\$ 3,595
State	-	1,013
Foreign	32	25
Total (benefit) provision for income taxes	<u>\$ (3,106)</u>	<u>\$ 4,633</u>

The tax effects of temporary differences that give rise to significant portions of deferred tax assets (liabilities) as of December 31, 2009 and 2008 were as follows:

<i>(in thousands)</i>	2009	2008
Deferred tax assets (liabilities)		
Research tax credit carryforwards	\$ 381	\$ -
Depreciation	294	(387)
Net operating loss carryforwards	702	219
Accrued liabilities and other	5,727	3,973
Total deferred tax assets	<u>7,104</u>	<u>3,805</u>
Valuation allowance	<u>(7,104)</u>	<u>(3,805)</u>
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

As of December 31, 2009, the Company had net operating loss carryforwards for state income tax purposes of approximately \$12.0 million, which will expire at various dates beginning in 2012 through 2031 if not utilized. The Company also has federal and state research and development tax credit carryforwards available to offset future tax of approximately \$347,000 and \$52,000, respectively. The federal research and development tax credit carryforwards will expire beginning in 2029, and the state credits carry forward indefinitely.

Utilization of the net operating losses may be subject to substantial annual limitation due to state ownership change limitations. The annual limitation could result in the expiration of the net operating losses before utilization.

Management believes that, based on a number of factors, it is more likely than not that the deferred tax assets will not be realized, and accordingly, a full valuation allowance has been recorded against the deferred tax assets.

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Effective January 1, 2009, the Company adopted the provisions of the FASB interpretation for the accounting for uncertainties in income taxes. The company recognizes interest and penalties related to unrecognized tax benefits within interest and other (expense) income, net in the accompanying statements of operations. Upon adoption, no adjustment to the Company's existing income taxes payable balance was necessary. Accrued interest and penalties are included within accrued liabilities in the balance sheets. There are no uncertainties expected to be resolved in the next 12 months. All of the Company's tax years remain open to tax examination. The Company is currently under tax examination for the 2008 U.S. federal tax return.

The aggregate changes in the balance of gross unrecognized tax benefits were as follows:

*(in thousands)*

<b>Balance at December 31, 2008</b>	<b>\$ 388</b>
Settlements and expiration of statutes	-
Decreases related to tax positions taken during prior years	-
Increases related to tax positions taken during prior years	-
Increases related to tax positions taken during the year	<u>129</u>
<b>Balance at December 31, 2009</b>	<b><u>\$ 517</u></b>

**5. Commitments and Contingencies**

**Lease Commitments**

The Company leases office space and software under various noncancelable operating and capital leases with various expiration dates between April 2010 and November 2015, some of which contain renewal options. Rent expense under these lease agreements totaled \$675,000 and \$460,000 for the years ended December 31, 2009 and 2008.

Under the terms of these agreements, the Company was required to make certain deposits which are held by a bank for the purpose of guaranteeing the fulfillment of the Company's obligations under these agreements. If the Company defaults under the terms of the lease agreements, the lessors will be entitled to use such funds in the amount necessary to cure the default. Deposits are included in other long-term assets in the accompanying consolidated balance sheets and totaled \$92,000 and \$73,000 at December 31, 2009 and 2008, respectively. In November 2010, the Company also obtained a letter of credit from a financial institution totaling approximately \$475,000 to meet obligations related to the Company's principal leased facility.

The Company's principal facility, located in San Francisco, California, consists of approximately 20,000 square feet of leased office and test space, with an initial expiration in 2010 and an option to renew. During 2010, the Company renewed this operating lease through March 2014. In connection with the renewal of the lease the Company also leased the first and second floor of the facility comprising an additional 40,000 square feet. In March 2011, the Company entered into an arrangement to sublease the second floor of the facility through March 2014. The Company also leases facilities in Sunnyvale, California and the United Kingdom, which are used for product development, sales, and marketing. The Sunnyvale lease expires in July 2014 and the United Kingdom lease expires in June 2016.

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Approximate future minimum lease payments (net of sublease income) under these noncancelable lease agreements are as follows:

<i>(in thousands)</i>	<b>Operating Leases</b>	<b>Capital Leases</b>
<b>Year Ending December 31,</b>		
2010	\$ 560	\$ 86
2011	1,256	64
2012	1,284	-
2013	1,412	-
2014	1,787	-
2015 and thereafter	1,802	-
Total minimum lease payments	<u>\$ 8,101</u>	<u>\$ 150</u>
Less: Amount representing interest		8
Present value of capital lease obligations		142
Less: Current portion		79
Capital lease obligations, net of current portion		<u>\$ 63</u>

**Letter of Credit**

In July 2007, the Company obtained a letter of credit from an investor of the Company totaling approximately \$10.0 million to meet obligations to its contract manufacturer. No amounts were drawn against the letter of credit as of December 31, 2008. The letter of credit expired in May 2009.

In April 2008, the Company obtained a letter of credit from a financial institution totaling approximately \$10.0 million to meet obligations to its contract manufacturer. This agreement was amended in July 2009 to reduce the amount of the letter of credit to \$3.8 million. No amounts have been drawn against the letter of credit. The letter of credit expired in February 2010.

In November 2010, the Company obtained a letter of credit from a financial institution totaling approximately \$475,000 to meet obligations related to leased office space. No amounts have been drawn against the letter of credit. The letter of credit expires in November 2015.

**Guarantees and Indemnifications**

The Company has entered into an inventory-related purchase agreement with its key contract manufacturer. Under this agreement, 100% of orders within 21 days of delivery are noncancelable. Beyond 21 days, but up to 78 days, the Company is liable for the cost of materials incurred by the contract manufacturer for the products ordered, or up to the actual cancellation charges incurred by the contract manufacturer. For certain components the liability to the Company extends to the lead time specified in the purchase agreement.

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To the extent committed inventory purchases under noncancelable purchase orders are for excess or obsolete parts or the related inventory is deemed to be in excess of its net realizable value, the Company records a provision for adverse purchase commitments. Charges are recorded as a component of cost of sales. In December 2008, the Company recorded a purchase commitment liability of \$5.2 million in connection with its key contract manufacturer. During the year ended December 31, 2009, the Company paid approximately \$2.5 million and reversed \$1.6 million related to this liability and the remaining liability under the purchase commitment of \$1.1 million was paid in June 2010.

**Contingencies**

From time to time, the Company may have certain contingent liabilities that arise in the ordinary course of its business activities. The Company accrues contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated. The Company is involved with the following litigation and other legal matters:

On January 15, 2009, Plantronics, Inc. ("Plantronics") filed a complaint against the Company alleging that the Company directly and indirectly infringes US Patent No. 5,712,453, and seeking declaratory relief, unspecified damages, and preliminary and permanent injunctive relief, as well as a finding that the infringement is willful, and an award of enhanced damages and attorney's fees. The Company denies any infringement and asserts, among other defenses, that the patent is invalid and is unenforceable. The Company is unable to predict the outcome of this case or the range of loss. Accordingly, no amount has been accrued as of December 31, 2009.

The Company is engaged in litigation involving one of the Company's former employees. The Company is both pursuing claims against the former employee and defending against cross-claims asserted against the Company. The Parties reached a final settlement agreement in July 2011 wherein the Company agreed to pay \$310,000; all claims by all parties have been dismissed with prejudice. The Company has recorded this amount as accrued litigation expense in the consolidated financial statements for the year ended December 31, 2009.

During 2009, Plantronics filed suit against certain current and former employees of the Company. These employees worked at Plantronics prior to being employed by the Company. In general, each complaint alleged trade secret misappropriation and several related claims that concerned Plantronics' documents and information alleged to have been brought to the Company by the former employees of Plantronics. In January 2011, the Company and Plantronics executed a Memorandum of Understanding ("MOU") setting forth the terms of a settlement. Without admitting any wrongdoing or violation of law and to avoid the distraction and expense of continued litigation and the uncertainty of a jury verdict on the merits, the Company agreed to make a one-time lump sum payment of \$5.1 million, which was accrued as litigation expense in the consolidated financial statements as of December 31, 2009.

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In January 2010, Wi-LAN commenced a patent infringement action in the Eastern District of Texas against a number of defendants, including the Company and its chip supplier CSR alleging infringement of certain patents held by Wi-LAN (Wi-LAN, Inc. v. Acer, Inc., Case No. 10-CV-00124). Subsequently Wi-LAN sent correspondence to the Company alleging that the Company's products infringed on the same patents. The Company filed a declaratory judgment action in the US District Court for the Northern District of California asserting the invalidity of the patents held by Wi-LAN (Aliphcom v. Wi-LAN, Inc., Case No. CV-10-02337). The action filed by the Company was subsequently transferred to the Eastern District of Texas to be consolidated with the already pending action. The Company entered into an indemnification agreement with Cambridge Silicon Radio ("CSR"), the manufacturer of bluetooth chips in the Company's products, with respect to this action.

Wi-LAN entered a settlement agreement with CSR, which firm provides the chips underlying the claims against the Company in this matter. The settlement agreement terms extend to protect CSR's customers. Claims asserted by and against the Company have been dismissed with prejudice.

In January 2011, the Company filed a declaratory judgment action in the Northern District of California relating to a third party's purported trademark rights with respect to the "MyTalk" mark. MyTalk answered the complaint in February 2011 asserting counterclaims, including trademark infringement. No procedure beyond initial pleading has yet taken place. The parties have been ordered to early mediation. The parties mediated and no settlement was reached. Fact discovery is set to close in September 2011. The Company anticipates filing a motion for summary judgment in fall 2011. The Company is unable to predict the outcome of this case or the range of loss. Accordingly, no amount has been accrued as of December 31, 2009.

The Company may from time to time be party to litigation arising in the normal course of business, including, without limitation, allegations relating to commercial transactions, business relationships or intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. Litigation in general and intellectual property litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings are difficult to predict.

Additionally, the Company's sales agreements indemnify customers for any expenses or liability resulting from alleged or claimed infringements of any United States letter patents of third parties. However, the Company is not liable for any collateral, incidental or consequential damages arising out of the patent infringement. The terms of these indemnification agreements are perpetual commencing after execution of the sales agreement or the date indicated on the order acknowledgement. The maximum amount of potential future indemnification is unlimited. However, to date, the Company has not paid any claims or been required to defend any lawsuits with respect to any such indemnity claims.

**6. Stockholders' Equity**

**Common Stock**

The Company's Articles of Incorporation, as amended, authorizes the Company to issue 215,000,000 shares of \$0.001 par value common stock.

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Each share of common stock is entitled to one vote, and as a class, shall elect two members of the Company's Board of Directors. The holders of common stock are also entitled to receive dividends whenever funds are legally available and when and if declared by the Board of Directors, subject to the prior rights of holders of all classes of stock outstanding. As of December 31, 2009, no dividends have been declared.

**Redeemable Convertible Preferred Stock**

As of December 31, 2009, the Company's Articles of Incorporation, as amended, authorizes the Company to issue 1,250,000 shares of Series 1-A convertible preferred stock ("Series 1-A"), 2,037,206 shares of Series 1-B convertible preferred stock ("Series 1-B"), 23,251,193 shares of Series 1-C convertible preferred stock ("Series 1-C"), 58,315,488 shares of Series 2 convertible preferred stock ("Series 2"), and 27,000,000 shares of Series 3 convertible preferred stock ("Series 3"). The convertible preferred stock under each of these series has a par value of \$0.001. Under the terms of the Articles of Incorporation, the Board of Directors may determine the rights, preferences and terms of the Company's unissued shares of preferred stock.

The following table summarizes the Company's convertible preferred stock:

<i>(in thousands, except share amounts)</i>	<b>Shares Authorized</b>	<b>Shares Issued and Outstanding</b>	<b>Carrying Value at December 31, 2009</b>	<b>Liquidation Value</b>
Series 1-A	1,250,000	1,250,000	\$ 987	\$ 1,000
Series 1-B	2,037,206	2,037,206	1,579	1,752
Series 1-C	23,251,193	23,251,193	6,232	7,655
Series 2	58,315,488	39,547,902	6,783	7,028
Series 3	27,000,000	22,190,990	28,144	30,000
	<u>111,853,887</u>	<u>88,277,291</u>	<u>\$ 43,725</u>	<u>\$ 47,435</u>

**Voting**

The holders of Series 1-A, 1-B, 1-C, 2 and 3 preferred stock have one vote for each share of common stock into which such shares may be converted.

As long as at least 5,500,000 shares of Series 3 are outstanding, the holders of such shares of preferred stock, voting as a separate class, shall be entitled to elect one of the Company's directors at the annual election of directors. As long as at least 10,000,000 shares of Series 2 are outstanding, the holders of such shares of preferred stock, voting as a separate class, shall be entitled to elect one of the Company's directors at the annual election of directors. The holders of any outstanding common stock, voting as a separate class, shall be entitled to elect two of the Company's directors at the annual election of directors. The holders of preferred stock and common stock (voting together as a single class and not as separate series, and on an as-converted basis) shall be entitled to elect any remaining directors.

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As long as at least 5,500,000 shares of Series 3, 10,000,000 shares of Series 2, or 10,000,000 shares of Series 1-A, 1-B and 1-C combined as a group of preferred stock remain outstanding, the Company must obtain approval from a majority of the holders of each of the above 3 classes of convertible preferred stock, voting as a separate class, in order to effect any amendment, alteration, or repeal of any provision of the Articles of Incorporation of the Company that alters or changes the voting or other powers, preferences or other special rights or restrictions of each class of convertible preferred stock so as to affect them adversely.

**Dividends**

Holders of Series 1-A, 1-B, 1-C, 2 and 3 preferred stock are entitled to receive noncumulative dividends at the per annum rate of 8% of the applicable Original Issue Price per share ("the 8% rate"), when and if declared by the Board of Directors, prior and in preference to any payment of any dividend on the common stock. Furthermore, for each Series of preferred stock, no dividends shall be paid to that Series until the preceding Series has been paid at the 8% rate. The order of the Series in terms of receiving priority for dividend payment are: Series 3, Series 2, Series 1-C, and lastly Series 1-A and 1-B as a combined group. After payment of such preferential dividends on the preferred stock during any year, any further dividends declared or paid during such year shall be declared and paid ratably on the outstanding preferred stock (on an as converted to common stock basis) and the common stock. At December 31, 2009 and 2008, no dividends had been declared.

**Liquidation**

In the event of any liquidation, dissolution, or winding up of the Company, either voluntary or involuntary, any distribution or payment shall be made in the following priority order:

Holders of the then outstanding Series 3 preferred stock are entitled to a liquidation preference equal to \$1.3519 per share, plus any declared but unpaid dividends for such shares. If, upon occurrence of such event, the assets and funds legally available for distribution among the holders of the Series 3 preferred stock are insufficient to permit the payment in full to such holders of the Series 3 liquidation preference amount, then the entire assets and funds of the Company legally available for distribution are to be distributed ratably among the holders of the Series 3 preferred stock in proportion to the liquidation preference amount each such holder is otherwise entitled to receive.

After payment of the full Series 3 preferred stock liquidation preference, holders of the then outstanding Series 2 preferred stock are entitled to a liquidation preference equal to \$0.1777 per share, plus any declared but unpaid dividends for such shares. If, upon occurrence of such event, the assets and funds legally available for distribution among the holders of the Series 2 preferred stock are insufficient to permit the payment in full to such holders of the Series 2 liquidation preference amount, then the entire assets and funds of the Company legally available for distribution shall be distributed ratably among the holders of the Series 2 preferred stock in proportion to the liquidation preference amount each such holder is otherwise entitled to receive.

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After payment of the full Series 3 preferred stock and Series 2 preferred stock liquidation preference, holders of the then outstanding Series 1-C preferred stock are entitled to a liquidation preference equal to \$0.32921 per share, plus any declared but unpaid dividends for such shares. If, upon occurrence of such event, the assets and funds legally available for distribution among the holders of the Series 1-C preferred stock are insufficient to permit the payment in full to such holders of the Series 1-C liquidation preference amount, then the entire assets and funds of the Company legally available for distribution shall be distributed ratably among the holders of the Series 1-C preferred stock in proportion to the liquidation preference amount each such holder is otherwise entitled to receive.

After payment of the full Series 3 preferred stock, Series 2 preferred stock, and Series 1-C preferred stock liquidation preference, holders of the then outstanding Series 1-A preferred stock and 1-B preferred stock as a combined class are entitled to a liquidation preference equal to \$0.80 per 1-A share, and \$0.86 per 1-B share, plus any declared but unpaid dividends for such shares. If, upon occurrence of such event, the assets and funds legally available for distribution among the holders of the Series 1-A preferred stock and Series 1-B preferred stock are insufficient to permit the payment in full to such holders of the full Series 1-A and Series 1-B liquidation preference amount, then the entire assets and funds of the Company legally available for distribution shall be distributed ratably among the holders of the Series 1-A and 1-B preferred stock in proportion to the liquidation preference amount each such holder is otherwise entitled to receive.

After the payment of all preferential amounts are made to the preferred stockholders, all the remaining funds and assets of the corporation shall be distributed on a pro rata basis among the common stock and the Series 2 preferred stock holders on an as-if-converted basis, until such time as the Series 2 preferred stock holders have received an aggregate amount per share of Series 2 preferred stock not to exceed \$0.5331. Thereafter, the remaining assets, if any, shall be distributed ratably to the holders of the common stock.

**Conversion**

Each share of Series 1-A preferred stock, Series 1-B preferred stock, Series 1-C preferred stock, Series 2 preferred stock and Series 3 preferred stock is convertible into such number of shares of common stock as is determined by dividing \$0.80, \$0.86, \$0.32921, \$0.1777 and \$1.3519, respectively, by the conversion price at the time in effect for each such share of preferred stock. As of December 31, 2008 and 2009 the conversion price was \$0.80, \$0.86, \$0.32921, \$0.1777 and \$1.3519 per share for Series 1-A preferred stock, Series 1-B preferred stock, Series 1-C preferred stock, Series 2 preferred stock and Series 3 preferred stock, respectively. Conversion is either at the option of the holder or is automatic upon the closing date of a public offering of the Company's common stock for which the aggregate offering price is not less than \$25.0 million, or upon the written consent of the holders of a majority of the outstanding Series 3 preferred stock, Series 2 preferred stock, and Series 1 (voting together as a single class on an as-converted basis) preferred stock, voting as a separate class for each series.

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**7. Warrants**

**Common Stock Warrants**

The common stock warrants outstanding at December 31, 2009 and assumptions used to calculate fair value at the measurement date of the warrants are summarized below:

(In thousands, except share and per share amounts)	Issue Date	Number of Shares	Exercise Price Per Share	Fair Value Assumptions			Dividend Yield	Fair Value at Grant Date
				Term	Volatility	Risk Free Interest Rate		
<b>Common stock warrants</b>								
Convertible note	Nov-06	3,336,096	\$ 0.0500	5 years	50.90 %	4.53 %	0 %	\$ 65
Letter of credit	Jul-07	3,600,000	0.0300	7 years	56.80	4.94	0	67
Professional services	Jul-08	389,098	0.2700	3 years	45.20	2.68	0	35
Professional services	Aug-08	104,167	0.2700	3 years	45.20	2.68	0	9
Technology license	Oct-08	100,000	0.2700	5 years	49.10	3.14	0	12
Professional services	Jul-09	117,500	0.1500	3 years	59.32	1.42	0	7
Total common stock warrants		<u>7,646,861</u>						

In connection with a convertible note in November 2006, the Company issued a warrant to purchase 3,336,096 shares of common stock at an exercise price of \$0.05 per share. The fair value of the warrant was allocated to debt discount using the relative fair value method. The debt discount was amortized to interest expense over the term of the convertible note using the effective interest method. The warrant is exercisable at any time and expires in November 2011. The Company has reserved 3,336,096 shares of common stock for issuance upon exercise of this warrant.

In connection with a letter of credit in July 2007, the Company issued a warrant to purchase 3,600,000 shares of common stock at an exercise price of \$0.03 per share. The fair value of the warrant was recorded as debt issuance costs and amortized to interest expense on a straight-line basis over the stated term of the credit facility. The warrant is exercisable at any time and expires in July 2014. The Company has reserved 3,600,000 shares of common stock for issuance upon exercise of this warrant.

In connection with a settlement agreement with a previous convertible debt holder and current shareholder in January 2008, the Company issued a warrant to purchase 1,688,238 shares of the Company's common stock at \$0.1777 per share. The warrant was immediately exercisable and expired on January 31, 2009. The fair value of the warrant was \$59,000, which was expensed as sales expense during the year ended December 31, 2008. The Company determined the fair value of the warrant using the Black-Scholes valuation model, assuming a fair value of the Company's common stock of \$0.1777 per share, a risk-free interest rate of 2.69%, a volatility factor of 46.6%, and a contractual life of 1 year. In January 2009, the warrants were exercised.

In connection with a professional service provider in July 2008, the Company issued a warrant to purchase 389,098 shares of the Company's common stock at \$0.27 per share. The warrant was immediately exercisable and expired unexercised on July 30, 2011. The value of the warrant was \$35,000, which was expensed as marketing expense during the year ended December 31, 2008.

In connection with a professional service provider in August 2008, the Company issued a warrant to purchase 104,167 shares of the Company's common stock at \$0.27 per share. The warrant was exercised on August 15, 2011. The value of the warrant was \$9,000, which was expensed as recruiting expense during the year ended December 31, 2008. The Company has reserved 104,167 shares of common stock for issuance upon the exercise of this warrant.

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In connection with the purchase of a technology license in October 2008, the Company issued a warrant to purchase 100,000 shares of the Company's common stock at \$0.27 per share. The warrant is immediately exercisable and expires on October 29, 2013. The value of the warrant was \$12,000, which was capitalized as an intangible asset during the year ended December 31, 2008. The Company has reserved 100,000 shares of common stock for issuance upon the exercise of this warrant.

In connection with a professional service provider in July 2009, the Company issued a warrant to purchase 117,500 shares of the Company's common stock at \$0.15 per share. The warrant is immediately exercisable and expires on July 15, 2012. The value of the warrant was \$7,000, which was expensed as recruiting expense during the year ended December 31, 2009. The Company has reserved 117,500 shares of common stock for issuance upon the exercise of this warrant.

**Preferred Stock Warrants**

Warrants to purchase the Company's redeemable preferred stock are subject to revaluation at each balance sheet date with any change in fair value recorded as "Warrant revaluation income (expense)" in the Consolidated Statements of Operations. The fair value of preferred stock warrants outstanding and assumptions used in the fair value calculation at December 31, 2009 and December 31, 2008 is summarized below:

(in thousands, except share and per share amounts)	Issue Date	Number of Shares	Fair Value Assumptions				Fair Value		
			Exercise Price Per Share	Term	Volatility	Risk Free Interest Rate	Dividend Yield	at December 31, 2009	2008
Preferred stock warrants									
Series 2 Financing	Jul-07	17,079,347	\$ 0.1777	0.5 year	50.06 %	0.28 %	0 %	\$ 6,874	\$ -
			0.1777	1.5 year	66.51	1.87	0		2,331

In connection with the Series 2 issuance in July 2007, the Company issued warrants to purchase 17,079,347 shares of Series 2 preferred stock at an exercise price of \$0.1777 per share. The warrants were immediately exercisable and expired on July 31, 2010. The fair value of the warrant of \$1.0 million, calculated at the date of issuance was recorded as a "discount" to the convertible preferred stock carrying amount. The Series 2 convertible preferred stock does not have a mandatory redemption date and is not optionally redeemable by the issuer, therefore the initial carrying value of the preferred stock assigned at the issuance date is not being accreted. In July 2010, the warrants were exercised.

**8. Stock Option Plans**

In April 2000, the Company adopted the 2000 Equity Incentive Plan (the "2000 Plan"), as amended. The Plan provides for the granting of stock options to employees and consultants of the Company. Options granted under the Plan may be either incentive stock options or nonqualified stock options. Incentive stock options (ISO) may be granted only to Company employees (including officers and directors who are also employees). Nonqualified stock options (NSO) may be granted to Company employees and consultants.

Options under the Plan may be granted for periods of up to 10 years. The exercise price of an ISO and NSO shall not be less than 100% and 85% of the estimated fair value of the shares on the date of grant, respectively, as determined by the Board of Directors. The exercise price of an ISO and NSO granted to a 10% shareholder shall not be less than 110% of the estimated fair value of the shares on the date of grant. Options granted generally vest over four years and vest at a rate of 25% upon the first anniversary and 1/48 per month thereafter.

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**Early Exercise of Stock Options**

At the discretion of the Company's Board of Directors, certain options may be exercisable prior to vesting in exchange for shares of restricted common stock. Restricted stock is subject to the Company's repurchase right, under which the Company has the right to buy back any unvested shares at the lower of the original exercise price or the fair value of the shares on the date of repurchase in the event of termination of services either voluntarily or involuntarily. Shares subject to the Company's repurchase right totaled 1,387,003 and 3,391,733 shares at December 31, 2009 and 2008, respectively. If significant, the Company treats cash received from employees for exercise of unvested options as a refundable deposit within accrued liabilities in its consolidated balance sheets. Amounts from accrued liabilities are transferred into common stock and additional paid-in capital as the shares vest. At December 31, 2009 and 2008, refundable deposits related to the exercise of unvested options were not material to the financial statements.

Option activity for 2009 and 2008 was as follows:

<i>(in thousands, except share and per share amounts)</i>	Shares Available for Grant	Options Outstanding		Weighted Average Remaining Contractual Term <i>(in years)</i>	Aggregate Intrinsic Value
		Number of Shares	Weighted Average Exercise Price		
<b>Balance at December 31, 2007</b>	29,157,799	12,069,990	\$ 0.06		
Repurchased	-	-	-		
Options granted	(18,706,010)	18,706,010	0.27		
Options exercised	-	(896,944)	0.23		\$ 44
Options canceled	8,928,926	(8,928,926)	0.24		
<b>Balance at December 31, 2008</b>	<u>19,380,715</u>	<u>20,950,130</u>	0.16		
Repurchased	-	-	-		
Options granted	(7,500,000)	7,500,000	0.15		
Options exercised	-	(652,562)	0.06		68
Options canceled	3,505,877	(3,505,877)	0.23		
<b>Balance at December 31, 2009</b>	<u>15,386,592</u>	<u>24,291,691</u>	0.15		68
Vested, December 31, 2009		7,742,722	0.15	7.79	37
Vested and expected to vest, December 31, 2009		19,919,187	0.15	8.37	-
Exercisable, December 31, 2009		13,519,588	0.14	7.83	119

The Company has computed the aggregate intrinsic value amounts as of December 31, 2009 disclosed in the table above based on the difference between the original exercise price of the options and management's estimate of the fair value of the Company's common stock at December 31, 2009 of \$0.15 per share. The intrinsic value for out-of-the money options is zero.

The total intrinsic value of options exercised during 2009 and 2008 was \$68,000 and \$44,000, respectively. The intrinsic value is calculated as the difference between the estimated fair value of the Company's stock on the date of exercise and the exercise price of the underlying shares.

Stock options granted to nonemployees are included in the above table. Stock-options granted to nonemployees during 2009 and 2008 represented 589,000 and 3,765,282 shares, respectively. Nonemployee stock-options to purchase 4,754,741 and 4,180,741 shares were outstanding at December 31, 2009 and 2008 with a weighted-average exercise price of \$0.22 and \$0.23 per share, respectively.

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In July 2007, the Company also granted an option to purchase 9,275,940 shares of common stock to an employee at an exercise price of \$0.03 per share outside of the 2000 Plan. At December 31, 2009, there are no remaining outstanding options that were granted outside the 2000 Plan.

**Exercise of Stock Options for Promissory Note**

During 2007, the Company issued 5,998,008 shares of common stock to an officer of the Company in exchange for a full recourse promissory note in the amount of \$180,000. The outstanding principal amount is due on September 17, 2011. Interest on the note accrues at an annual rate of 4.82%. The note receivable has been classified as a reduction of stockholders' equity.

**Stock-Based Compensation**

The Company estimated the fair value of each option award on the date of grant using the Black-Scholes option pricing model. In applying the Black-Scholes option pricing model, the Company's determination of fair value of the share-based payment award on the date of grant is affected by the Company's estimated fair value of common shares, as well as assumptions regarding a number of subjective variables. These variables include, but are not limited to, the Company's expected stock price volatility over the term of the stock options and the employees' actual and projected stock option exercise and pre-vesting employment termination behaviors.

The Company accounts for stock-based compensation arrangements with nonemployees, using the Black-Scholes option-pricing model, based on the fair value as these instruments vest. Accordingly, at each reporting date, the Company revalues the unearned portion of the stock-based compensation and the resulting change in fair value is recognized in the consolidated statements of operations over the period the related services are rendered.

During 2009 and 2008, the Company recorded \$32,000 and \$100,000, respectively, of compensation expense in connection with common stock options granted to nonemployees. The assumptions used to calculate the fair value of nonemployee options were the same as the employee assumptions except the expected life is considered to be the lesser of the remaining contractual life of the option or ten years and the related volatility and risk-free interest rate is adjusted accordingly.

For 2009 and 2008 the main variables used in applying the Black-Scholes option pricing model were determined as follows:

- *Expected Term* — represents the period that the Company's stock-based awards are expected to be outstanding and is determined using the simplified method described in the Staff Accounting Bulletin (SAB) 107, as amended by SAB 110, *Share-Based Payment*.
- *Expected Volatility* — based on comparable public company volatility for similar stock-based award terms.
- *Expected Dividend* — zero, as the Company has never paid dividends and has no plans to pay dividends.
- *Risk-Free Interest Rate* — based on the U.S. Treasury zero coupon issues in effect at the time of grant for periods corresponding with the expected term of the stock option.

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The stock options were granted with an exercise price equal to the estimated fair value of the underlying common stock on the date of grant as determined by the Company's board of directors. In the absence of a public trading market, the Company's board of directors considered numerous objective and subjective factors, including information provided by an outside valuation firm to determine its best estimate of the fair value of the Company's common stock as of each valuation date. Accordingly, the following assumptions were used to value options granted during 2009 and 2008:

	2009	2008
Volatility	52.0 %	51.0 %
Dividend yield	0.0 %	0.0 %
Risk-free interest rate	2.5 %	4.4 %
Expected term (in years)	6.08	6.08

The weighted-average fair value of options on the date of grant was \$0.08 and \$0.15 per share for options granted during 2009 and 2008, respectively.

Employee stock-based compensation expense recognized in 2009 and 2008 was calculated based on stock awards ultimately expected to vest and, therefore, has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

At December 31, 2009, the Company had \$1.1 million of total unrecognized compensation expense, net of estimated forfeitures that will be recognized over a weighted-average period of approximately 2.7 years.

The following table summarizes stock-based compensation expense by functional area for 2009 and 2008:

<i>(in thousands)</i>	2009	2008
Cost of revenues	\$ 17	\$ 11
Selling, general and administrative	292	188
Research and development	182	134
	<u>\$ 491</u>	<u>\$ 333</u>

**9. 401(k) Plan**

The Company maintains a defined contribution plan (the "401(k) Plan") in the United States, which was adopted on January 1, 2008 and qualifies as a tax deferred savings plan under Section 401(k) of the Internal Revenue Code ("IRC"), which was adopted on January 1, 2008. Eligible U.S. employees may contribute a percentage of their pre-tax compensation, subject to certain IRC limitations. The Plan provides for employer matching contributions to be made at the discretion of the Board of Directors. Through December 31, 2009, the Company has not elected to contribute to the 401(k) Plan.

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**10. Related Party Transactions**

In 2006, a private company owned by a relative of one of the Company's founders, entered into an exclusive distribution agreement with the Company for distribution rights in the Middle East and North Africa. The agreement specified a commission rate of 7% on the Free on Board (FOB) unit wholesale price. In 2009, the Company entered into a termination agreement in exchange for payment of \$170,000. The \$170,000 was recorded as sales commission expense in the year ended December 31, 2009, and was paid in full in February 2010.

In January 2009, the Company entered into a settlement agreement with an investor and a sales representative of the Company, under which the Company agreed to pay the investor \$300,000 in exchange for termination and release of all obligations with respect to all sales representation agreements with such investor. Payments made to the investor for the years ended December 31, 2009 and 2008 were \$96,000 and \$897,000, respectively. Payments due to the investor at December 31, 2009 and 2008 totaled \$0 and \$300,000, respectively.

In connection with a settlement agreement with an investor in January 2008, the Company issued a warrant to purchase 1,688,238 shares of the Company's common stock at \$0.1777 per share. The issuance of the warrant was in lieu of the investor exercising the participation right under the Senior Convertible Promissory Note issued by the Company to the investor on May 9, 2006.

In July 2007, the Company obtained a letter of credit from an investor of the Company totaling approximately \$10.0 million to meet obligations to its contract manufacturer. The letter of credit expired in May 2009. In connection with the letter of credit, the Company issued a warrant to purchase 3,600,000 shares of common stock at an exercise price of \$0.03 per share. No payments were made to the investor for the years ended December 31, 2009 and 2008, respectively. Payments due to the investor at both December 31, 2009 and 2008 totaled \$250,000. In June 2010, the \$250,000 was paid in full.

**11. Subsequent Events**

In July 2010, the Company adopted the 2010 Equity Incentive Plan. The 2010 plan is intended as the successor to and continuation of the 2000 Stock Plan. The Company reserved 5,800,000 shares of the common stock of the Company for issuance pursuant to the plan.

In March 2011, the Company approved the issuance of up to 7,150,000 shares of newly authorized Series 4 preferred stock and issued 7,131,940 shares of Series 4 preferred stock at \$3.926 per share for proceeds of \$27.8 million, net of issuance costs of approximately \$161,000. In connection with the issuance of Series 4 preferred stock, the Company amended its Articles of Incorporation to increase the number of authorized shares of common and preferred stock to 225,000,000 shares and 115,003,887 shares, respectively. The holders of Series 4, in preference to the holders of other preferred and common stock, are entitled to noncumulative dividends when and if declared by the board of directors at the rate of 8% of the applicable original issue price per annum. Each holder of Series 4 shall be entitled to the number of votes equal to the number of shares of common stock into which such shares of Series 4 preferred stock could be converted.

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As long as 5,500,000 shares of Series 4 remain outstanding, the holders of such shares of preferred stock shall be entitled to elect one of the Company's directors at the annual election of directors. As long as at least 5,500,000 shares of Series 4 remain outstanding, the Company must obtain approval from a majority of the holders of the outstanding Series 4 preferred stock in order to effect any amendment, alteration, or repeal of any provision of the Articles of Incorporation of the Company that alters or changes the voting or other powers, preferences or other special rights or restrictions of each class of convertible preferred stock so as to affect them adversely.

In March 2011, the Company also issued 2,025,300 shares of common stock at \$0.54 per share for proceeds of \$1.1 million to the purchaser of the Series 4 preferred stock.

In June 2011, the Company approved the issuance of up to 11,500,000 shares of newly authorized Series 5 preferred stock and issued 5,562,408 shares of Series 5 preferred stock at \$7.19113 per share for proceeds of \$38.3 million, net of issuance costs of approximately \$1.7 million. In connection with the issuance of Series 5 preferred stock, the Company amended its Articles of Incorporation to increase the number of authorized shares of common and preferred stock to 240,000,000 shares and 126,503,887 shares, respectively.

The holders of Series 5 and Series 4, in preference to the holders of other preferred and common stock, are entitled to noncumulative dividends when and if declared by the board of directors at the rate of 8% of the applicable original issue price per annum. The holders of Series 5 and Series 4 have liquidation preferences equal to \$7.19113 and \$6.73 per share, respectively, over the other preferred holders and common stockholders. Each holder of Series 5 shall be entitled to the number of votes equal to the number of shares of common stock into which such shares of Series 5 preferred stock could be converted.

As long as at least 5,500,000 shares of Series 5 remain outstanding, the Company must obtain approval from a majority of the holders of the outstanding Series 5 preferred stock in order to effect any amendment, alteration, or repeal of any provision of the Articles of Incorporation of the Company that alters or changes the voting or other powers, preferences or other special rights or restrictions of each class of convertible preferred stock so as to affect them adversely.