

AliphCom
Consolidated Financial Statements
December 31, 2010 and 2009

AliphCom
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December 31, 2010 and 2009

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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, 2010 and 2009, 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.

As discussed in Note 1 to the consolidated financial statements, the Company adopted new accounting rules for revenue recognition in 2010.

PricewaterhouseCoopers LLP

April 2, 2012

AliphCom
Consolidated Balance Sheets
December 31, 2010 and 2009

(in thousands, except share and per share amounts)

	2010	2009
Assets		
Current assets		
Cash and cash equivalents	\$ 28,993	\$ 34,091
Accounts receivable	6,952	5,644
Inventories	15,237	5,396
Prepaid and other current assets	1,978	1,032
Total current assets	<u>53,160</u>	<u>46,163</u>
Property and equipment, net	2,818	2,357
Other long-term assets	1,587	6,259
Total assets	<u>\$ 57,565</u>	<u>\$ 54,779</u>
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 21,370	\$ 10,082
Accrued liabilities	15,965	13,970
Deferred revenue, current portion	2,895	1,937
Capital lease obligations, current portion	63	79
Income tax payable	441	553
Total current liabilities	<u>40,734</u>	<u>26,621</u>
Preferred stock warrant liability	-	6,874
Capital lease obligations, less current portion	-	63
Deferred revenue, less current portion	483	1,452
Total liabilities	<u>41,217</u>	<u>35,010</u>
Commitments and contingencies (Note 5)		
Stockholders' equity		
Redeemable convertible preferred stock: \$0.001 par value; 111,853,887 shares authorized at December 31, 2010 and 2009, 105,356,638 and 88,277,291 shares issued and outstanding at December 31, 2010 and 2009, respectively	53,631	43,725
Common Stock: \$0.001 par value; 215,000,000 shares authorized at December 31, 2010 and 2009, 45,238,384 and 40,724,308 shares issued and outstanding at December 31, 2010 and 2009, respectively	45	40
Additional paid-in capital	4,422	3,329
Stockholder's notes receivable	(180)	(180)
Accumulated deficit	<u>(41,570)</u>	<u>(27,145)</u>
Total stockholders' equity	<u>16,348</u>	<u>19,769</u>
Total liabilities and stockholders' equity	<u>\$ 57,565</u>	<u>\$ 54,779</u>

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

AliphCom
Consolidated Statements of Operations
Years Ended December 31, 2010 and 2009

<i>(in thousands)</i>	2010	2009
Revenues	\$ 87,483	\$ 66,789
Cost of revenues	<u>59,583</u>	<u>42,706</u>
Gross profit	27,900	24,083
Operating expenses		
Research and development	13,777	9,902
Selling, general and administrative	<u>29,191</u>	<u>29,678</u>
Total operating expenses	<u>42,968</u>	<u>39,580</u>
Loss from operations	(15,068)	(15,497)
Total other (expense) income, net		
Warrant revaluation income (expense)	3	(4,543)
Interest expense	-	(60)
Interest and other (expense) income, net	<u>15</u>	<u>(23)</u>
Total other income (expense), net	<u>18</u>	<u>(4,626)</u>
Net loss before income taxes	(15,050)	(20,123)
(Benefit) provision for income tax	<u>(625)</u>	<u>(3,106)</u>
Net loss	<u>\$ (14,425)</u>	<u>\$ (17,017)</u>

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

AliphCom
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2010 and 2009

(in thousands, except share amounts)	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Stockholder's Notes Receivable	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance at December 31, 2008	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	-	-	1,688,238	2	298	-	-	300
Stock-based compensation expense	-	-	-	-	523	-	-	523
Exercises of common stock options	-	-	652,562	-	41	-	-	41
Net loss	-	-	-	-	-	-	(17,017)	(17,017)
Balance at December 31, 2009	88,277,291	43,725	40,724,308	40	3,329	(180)	(27,145)	19,769
Issuance of common stock warrants	-	-	-	-	21	-	-	21
Exercise of preferred stock warrants	17,079,347	9,906	-	-	-	-	-	9,906
Stock-based compensation expense	-	-	38,021	-	806	-	-	806
Exercises of common stock options	-	-	4,476,055	5	266	-	-	271
Net loss	-	-	-	-	-	-	(14,425)	(14,425)
Balance at December 31, 2010	105,356,638	\$ 53,631	45,238,384	\$ 45	4,422	(180)	\$ (41,570)	\$ 16,348

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

AlphCom
Consolidated Statements of Cash Flows
Years Ended December 31, 2010 and 2009

<i>(in thousands)</i>	2010	2009
Cash flows from operating activities		
Net loss	\$ (14,425)	\$ (17,017)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities		
Inventory write-down	(376)	478
Issuance of warrants for services	21	7
Depreciation and amortization	1,733	2,509
Stock-based compensation	806	523
Remeasurement of preferred stock warrant liability	(3)	4,543
Changes in current assets and liabilities		
Accounts receivable	(1,308)	(4,131)
Inventories	(9,464)	(600)
Prepaid and other assets	401	(2,367)
Accounts payable	11,288	2,220
Accrued liabilities and other long-term liabilities	1,995	3,628
Deferred revenue	(11)	3,389
Income taxes payable	(112)	(4,203)
Net cash used in operating activities	<u>(9,455)</u>	<u>(11,021)</u>
Cash flows from investing activities		
Purchases of property and equipment	(2,194)	(885)
Changes in restricted cash	3,325	7,200
Net cash provided by investing activities	<u>1,131</u>	<u>6,315</u>
Cash flows from financing activities		
Proceeds from exercises of stock options and warrants	3,305	341
Repayment of capital lease obligations	(79)	(44)
Net cash provided by financing activities	<u>3,226</u>	<u>297</u>
Net decrease in cash and cash equivalents	(5,098)	(4,409)
Cash and cash equivalents		
Beginning of year	<u>34,091</u>	<u>38,500</u>
End of year	<u>\$ 28,993</u>	<u>\$ 34,091</u>
Supplemental cash flow information		
Cash paid for income taxes	\$ -	\$ 2,450
Cash paid for interest	-	34
Supplemental noncash investing and financing activities		
Exercise of preferred stock warrant liability	6,871	-

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

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Notes to Consolidated Financial Statements
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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 and wireless speakers under the Jawbone® brand. The Company sells its products primarily through a global sales channel network, which includes distributors and traditional retailers.

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 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 July and December 2011, the Company issued 7,578,781 shares of Series 5 preferred stock at \$7.19113 per share for proceeds of \$52.8 million, net of issuance costs of approximately \$1.7 million. In December 2011, the Company issued 3,150,582 shares of Series 2 and 2,978,707 shares of common stock, each at \$3.96752 per share for total proceeds of \$24.3 million. However, the Company has incurred significant losses and negative cash flows from operating activities. For the year ended December 31, 2010, the Company incurred a loss from operations of approximately \$14.4 million and negative cash flows from operating activities of approximately \$9.5 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 be required to reduce expenses.

Basis of Presentation

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 Company has made certain reclassifications to the prior period financial statements in order to conform to the current period presentation.

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.

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Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") 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: sales returns reserve, the assessment of collectability of accounts receivable, inventory valuations, the determination of accruals, the estimation of the 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.

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. The related reserves for sales returns, price protection and sales incentives are recorded in the current liabilities. Management analyzes historical returns, 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.

Revenue Recognition for Arrangements With Multiple Deliverables

In October 2009, the Financial Accounting Standards Board ("FASB") amended the accounting standards for revenue recognition to remove tangible products containing software components and nonsoftware components that function together to deliver the product's essential functionality from the scope of the software revenue recognition guidance.

In October 2009, the FASB also amended the accounting standards for multiple deliverable revenue arrangements to:

- provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the considered should be allocated;
- require an entity to allocate revenue in an arrangement using best estimated selling price ("BESP") of deliverables if a vendor does not first have vendor-specific objective evidence ("VSOE") of selling price or secondly does not have third-party evidence ("TPE") of selling price; and
- eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

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The Company elected to early adopt this accounting guidance on January 1, 2010 on a prospective basis for applicable transaction originating or materially modified after December 31, 2009. As a result, substantially all of the Company's products are no longer within the scope of the software revenue recognition guidance.

For multi-element arrangements that include hardware products containing undelivered software elements that relate to the hardware product's firmware, the Company allocates revenue to all deliverables based on their relative selling prices. In such circumstances, the Company uses a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) vendor-specific objective evidence of fair value, (ii) third-party evidence of selling price, and (iii) best estimate of the selling price. VSOE generally exists only when the Company sells the deliverable separately and is the price actually charged by the Company for that deliverable. TPE is determined based on competitor prices for similar deliverables when sold separately. BESP's reflect the Company's best estimates of what the selling prices of elements would be if they were sold regularly on a stand-alone basis.

For sales of Icon products late in 2009, and Jambox and Era products beginning in January 2010, the Company has indicated it may from time-to-time provide future unspecified updates and features to the firmware bundled with each of these hardware products free of charge to customers via the Company's MyTalk platform. The Company has identified two deliverables in arrangements involving the sale of these devices. The first deliverable is the hardware and firmware essential to the functionality of the hardware device delivered at the time of sale. The second deliverable is the embedded right included with the purchase of these devices to receive on a when-and-if-available basis, future unspecified updates and features relating to the product's firmware.

The Company allocates revenue between these deliverables using the relative selling price method. Because the Company has neither VSOE nor TPE for these deliverables, the allocation of revenue has been based on the Company's BESP. Amounts allocated to the delivered hardware and the related essential firmware are recognized at the time of sale provided the other conditions for revenue recognition have been met. Amounts allocated to the embedded unspecified update rights are deferred and recognized on a straight-line basis over the estimated lives of each of these devices, which is 21 months. Cost of sales related to delivered hardware and related essential firmware, including estimated warranty costs, are recognized at the time of sale. Costs incurred to provide when-and-if updates are recognized as operating expenses as incurred.

The Company's process for determining its BESP for deliverables without VSOE or TPE considers consumer behaviors as well as the Company's internal pricing model. The Company believes its customers, particularly consumers, would be reluctant to buy unspecified firmware update rights related to Jawbone devices. This view is primarily based on the fact that unspecified update rights do not obligate the Company to provide upgrades at a particular time or at all, and do not specify to customers which upgrades or features will be delivered. Therefore, the Company has concluded that if it were to sell update rights on a standalone basis, the selling prices would be relatively low. Key factors considered by the Company in developing the BESP for MyTalk update rights include market trends for pricing of mobile updates such as smartphone apps, the Company's historical pricing practices, the nature of the update rights (e.g., unspecified and when-and-if-available), and the relative BESP of the update rights as compared to the total selling price of the product. BESP for the hardware and essential firmware as delivered at the time of sale was determined by the Company's internal pricing practices, which take into account pricing trends in the consumer electronics market as well as the requirement for an acceptable profit margin.

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The Company's BESP for the unspecified firmware update rights are as follows: 3.3% of Icon sales, 1.7% of Jambox sales and 2.6% of Era sales. Amounts allocated to the embedded unspecified firmware update rights associated with these Jawbone products are recognized on a straight-line basis over the estimated life of the product, 21 months in all cases. The Company regularly reviews its basis for establishing BESP.

Total net revenues as reported and adjusted total net revenues that would have been reported during the year ended December 31, 2009, if the transactions were subject to current accounting guidance, are shown in the following table (in thousands):

Year Ended December 31, 2009	
Net revenue, as reported	\$ 66,789
Net revenue, as adjusted	70,066

The impact to total net revenues during the year ended December 31, 2010, due to the adoption of the accounting guidance, was primarily attributable to net product revenues. This will generally result in an increase in the amount of upfront product revenue recognized and a decrease in services revenue recognized.

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 financial institutions which are A1 or A+ rated. At December 31, 2010 and 2009, cash equivalents consisted primarily of money market funds.

Deposits

Certain deposits are required by the Company's landlords to guarantee the contractual obligations under its office lease agreements. As of December 31, 2010 and 2009, deposits totaled \$358 thousand and \$92 thousand, respectively, and were recorded within other long-term assets in the accompanying consolidated balance sheets.

Restricted Cash

At December 31, 2010 and 2009, the Company maintained \$475 thousand and \$3.8 million, respectively, of restricted cash in the form of institutional money market funds and certificates of deposit. The December 31, 2010 balance was to support a letter of credit required by the Company's lessor as part of the lease agreement and is recorded in prepaid and other current assets on the balance sheet. The December 31, 2009 balance was to support letters of credit required by the Company's primary inventory supplier and is recorded within other long-term assets in the 2009 consolidated balance sheets. The letters of credit requirement by the Company's supplier was relinquished in March 2010.

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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. 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 financial institutions in the United States which are A1 or A+ rated. 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.

As of and for the years ended December 31, 2010 and 2009, customers representing 10% or more of the accounts receivable balance and/or revenues were as follows:

	Percentage of Accounts Receivable		Percentage of Net Revenues	
	2010	2009	2010	2009
Customer A	22 %	52 %	54 %	59 %
Customer B	28	-	17	2
Customer C	-	-	13	12
Customer D	11	-	1	-

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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 of 1.5 years to 3 years
Leasehold improvements	The shorter of the lease term or the estimated useful lives of the improvements of 1-2 years

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 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, 2010, 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.

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Income Taxes

The Company accounts for income taxes based on the asset and liability method whereby deferred tax asset and liability 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, 2010 and 2009 was \$892 thousand and \$507 thousand, 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.

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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, 2010 and 2009 was as follows:

<i>(in thousands)</i>	2010	2009
Balance at beginning of the year	\$ 276	\$ 626
Provision for warranty liability made during the year	1,133	687
Settlements made during the year	<u>(928)</u>	<u>(1,037)</u>
Balance at end of the year	<u>\$ 481</u>	<u>\$ 276</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 2009 consolidated balance sheet. The warrant was exercised in June 2010 and subsequently recorded as Series 2 preferred stock on the 2010 consolidated balance sheet. The warrant was subject to re-measurement at each balance sheet date and an increase in fair value of \$3 thousand was recognized in 2010 as a component of interest and other expense, net.

Stock-Based Compensation

Stock-based compensation expense for the years ended December 31, 2010 and 2009, 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.

Recently Adopted Accounting Standards

In January 2010, the FASB issued 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). As of December 31, 2010, this guidance has no effect on the Company's financial statements or disclosures.

Recently Issued Accounting Standards

In 2011, the FASB issued new disclosure guidance related to the presentation of the Statement of Comprehensive Income. This guidance eliminates the current option to report other comprehensive income and its components in the consolidated statement of stockholders' equity. The requirement to present reclassification adjustments out of accumulated other comprehensive income on the face of the consolidated statements of income has been deferred. The Company will adopt this accounting standard upon its effective date for periods beginning on or after December 15, 2011, and this adoption will not have any impact on the Company's financial position or results of operations but will impact the financial statements presentation.

2. Fair Value of Financial Instruments

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 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, 2010 and 2009, 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.

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The following table presents information about assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 and 2009, and indicates the fair value hierarchy utilized to determine such fair value.

<i>(in thousands)</i>	2010				2009			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Money market funds ⁽¹⁾	\$ 29,913	\$ -	\$ -	\$ 29,913	\$ 35,902	\$ -	\$ -	\$ 35,902
Certificates of deposit ⁽²⁾	-	475	-	475	-	20	-	20
Total assets measured at fair value	\$ 29,913	\$ 475	\$ -	\$ 30,388	\$ 35,902	\$ 20	\$ -	\$ 35,922
Liabilities								
Preferred stock warrant liability	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 6,874	\$ 6,874
Total liabilities measured at fair value	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 6,874	\$ 6,874

⁽¹⁾ Included in cash and cash equivalents (2010) and other long-term assets (2009) on the Company's consolidated balance sheets.

⁽²⁾ Included in prepaid and other current assets (2010) other long-term assets (2009) on the Company's consolidated balance sheets.

The change in the fair value of the Level 3 preferred stock warrant liability is summarized below. See note 7 for further description:

<i>(in thousands)</i>	2010	2009
Fair value at beginning of year	\$ 6,874	\$ 2,331
Warrant exercise	6,871	-
Change in fair value recorded in warrant revaluation income (expense)	3	(4,543)
Fair value at end of year	\$ -	\$ 6,874

3. Balance Sheet Components

Inventories

<i>(in thousands)</i>	December 31,	
	2010	2009
Finished goods	\$ 15,237	\$ 5,396

Property and Equipment, Net

<i>(in thousands)</i>	December 31,	
	2010	2009
Computer equipment	\$ 1,132	\$ 619
Software	472	247
Office equipment, furniture and fixtures	818	870
Leasehold improvements	584	552
Manufacturing equipment and tools	5,650	4,177
	8,656	6,465
Accumulated depreciation and amortization	(5,838)	(4,108)
Property and equipment, net	\$ 2,818	\$ 2,357

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Depreciation and amortization expense totaled \$1.7 million and \$2.5 million for the years ended December 31, 2010 and 2009, respectively. There was no property and equipment acquired through capital leases on the Company's consolidated balance sheets at December 31, 2010 and 2009 and no related accumulated depreciation and amortization at December 31, 2010 and 2009.

Accrued Liabilities

<i>(in thousands)</i>	December 31,	
	2010	2009
Accrued compensation	\$ 1,121	\$ 1,016
Purchase commitment	446	1,100
Accrued product returns	4,284	4,794
Litigation expense	5,521	5,410
Price protection and discounts	983	591
Product warranty reserve	481	276
Accrued royalties	543	203
Other accrued liabilities	2,586	580
Accrued liabilities	<u>\$ 15,965</u>	<u>\$ 13,970</u>

4. Income Taxes

The components of the provision for income taxes for the years ended December 31, 2010 and 2009 were as follows:

<i>(in thousands)</i>	2010	2009
Current income tax (benefit) expense		
Federal	\$ (566)	\$ (3,138)
State	(48)	-
Foreign	(11)	32
Total (benefit) provision for income taxes	<u>\$ (625)</u>	<u>\$ (3,106)</u>

The tax effects of temporary differences that give rise to significant portions of deferred tax assets (liabilities) as of December 31, 2010 and 2009 were as follows:

<i>(in thousands)</i>	2010	2009
Deferred tax assets		
Depreciation and amortization	\$ 547	\$ 294
Reserves and accruals	6,141	5,997
Research and development credits	1,493	381
Net operating loss carryforwards	4,835	702
Total deferred tax assets	13,016	7,374
Valuation allowance	(13,016)	(7,374)
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

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The 2010 effective tax rate of 4.1% differs from the statutory rate of 39.6% primarily due to a full valuation allowance that offsets the current year tax benefit that would have otherwise been recorded. The 4.1% benefit is primarily the result of a 2010 carryback claim that the Company intends to file as a result of the 2010 federal income tax loss.

As of December 31, 2010, the Company had approximately \$10 million and \$25.8 million of federal and state net operating loss carryforwards, respectively. Such carryforwards will expire at various dates beginning in 2014 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 \$1.4 million and \$200 thousand, respectively. The federal research and development tax credit carryforwards will expire beginning in 2020, and the state carryforwards 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.

Effective January 1, 2009, the Company adopted the provisions of the FASB ASC No. 740, *Income Taxes*, for unrecognized tax benefits. ASC No. 740 requires a more-likely-than-not threshold for financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return.

Upon adoption, the Company made no adjustment to beginning retained earnings. Accrued interest and penalties are included within accrued liabilities in the balance sheets. The Company recognizes interest and penalties related to unrecognized tax benefits within interest and other (expense) income, net in the accompanying statements of operations. 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 aggregate changes in the balance of gross unrecognized tax benefits were as follows:

(in thousands)

Balance at December 31, 2008	\$ 388
Increases related to tax positions taken during the year	<u>129</u>
Balance at December 31, 2009	517
Decreases related to tax positions taken during prior years	(24)
Increases related to tax positions taken during the year	<u>143</u>
Balance at December 31, 2010	<u>\$ 636</u>

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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 June 2016, some of which contain renewal options. Rent expense under these lease agreements totaled \$1.0 million and \$675 thousand for the years ended December 31, 2010 and 2009.

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 \$358 thousand and \$92 thousand at December 31, 2010 and 2009, respectively. In November 2010, the Company also obtained a letter of credit from a financial institution totaling approximately \$475 thousand 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.

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

<i>(in thousands)</i>	Operating Leases	Capital Leases
Year Ending December 31,		
2011	\$ 1,545	\$ 64
2012	2,297	-
2013	2,320	-
2014	2,674	-
2015	1,726	-
2016 and thereafter	66	-
Total minimum lease payments	\$ 10,628	\$ 64

Letter of Credit

In July 2007, the Company obtained a letter of credit from an investor of the Company totaling approximately \$10 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.

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In April 2008, the Company obtained a letter of credit from a financial institution totaling approximately \$10 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 thousand 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.

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. As of December 31, 2010, the outstanding purchase commitment liability pertaining to new commitments in 2010 was \$446 thousand.

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 denied any infringement and asserted, among other defenses, that the patent was invalid and is unenforceable. On March 23, 2012, the case was dismissed and patent 5,712,453 was declared invalid. Accordingly, no amount has been accrued as of December 31, 2010.

The Company was engaged in litigation involving one of the Company's former employees. The Company was 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 thousand; all claims by all parties have been dismissed with prejudice. The Company recorded this amount as accrued litigation expense in the consolidated financial statements for the year ended December 31, 2009. No activity was recorded in 2010 and the amount was remitted to the former employee in 2011.

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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. No activity was recorded in 2010 and the amount was remitted to Plantronics in 2011.

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. The defendant answered the complaint in February 2011 asserting counterclaims, including trademark infringement. No procedure beyond initial pleading has yet taken place. In September 2011, both parties entered a settlement agreement whereby the Company remitted \$157 thousand to the third party and the case was dismissed. Subsequent to the settlement agreement, the disputed trademark was assigned to the Company. No amount was recorded for this settlement at December 31, 2010.

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.

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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.

Redeemable Convertible Preferred Stock

As of December 31, 2010, 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>	Shares Authorized	Shares Issued and Outstanding	Carrying Value at December 31, 2010	Liquidation Value
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	56,627,249	16,689	10,063
Series 3	27,000,000	22,190,990	28,144	30,000
	<u>111,853,887</u>	<u>105,356,638</u>	<u>\$ 53,631</u>	<u>\$ 50,470</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.

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.

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, 2010 and 2009, no dividends had been declared.

The holders of common stock are also entitled to receive dividends whenever funds are legally available 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, 2010, no dividends have 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, 2010 and 2009 the conversion price was \$0.80, \$0.86, \$1.32921, \$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 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, 2010 and assumptions used to calculate fair value at the measurement date at inception 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				Fair Value at Grant Date
				Term	Volatility	Risk Free Interest Rate	Dividend Yield	
Common stock warrants								
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
Professional services	May-10	45,833	0.3600	3 years	59.20	1.11	0	7
Professional services	Dec-10	100,000	0.3600	3 years	59.20	1.11	0	14
Total common stock warrants		<u>7,792,694</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. In March and April 2011, options to purchase 2,780,080 shares of common stock were exercised. The Company has reserved 556,016 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 thousand, 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 thousand, which was expensed as marketing expense during the year ended December 31, 2008.

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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 thousand, which was expensed as recruiting expense during the year ended December 31, 2008.

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 thousand, 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 thousand, 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.

In connection with a professional service provider in May 2010, the Company issued a warrant to purchase 45,833 shares of the Company's common stock at \$0.36 per share. The warrant is immediately exercisable and expires on May 1, 2013. The value of the warrant was \$7 thousand, which was expensed as recruiting expense during the year ended December 31, 2010. The Company has reserved 45,833 shares of common stock for issuance upon the exercise of this warrant.

In connection with a professional service provider in December 2010, the Company issued a warrant to purchase 100,000 shares of the Company's common stock at \$0.36 per share. The warrant is immediately exercisable and expires on December 8, 2013. The value of the warrant was \$14 thousand, which was expensed as recruiting expense during the year ended December 31, 2010. The Company has reserved 100,000 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. In July 2010, the preferred stock warrants were exercised. The fair value of preferred stock warrants outstanding and assumptions used in the fair value calculation at December 31, 2009 is summarized below:

(in thousands, except share and per share amounts)	Issue Date	Number of Shares	Exercise Price Per Share	Fair Value Assumptions				Fair Value December 31, 2009
				Term	Volatility	Risk Free Interest Rate	Dividend Yield	
Preferred stock warrants								
Series 2 Financing	Jul-07	17,079,347	\$ 0.1777	0.5 year	50.66 %	0.28 %	0 %	\$ 6,874

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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 fair value of the warrant of \$1 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, upon the exercises of the warrants, the preferred stock warrant liability was reclassified to stockholders' equity. Prior to reclassifying the warrant liability to equity on the date of exercise, the Company recorded a \$3 thousand warrant revaluation income as a final mark to market adjustment on the preferred stock warrant liability.

8. Stock Option Plans

In July 2010, the Company adopted the 2010 Equity Incentive Plan (the "2010 Plan"). The 2010 plan is intended as the successor to and continuation of the 2000 Stock Plan (the "2000 Plan"). The Company reserved 5,800,000 shares of the common stock of the Company for issuance pursuant to the 2010 Plan. No additional awards shall be granted under the 2000 Plan. All outstanding stock awards granted under the 2000 Plan shall remain subject to the terms of the 2000 Plan; provided, however, that after July 23, 2010, any shares underlying outstanding stock awards granted under the 2000 Plan that expire or terminate for any reason prior to exercise or settlement or are forfeited because of the failure to meet a contingency or condition required to vest such shares shall become available for issuance pursuant to the 2010 Plan. All stock awards granted on or after the effective date of the 2010 Plan shall be subject to the terms of the 2010 Plan. Under the plan, the Company may grant stock options, stock appreciation rights, restricted stock awards, and restricted stock unit awards.

The 2000 and 2010 Plans provide for the granting of stock options to employees and consultants of the Company. Options granted under the Plans 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 plans 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 199,219 and 1,387,003 shares at December 31, 2010 and 2009, 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, 2010 and 2009, refundable deposits related to the exercise of unvested options were not material to the financial statements.

Option activity for 2010 and 2009 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		
Balance at December 31, 2008	10,104,775	20,950,130	\$ 0.16		
Options granted	(7,500,000)	7,500,000	0.15		
Options exercised	-	(652,562)	0.06		
Options canceled	<u>3,505,877</u>	<u>(3,505,877)</u>	0.23		
Balance at December 31, 2009	6,110,652	24,291,691	0.15		
Shares authorized	5,800,000	-			
Options granted	(9,768,623)	9,768,623	0.35		
Options exercised	-	(4,476,055)	0.06		\$ 1,331
Options canceled	<u>1,369,632</u>	<u>(1,369,632)</u>	0.18		
Balance at December 31, 2010	<u>3,511,661</u>	<u>28,214,627</u>	0.23	8.13	3,590
Vested at December 31, 2010		<u>12,897,945</u>	0.17	7.18	2,493
Vested and expected to vest at December 31, 2010		<u>24,264,579</u>	0.23	8.03	3,087
Exercisable at December 31, 2010		<u>15,487,839</u>	0.18	7.25	2,743

The Company has computed the aggregate intrinsic value amounts as of December 31, 2010 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, 2010 of \$0.36 per share. The intrinsic value for out-of-the money options is zero.

The total intrinsic value of options exercised during 2010 and 2009 was \$1,331 thousand and \$68 thousand, 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.

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Stock options granted to nonemployees are included in the above table. Stock-options granted to nonemployees during 2010 and 2009 represented 792,500 and 589,000 shares, respectively. Nonemployee stock-options to purchase 1,356,071 and 4,754,741 shares were outstanding at December 31, 2010 and 2009 with a weighted-average exercise price of \$0.23 and \$0.22 per share, respectively.

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, 2010, 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 thousand which is outstanding of December 31, 2010. 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 unvested 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 2010 and 2009, the Company recorded \$184 thousand and \$32 thousand, 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 2010 and 2009 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.

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- 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.

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 2010 and 2009:

	2010	2009
Volatility	45.9 %	52.0 %
Dividend yield	0.0 %	0.0 %
Risk-free interest rate	2.1 %	2.5 %
Expected term (in years)	5.58	6.08

The weighted-average fair value of options on the date of grant was \$0.16 and \$0.08 per share for options granted during 2010 and 2009, respectively.

Employee stock-based compensation expense recognized in 2010 and 2009 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, 2010, the Company had \$1,743 thousand of total unrecognized compensation expense, net of estimated forfeitures that will be recognized over a weighted-average period of approximately 3.7 years.

The following table summarizes stock-based compensation expense by functional area for 2010 and 2009:

<i>(in thousands)</i>	2010	2009
Cost of revenues	\$ 38	\$ 17
Selling, general and administrative	337	292
Research and development	247	182
	<u>\$ 622</u>	<u>\$ 491</u>

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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, 2010, the Company has not elected to contribute to the 401(k) Plan.

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 thousand. The \$170 thousand was recorded as sales commission expense in the year ended December 31, 2009, and was paid in full in February 2010.

In July 2007, the Company obtained a letter of credit from an investor of the Company totaling approximately \$10 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 \$0.1777 per share. As of December 31, 2010 and 2009, the amounts outstanding were zero and \$250 thousand, respectively.

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 thousand 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, 2010 and 2009 were zero and \$96 thousand, respectively. No payments were due to the investor at December 31, 2010 and 2009.

11. Subsequent Events

Equity Financing Related

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 thousand. 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. In July and December 2011, the Company issued 7,578,781 shares of Series 5 preferred stock at \$7.19113 per share for proceeds of \$52.8 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.

In connection with the December 2011 closing, the Company issued warrant to purchase 1,150,000 shares of common stock at a price of \$0.77 per share. The warrant is exercisable immediately and expires in December 2018. The Company has certain rescission rights as to the holder's right to exercise certain number of shares.

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.

In December 2011, the Company issued 3,150,582 shares of Series 2 and 2,978,707 shares of common stock, each at \$3.96752 per share for total proceeds of \$24.3 million.

Product Launch Related

In October 2011, the Company made UP by Jawbone available for sale in retail stores and online. UP is a wristband device that, combined with an iPhone application, measures the daily physical activity and sleep patterns of the user. By the end of November 2011, many users began to report various hardware defects with the units they had purchased. In December 2011, the Company announced the "UP No Questions Asked Guarantee" ("the Guarantee") on its website and via email to registered users of UP. The details of the Guarantee include full refunds to all UP customers and the temporary halt of UP sales. Other implications to the Company of the Guarantee include exposure to channel partners for the authorization of returns of all unsold units. The Company estimates that it will incur up to approximately \$19.5 million in aggregate expenses related to the product launch and subsequent Guarantee.